Staff paper

Agenda reference: 5B

IFRS® Interpretations Committee meeting

Date	**June 2023**
Project	**Consolidation of a Non-Hyperinflationary Subsidiary by a Hyperinflationary Parent (IAS 21 and IAS 29)**
Topic	**Scope of a possible narrow-scope standard-setting project**
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Purpose of the paper

1. This paper includes our analysis and recommendations of whether—considering the relevant criteria in the *Due Process Handbook*—the Committee should refer the matter to the IASB by recommending that the IASB develop a narrow-scope amendment.

Structure

2. This agenda paper includes:

   (a) analysis of addressing only the submitted fact pattern;

   (b) analysis of also addressing other related matters;

   (c) staff recommendations; and

   (d) an appendix—relevant extracts from the *Due Process Handbook*.

Addressing only the submitted fact pattern

3. Phase I of our additional research (see Agenda Paper 5A) confirms that the submitted fact pattern is prevalent and could be material (paragraph 5.16(a) of the *Due Process Handbook*). At its June 2022 meeting, the Committee could not conclude that the principles and requirements in IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies* provide an adequate basis for a hyperinflationary parent to determine the required accounting. Additionally, the diversity in practice reduces the ability of users of financial statements to compare reporting entities from period to period.

4. Accordingly, it could be argued that it is necessary to add or change requirements in IFRS Accounting Standards to improve financial reporting (paragraph 5.16(b) of the *Due Process Handbook*).

5. The matter in the submitted fact pattern could be resolved efficiently within the confines of existing IFRS Accounting Standards (paragraph 5.16(c) of the *Due Process Handbook*). Considering the findings from Phase I of our additional research, a project to address only the submitted fact pattern could analyse the accounting treatments observed in practice (see View 1, View 2 and View 3 in the table in paragraph 13 of Agenda Paper 5A) and amend IAS 29 to require a hyperinflationary parent to apply one of those three views.

6. While narrow in scope, such a project:

   (a) would lead to a rules-based solution—our additional research has not identified a broader principles-based solution that could be developed for only the submitted fact pattern; and

   (b) could require significant additional resources—respondents had split views about the costs and benefits of each of the different views and our additional research did not identify which of the three views, if any, might provide the best solution.

7. Additionally, feedback suggests that for some stakeholders, given other challenges in applying IAS 29, the submitted fact pattern is not the most important matter to address in a standard-setting project.

8. Paragraph 5.16(d) of the *Due Process Handbook* requires that the matter in a standard-setting project is not so narrow that it is not cost-effective for the International Accounting Standards Board (IASB) and stakeholders to undertake the due process required to change an IFRS Accounting Standard. Based on our analysis, a narrow-scope standard-setting project to address only the submitted fact pattern in the manner described in paragraph 5 may be too narrow to be cost effective.

9. Consequently, we analysed the possibility of including other related matters (as identified by respondents) in the project to increase the project's benefits and to make undertaking a standard-setting project more cost effective.

Addressing other matters

10. Paragraphs 22–30 of Agenda Paper 5A summarise other matters our additional research identified. These are:

    (a) presenting financial statements in a hyperinflationary currency;

    (b) accumulated exchanged differences of an entity when presenting its own financial statements in a different presentation currency;

    (c) applying paragraph B86 of IFRS 10; and

    (d) other matters.

11. To ensure the project remains sufficiently narrow in scope (paragraph 5.16(d) of the *Due Process Handbook*), we analysed the possibility of including the other matters in the project using the following two criteria:

    (a) whether the matter deals with the interaction between IAS 21 and the IAS 29. The submitted fact pattern asks the question of whether a hyperinflationary parent applies particular IAS 29 requirements after applying IAS 21.

(b) whether the matter can be resolved with a narrow-scope solution concurrently with the submitted fact pattern without requiring a fundamental change to the principles and requirements in IAS 21 and IAS 29. The IASB recently concluded its third agenda consultation and did not include a project to review either of these Standards as part of its work plan.

Other matters that satisfy the criteria

12. In our view, the matter dealing with presenting financial statements in a hyperinflationary currency (the related matter)—see paragraphs 23–24 of Agenda Paper 5A—satisfies both criteria in paragraph 11. The matter relates to an entity (whose functional currency is non-hyperinflationary) that presents its financial statements in a hyperinflationary currency. This entity applies paragraph 39 of IAS 21 to translate its financial statements into that presentation currency. This is the same paragraph that a hyperinflationary parent applies to the financial statements of its non-hyperinflationary subsidiary in the submitted fact pattern. Applying this paragraph, the entity translates its current period income and expenses at exchange rates at the dates of the transaction and assets and liabilities at the closing rate at the date of the financial statements.

