Staff paper

Agenda reference: 5A

IFRS® Interpretations Committee meeting

Date	**June 2023**
Project	**Consolidation of a Non-Hyperinflationary Subsidiary by a Hyperinflationary Parent (IAS 21 and IAS 29)**
Topic	**Additional research**
Contacts	Braian Paoli (bpaoli@ifrs.org) Dennis Deysel (ddeysel@ifrs.org)

Introduction and purpose

1. At its June 2022 meeting, the IFRS Interpretations Committee (Committee) asked us to perform additional research to obtain:
   (a) further information on the prevalence of the submitted fact pattern and whether that fact pattern has (or is expected to have) a material effect on entities affected;
   (b) information about other related matters (if any) with respect to the application of IAS 29 *Financial Reporting in Hyperinflationary Economies*; and
   (c) information about the feasibility of possible narrow-scope standard-setting and the usefulness of the information provided by those possibilities.
2. This paper summarises our approach to, and the results of, the additional research.

Structure

3. This agenda paper includes:

   (a) summary of prior research;

   (b) summary of additional research:

      (i) two phased approach; and

      (ii) findings from Phase I.

Summary of prior research

4. Paragraphs 17–22 of Agenda Paper 2 of the June 2022 Committee meeting (June agenda paper) summarise feedback from information requests to members of the International Forum of Accounting Standard-Setters, securities regulators and large accounting firms. The request asked those participating to provide information about whether the submitted fact pattern was common and, if so in which jurisdictions and whether there was diversity in accounting for the submitted fact pattern.

5. We received 12 responses—seven from large accounting firms, three from national standard-setters and two from securities regulators. Many said the submitted fact pattern was common in particular jurisdictions, namely Argentina, Lebanon, Turkey and Zimbabwe. Some of those respondents said the matter does not always have a material effect on those affected because non-hyperinflationary subsidiaries might represent only a small proportion of the entity's operations. Most respondents who said the submitted fact pattern was common observed diversity in the accounting treatment.

Additional research

Two phased approach

6. We conducted additional research in two phases. During the first phase, we met with four large accounting firms, an organization representing a group of national standard-setters, a regulator and two users of financial statements (investors).[1,2] We selected these respondents because they are from, or have experience in, the particular jurisdictions listed in paragraph 5. We asked about:

   (a) the prevalence and materiality of the submitted fact pattern;

   (b) the accounting treatment(s) applied and their prevalence;

   (c) usefulness of information provided by different accounting treatments;

   (d) the costs of applying different accounting treatments; and

   (e) the scope of any narrow-scope standard-setting project.

7. Paragraphs 10–30 summarise feedback on these questions.

8. We used information from Phase I to:

   (a) analyse the feasibility of a possible narrow-scope standard-setting project and the scope of such a project (see Agenda Paper 5B).

   (b) develop a preliminary view of a possible solution to address this matter (see Agenda Paper 5C).

9. During the second phase of additional research, we met with three large accounting firms and one preparer operating in a hyperinflationary economy that has a non-hyperinflationary subsidiary.[3] We asked them to comment on the costs and benefits of

[1] The views received represent informal opinions and do not reflect the official views of those respondents or their organisations.

[2] For ease of reference, Agenda Papers 5A–5C to this meeting refer to 'Phase I' when we talk about the first phase of our additional research.

[3] For ease of reference, Agenda Papers 5A–5C to this meeting refer to 'Phase II' when we talk about the second phase of our additional research.

the possible solution. We considered this feedback to refine the possible solution. Agenda Paper 5C includes our analysis and preliminary view of the possible solution together with relevant feedback from Phase II.

Findings from Phase I

Prevalence and materiality of the submitted fact pattern

10. Respondents say the submitted fact pattern is prevalent and could be material in hyperinflationary economies (for example, Argentina, Lebanon and Zimbabwe). In the case of Turkey, which we understand only recently became hyperinflationary, most respondents say there is not yet enough evidence that this fact pattern is prevalent, but they expect the fact pattern to be prevalent.

Accounting treatments applied and their prevalence

11. Respondents say they observe diversity in whether a hyperinflationary parent, after applying IAS 21 to translate the results and financial position of the non-hyperinflationary subsidiary, restates a non-hyperinflationary subsidiary's current period income and expenses and all comparative information. The feedback did not indicate a particular accounting treatment as being the most prevalent.

12. A few respondents say they observe some entities applying an accounting treatment different to the two views considered by the Committee (see Agenda Paper 5 to this meeting). Applying this third view (View 3) the hyperinflationary parent does not restate the subsidiary's current period income and expenses but restates only the subsidiary's comparative information by applying the change in the general price index from the beginning of the reporting period to the comparative information. Proponents of this view say:

    (a) paragraph 35 of IAS 29 requires a hyperinflationary parent to deal with the financial statements of subsidiaries that do not report in the currencies of hyperinflationary economies in accordance with IAS 21 *The Effects of*

Changes in Foreign Exchange Rates. [4] Consistent with proponents of View 1, proponents of View 3 also say the hyperinflationary parent is not required to restate the subsidiary's current period income and expenses and comparative information; but

(b) paragraph 34 of IAS 29, read together with paragraph 1 of that Standard, requires a hyperinflationary parent to apply to the comparative consolidated financial statements (which includes the results and financial position of the subsidiary) the change in the general price index from the beginning of the reporting period.

