APPLICATION CHALLENGES OF IAS 29 FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES

Emerging Economies Group (EEG)

8 May 2025

Context

- Several issues that impede consistent and comparable financial reporting across our subsidiaries operating in hyperinflationary and potential hyperinflationary economies identified.
- While we acknowledge the need to provide transparent and meaningful financial information, we believe that the current standard, in its existing form, presents several challenges that must be addressed to ensure its effectiveness.

This submission deals with the following key issues:

1. Indicators for Determining Hyperinflationary Economies.
2. Reliability and Usefulness of Constant Purchase Power Accounting.
3. Presentation of IAS 29 Restatements in Consolidated Financial Statements when the group entity is not hyperinflationary.

- IAS 29 has become increasingly complex as more economies meet the quantitative indicator particularly due to the high inflationary environment globally which is unprecedented.

•1 Issue 1: Indicators for Determining Hyperinflationary Economies

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- Sub-issue 1: Diverse Interpretations in Practice

Diverse Interpretations in Practice

View A: Audit firms often place a predominant focus on the 3-year cumulative inflation rate exceeding 100%. This quantitative indicator, being easily measurable and auditable, tends to overshadow the qualitative indicators, which are more subjective and require professional judgment. This approach, while practical, can lead to premature or inappropriate application of IAS 29, especially in cases where the 3-year cumulative inflation rate is met due to short-term, exceptional spikes rather than sustained economic instability.

View B: From a broader market perspective, professional judgment is more widely applied, considering all indicators outlined in IAS 29, as the standard does not establish an absolute rate at which an economy is deemed hyperinflationary. This approach acknowledges that hyperinflation is not merely a function of the cumulative inflation rate but also of various economic factors that may not be immediately quantifiable.

Issue 1: Indicators for Determining Hyperinflationary Economies

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- Sub-issue 2: Conflicting Guidance Between Regulators and Audit Firms

Conflicting Guidance Between Regulators and Audit Firms

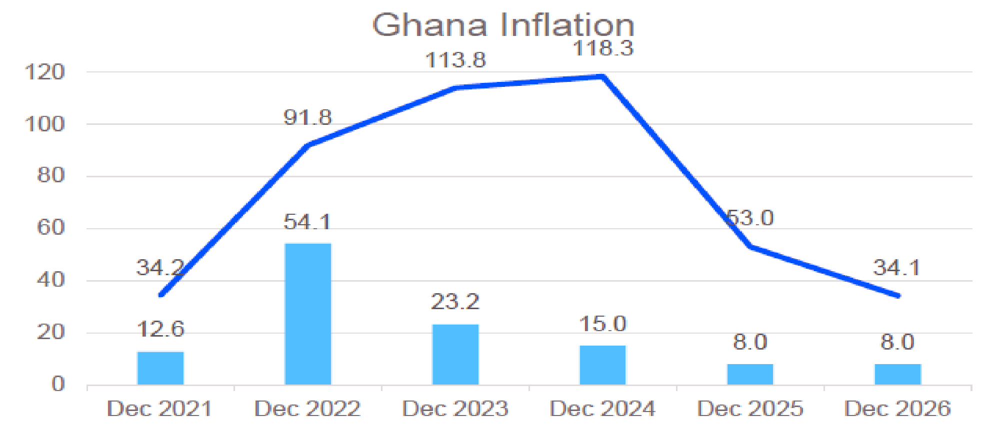
View A: Audit firms within hyperinflationary economies typically align to guidance issued by country regulators or local accounting bodies. Globally, audit firms independently issue guidance, which may differ from the guidance issued in-country. This situation places multinational entities in a difficult position given the different application by audit firms in-country versus globally.

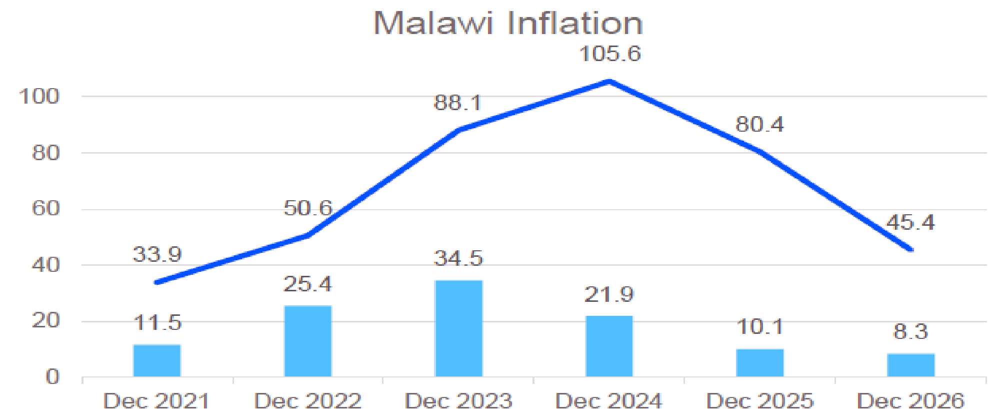
View B: In several instances, country regulators, acting in what they deem a reasonable manner, issue directives on whether the economy is hyperinflationary, requiring local entities to comply with these directives. These positions are typically grounded in a holistic view of the economy, considering both qualitative and quantitative indicators and should be applied consistently within a Group scenario.