13. Paragraph 1 of IAS 29 says (emphasis added): 'This Standard shall be applied to the financial statements, including the consolidated financial statements, of any entity whose *functional currency* is the currency of a hyperinflationary economy.' In the related matter, the entity's functional currency is non-hyperinflationary and consequently, the entity cannot restate its current period income and expenses or comparative amounts applying IAS 29. Therefore, in our view, the principles and requirements in IAS 21 provide an adequate basis for an entity to determine the required accounting for the related matter.

14. However, stakeholders question the usefulness of the financial statements of such an entity because current period income and expenses and comparative information are not expressed in the current measuring unit. They note paragraph 2 of IAS 29 which

says reporting of operating results and financial position in a hyperinflationary local currency without restatement is not useful.

15. In addition, they say not applying IAS 29 leads to a lack of comparability between financial statements of such an entity and entities in the same hyperinflationary economy that are in the scope of IAS 29 which can be confusing for investors.

16. Accordingly, in both the submitted fact pattern and the related matter there is a question as to whether applying paragraph 39 of IAS 21 in these situations result in useful information or whether the usefulness of information would be improved by expressing financial statements in terms of the current measuring unit. We understand from our research that the related matter is common.

17. Agenda Paper 5C discusses a possible solution that, in our view, meets the criteria in paragraphs 5.16(a)–5.16(d) of the *Due Process Handbook*. The possible solution would:

    (a) be narrow in scope while applying to both the submitted fact pattern and the related matter;

    (b) not require a fundamental change to the principles and requirements in IAS 21 and IAS 29;

    (c) resolve diversity in accounting for the submitted fact pattern and improve:

        (i) the usefulness of information provided for both the submitted fact pattern and the related matter; and

        (ii) comparability of information within and across entities' financial statements;

    (d) be practical to apply and cost-effective to pursue.

Other matters that do not satisfy the criteria

18. The other matters listed in paragraph 10 do not, in our view, satisfy the criteria in paragraph 11. In particular, the other matters:

(a) do not relate to application questions about the interaction of IAS 21 and IAS 29 (for example, questions on applying IAS 29 or the request to incorporate particular agenda decisions into IFRS Accounting Standards);

(b) are not sufficiently narrow in scope that the IASB or the Committee can address it in an efficient (for example, the matter about accumulated exchanged differences of an entity when presenting its own financial statements in a different presentation currency or applying paragraph B86 of IFRS 10); and/ or

(c) have been considered by the IASB as part of the Third Agenda Consultation (for example, extending the scope of IAS 29 to economies with high inflation).

Staff recommendation

19. Based on our analysis, and subject to the Committee's views on the possible solution discussed in Agenda Paper 5C, we recommend that the Committee refers the matter to the IASB by recommending that the IASB develop a narrow-scope amendment that addresses:

(i) the submitted fact pattern, and

(ii) the related matter.

Appendix—Relevant extracts from the Due Process Handbook

5.13 The [IASB] and the Interpretations Committee work together in supporting the consistent application of IFRS Standards. They do so by, among other things, issuing narrow-scope amendments to the Standards, issuing IFRIC Interpretations and publishing agenda decisions to address application questions. The [IASB] and Interpretations Committee seek to achieve a balance between maintaining the principle-based nature of the Standards and adding or changing requirements in response to emerging application questions.

…

5.16 The Interpretations Committee decides a standard-setting project should be added to the work plan, either by recommending that the [IASB] develop a narrow-scope amendment or by deciding to develop an IFRIC Interpretation, when all of the following criteria are met:

(a) the matter has widespread effect and has, or is expected to have, a material effect on those affected;

(b) it is necessary to add or change requirements in IFRS Standards to improve financial reporting—that is, the principles and requirements in the Standards do not provide an adequate basis for an entity to determine the required accounting;

(c) the matter can be resolved efficiently within the confines of the existing Standards and the *Conceptual Framework*[1]; and

(d) the matter is sufficiently narrow in scope that the [IASB] or the Interpretations Committee can address it in an efficient manner, but not so narrow that it is not cost-effective for the [IASB] or the Interpretations Committee and stakeholders to undertake the due process required to change a Standard.

…

5.18 If the Interpretations Committee recommends that the Board should develop a narrow-scope amendment, it refers the matter to the Board…

[1] In the Due Process Handbook, 'Conceptual Framework' refers to the *Conceptual Framework for Financial Reporting*.