13. Consequently, we understand that a hyperinflationary parent, after applying IAS 21 to translate the results and financial position of the non-hyperinflationary subsidiary, applies one of the following accounting treatments:

Financial statements of non-hyperinflationary subsidiary	View 1[6]	View 2[7]	View 3
assets and liabilities as at the end of the current reporting period	no adjustment	no adjustment	no adjustment
income and expenses for the current reporting period	no adjustment	apply change in the general price index from the dates the income and expenses are initially recognised	no adjustment

[4] Appendix A of Agenda Paper 5 includes the relevant extracts of IAS 21 and IAS 29.

[5] We are using the word 'restate' to mean "applying the change in the general price index to reflect financial information in terms of the current measuring unit" in this and the rest of the agenda papers.

[6] See paragraphs 11 of Agenda Paper 5.

[7] See paragraph 12 of Agenda Paper 5.

comparative information	no adjustment	apply change in the general price index from the beginning of the reporting period	apply change in the general price index from the beginning of the reporting period

Usefulness of information provided by different accounting treatments

14. Many respondents, including the organisation representing a group of national standard-setters and a regulator, say View 2 gives more useful information. They say View 2 improves understandability and comparability because the income and expenses and comparative information of all entities within the group are expressed in terms of the current measuring unit.

15. Other respondents, including investors we spoke to, say financial statements prepared applying IAS 29 are generally difficult to understand (this matter was also reported to the IASB as part of its Third Agenda Consultation). These respondents said each of the three accounting treatments has its own costs and benefits without any one of the views necessarily resulting in more useful information when compared to another. In their view, it was more important for a hyperinflationary parent to disclose how it has included in its consolidated financial statements the financial statements of the non-hyperinflationary subsidiary.

16. Investors say it would also be useful to receive information about the summarised financial position and results of the non-hyperinflationary subsidiary *in the non-hyperinflationary functional currency* or the proportion of the group's assets, liabilities and results that the non-hyperinflationary subsidiary represents.

Recognising any restatement gain or loss applying View 2

17. As paragraph 12(b) of Agenda Paper 5 explains, View 2 results in a restatement gain or loss because an entity restates current period income and expenses but not assets and liabilities. A few respondents comment on this restatement gain or loss and say that, applying paragraph 39(c) of IAS 21, a hyperinflationary parent presents this gain

or loss as part of exchange differences in other comprehensive income. These respondents say IFRS Accounting Standards do not specify where to present the restatement gain or loss. Although the fact pattern differs, these respondents look to the Agenda Decision Translation of a Hyperinflationary Foreign Operation—Presenting Exchange Differences (IAS 21 and IAS 29) and view the restatement gain or loss as an exchange difference as defined in IAS 21.

18. These respondents are of the view that the resulting exchange difference presented in other comprehensive income for the non-hyperinflationary subsidiary reflects the effect of translation in real terms instead of in nominal terms, which means that it reflects the movement in the exchange rates without the effect of inflation in the period. For example, if the exchange rates fully reflect differing price levels between the two economies to which they relate, after accounting for the restatement gain or loss as an exchange difference in other comprehensive income, the net effect will be zero. The net zero amount reflects that in real terms there was no devaluation arising from the translation of the transactions of the subsidiary.

The costs of applying different accounting treatments

19. Respondents had different views about which of the three accounting treatments described in paragraph 13 is the most practical (and least costly). Some respondents say View 1 is most practical because a hyperinflationary parent applies IAS 21 and makes no further adjustments. However, other respondents disagree and say View 2 and View 3 do not create additional practical challenges because a hyperinflationary parent already has systems and processes in place to apply to the financial statements of the non-hyperinflationary subsidiary any changes in the general price index. This is because the hyperinflationary parent is already required to restate its own income and expenses and comparative information applying changes in the general price index.

20. A few respondents say:

(a) View 1 results in practical challenges when preparing comparative information. Applying View 2 or View 3, the hyperinflationary parent restates all comparative information regardless of whether any of that comparative information arises from the non-hyperinflationary subsidiary. However, applying View 1, the hyperinflationary parent does not restate the comparative financial statements of the non-hyperinflationary subsidiary but, applying paragraph 34 of IAS 29, restates other comparative information. Consequently, View 1 would require the hyperinflationary parent to reperform the consolidation for the comparative period.