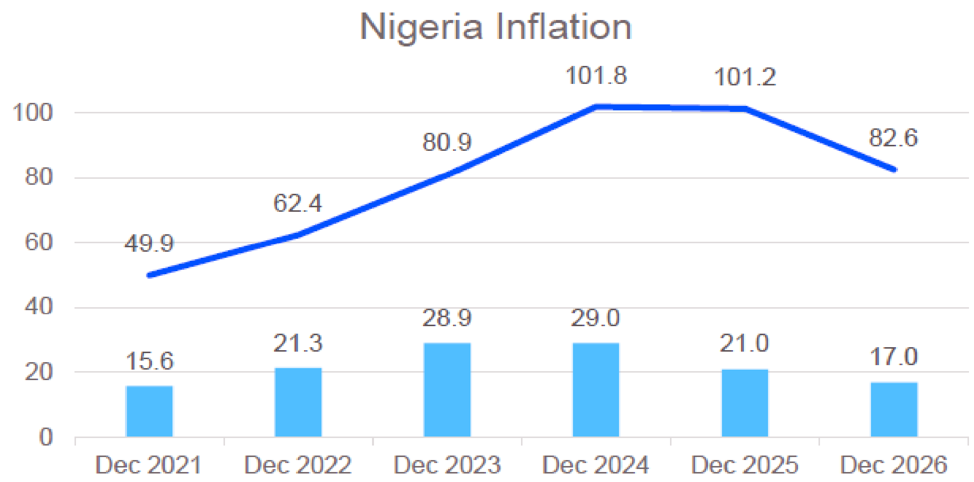
Case Example: Ghana in 2023
During the 2023 reporting period, Ghana's economy was flagged by global audit firms as hyperinflationary based on the 3-year cumulative inflation rate exceeding 100%. However, the Institute of Chartered Accountants Ghana (ICAG) issued a directive stating that IAS 29 would not apply, citing a downward trend in inflation and arguing that the qualitative indicators did not support hyperinflationary classification. SBG’s own assessments aligned with ICAG’s view, recognising the stability of the Ghanaian Cedi against major currencies and the trend of declining inflation rates. Despite this, the divergence between ICAG and global audit firms created challenges in ensuring consistent financial reporting within the SBG group.

Issue 1: Indicators for Determining Hyperinflationary Economies

- IMF WEO Data high level analysis of certain economies (end of period inflation rates)







Issue 1: Indicators for Determining Hyperinflationary Economies

- Request

Differences in outcome between the two interpretations in both sub-issues are substantial and potentially create significant diversity in practice. It is supportive that View B should be applied in both sub-issues. As an organisation and country that operates within emerging markets, it becomes increasingly important to assess all the indicators, both qualitative and quantitative, to determine whether the economy is indeed hyperinflationary. Our interpretation of the standard is to capture extreme inflation, which would erode the value of the local currency and often result in a switch from local currency to a more stable currency.

We believe that View B is further supported and consistent with other guidance:

- Module 31 of IFRS for SMEs.
- Other IASB discussions on hyperinflation, which stated that the threshold for entering into hyperinflation should be very high and not limited to just the quantitative threshold

•2 Issue 2: Reliability and Usefulness of Constant Purchase Power Accounting

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• Distortion of Economic Reality

- Current application of constant purchase power accounting under IAS 29 can lead to financial results that do not accurately reflect the economic reality of an entity's operations.
- This is particularly evident given that only non-monetary items are indexed, which creates basis risk when an entity holds non-hyperinflationary monetary assets (such as hard currency) and distorts the true economic performance. This basis risk exists due to exchange rates not always being directly correlated with inflation.
- For example, in hyperinflationary economies, entities often hold hard currency as a natural hedge against inflation. However, the current IAS 29 approach can result in a situation where holding hard currency appears less economically beneficial than holding non-monetary assets. See example below:

Zimbabwean entity with ZWL functional currency - 1 January 2024 to 28 February 2024 holding USD 100