(b) View 2 results in practical challenges when preparing the current period consolidated financial statements. Restating the subsidiary's income and expenses for the current period requires the non-hyperinflationary subsidiary to make available to the hyperinflationary parent granular information about the timing (or ageing) of transactions to calculate the restatement.

The scope of any narrow-scope standard-setting project

21. Respondents had mixed views about the merits of a narrow-scope standard-setting project that addresses only the submitted fact pattern. Some say a narrow-scope standard-setting project has merits because it will remove diversity and improve financial reporting. Others say there are other challenges when applying IAS 29 and they think the submitted fact pattern is not the most important matter to address in a standard-setting project.

22. In addition, respondents identified other matters that can be addressed in a narrow-scope standard-setting project.

Presenting financial statements in a hyperinflationary currency

23. The related matter that most respondents suggest addressing with the submitted fact pattern is a situation where an entity with a non-hyperinflationary functional currency presents its financial statements in a hyperinflationary currency. For example, we understand that in Argentina, all entities, including those with a non-hyperinflationary functional currency, are required to present financial statements in the local hyperinflationary currency.

24. Respondents say a question similar to the one raised in the submission arises in the related matter, that is, whether the entity, after applying paragraphs 39–41 of IAS 21, applies paragraphs 26 and 34 of IAS 29 to restate its current period income and expenses and all comparative information in terms of the current measuring unit. This related matter was also identified by respondents to our outreach request when preparing for the June 2022 Committee meeting. Some respondents agreed that for the related matter, IFRS Accounting Standards provide an adequate basis for an entity to determine the required accounting. The entity is not within the scope of IAS 29 because its functional currency is not the currency of a hyperinflationary economy (see paragraph 1 of IAS 29). Respondents, however, say that not restating the current period income and expenses and all comparative information in terms of the current measuring unit reduces understandability and comparability. In their view, a narrow-scope standard-setting project that requires the entity in the related matter to restate its income and expenses and comparative information in terms of the current measuring unit will improve financial reporting.

Accumulated exchange differences of an entity when presenting its own financial statements in a different presentation currency

25. A few respondents question the usefulness of exchange differences that accumulate in equity through other comprehensive income for an entity that applies paragraph 39 of IAS 21 to its own financial statements and suggest reconsidering the accounting for exchange differences in this situation.

26. For some respondents, this question is particularly important for the related matter because substantial amounts of exchange differences can accumulate in equity given the level of inflation and resulting devaluation of the local currency. The accumulated exchange differences never recycle to profit or loss because it does not relate to foreign operations.

Applying paragraph B86 of IFRS 10 to the submitted fact pattern

27. A few respondents say application questions arise for the submitted fact pattern applying paragraph B86 of IFRS 10, for example when eliminating in full intragroup

income and expenses relating to transactions between entities of the group (IFRS 10 paragraph B86(c)).[5] In the submitted fact pattern, the amounts that need to be eliminated are not necessarily set in terms of the same measuring unit. The parent, applying IAS 29, restates its income and expenses by applying a general price index. The parent may not restate the income and expenses of the subsidiary. Questions arise as to where in the financial statements the hyperinflationary parent accounts for any differences in amounts that are not eliminated. This same question arises in other fact patterns, such as an intercompany transaction between a parent whose functional currency is non-hyperinflationary and a subsidiary whose functional currency is hyperinflationary. The respondents suggest any narrow-scope standard-setting project clarify how to apply the requirements of IFRS 10 to groups that include entities with hyperinflationary functional currencies.

Other matters

28. A few respondents identified other matters related to applying IAS 29 that they suggest considering as part of a narrow-scope standard-setting project:

    (a) how an entity restates inventory and cost of sales in terms of the current measuring unit. Respondents say entities typically restate cost of sales only from the date of the sale and not from the date inventory was purchased.

    (b) whether the tax base of both monetary and non-monetary items have the same treatment applying IFRIC 7 *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies*;

    (c) whether the impairment of goodwill makes goodwill an amount current as of the date of the impairment; and

[5] Paragraph B86 of IFRS 10 says: 'Consolidated financial statements:

(a) combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.

(b) offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (IFRS 3 explains how to account for any related goodwill).

(c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full). Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements. IAS 12 *Income Taxes* applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.'

(d) understanding the interaction between IAS 34 *Interim Financial Reporting* and IAS 29 when a currency becomes hyperinflationary in an interim period.

29. A few respondents suggest extending the scope of IAS 29 to economies with high inflation (this matter was considered in the IASB's Third Agenda Consultation.)

30. A few respondents suggest amending IFRS Accounting Standards to incorporate the following agenda decisions published in March 2020:

(a) Cumulative Exchange Differences before a Foreign Operation becomes Hyperinflationary (IAS 21 and IAS 29);

(b) Translation of a Hyperinflationary Foreign Operation—Presenting Exchange Differences (IAS 21 and IAS 29); and

(c) Presenting Comparative Amounts when a Foreign Operation first becomes Hyperinflationary (IAS 21 and IAS 29)