The ZWL currency devalued by 145%:
1 January 2024 = USD/ZWL 6 105
28 February 2024 = USD/ZWL 14 939

The ZWL inflation index devalued by 294%:
1 January 2024 = 65 703
28 February 2024 = 258 942

USD/ZWL spot rates		6 105		14 939	
Date		**1 January 2024**		**28 February 2024**	
	USD	**ZWL**	**Devaluation**	**ZWL**	**USD**
Cash	100	610 500	145%	1 493 900	100
Equity	(100)	(610 500)	294%	(2 406 041)	(161)
Profit or loss:				**(912 141)**	**(61)**
IAS 21 translation gain				883 400	59
IAS 29 hyperinflation loss				(1 795 541)	(120)

Issue 2: Reliability and Usefulness of Constant Purchase Power Accounting

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- Operational Challenges and Complexity

- Process of restating financial statements under IAS 29 involves complex calculations, particularly in identifying and applying appropriate price indices. In many cases, the availability and reliability of such indices are questionable, leading to further subjectivity and variability in the financial statements of entities operating in the same economy.

Case Example: Zimbabwe 2024
In Zimbabwe, the official Consumer Price Index (CPI) exhibited extreme volatility, moving from 65,703 in December 2023 to 258,942 in February 2024. This volatility not only caused significant swings in financial reporting outcomes but also made it challenging for entities to provide consistent and understandable financial information to stakeholders. The current IAS 29 requirements, by not accommodating such volatility, exacerbate the operational difficulties and contribute to less reliable financial reporting.

- Restatement of financial results under IAS 29 often produces outcomes that are not aligned with investors' expectations or the economic fundamentals they use to evaluate companies.
- Investors typically assess returns in nominal terms, not in constant purchase power terms.

Issue 2: Reliability and Usefulness of Constant Purchase Power Accounting

- Example – Difference between IAS 29 and US GAAP

- A South African based group incorporates a Ghanaian entity on 1 January 2023 and injects 1 million Ghanaian Cedi (GHS) in an interest-bearing account within this entity. This GHS 1 million is extracted out of Ghana on 31 December 2023. It is assumed that Ghana has been triggered as a hyperinflationary economy on 1 January 2024. Facts and assumptions are as follows:

Exchange rates	
South African Rand (ZAR) / GHS exchange rate at 1 January 2023	0,60
Average ZAR / GHS exchange rate for 2023	0,63
ZAR / GHS exchange rate at 31 December 2023	0,65
Inflation	
Year-on-year inflation for Ghana in 2023	23,2%
Interest rate	
Average interest rate earned for the year	15%

Income statement

	IAS 29 - GHS	IAS 29 - ZAR	US GAAP - ZAR
Interest income	150 000	230 769	238 095
Exchange loss	-	-	(135 531)
Hyperinflation loss	(232 000)	(356 923)	-
	(82 000)	(126 154)	102 564
Return		*-7.60%*	*6.20%*

Issue 2: Reliability and Usefulness of Constant Purchase Power Accounting

- Request

- Suggests that the IASB consider revising the standard to align it more closely with the US GAAP requirements for hyperinflationary economies and/or a fair value model.
- Specifically, we suggest that the IASB explore the possibility of requiring entities in hyperinflationary economies to change their functional currency to the reporting currency of the parent entity for consolidation purposes when the parent entity is operating in a non-hyperinflationary economy.
- This approach would reduce the basis risk inherent in the current model and provide a more accurate reflection of the economic reality faced by entities in hyperinflationary environments.

- 3 Issue 3: Presentation of IAS 29 Restatements in Consolidated Financial Statements when the group entity is not hyperinflationary

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- Volatility in Group Earnings

- IAS 21 requires that all amounts of a hyperinflationary entity be translated at the closing rate at the reporting date. For multinational entities, this often results in substantial losses at the group level, as the combined effects of IAS 29 restatements and IAS 21 exchange rate adjustments can significantly erode reported earnings.
- For instance, in cases where the local price index and currency have devalued substantially, the group entity may recognise significant losses on both the IAS 29 restatement and the IAS 21 closing rate translation. These accounting adjustments can sometimes eliminate the total earnings of the hyperinflationary foreign operation, presenting a distorted view of the entity's financial health.

Inconsistencies in Comparative Information

- IAS 21 does not require the restatement of comparative information for group entities whose reporting currency is not hyperinflationary. This creates inconsistencies in the presentation of financial results, particularly when comparing current year results with those of prior periods. The lack of clarity in how these adjustments should be presented further complicates the consolidation process.

Issue 3: Presentation of IAS 29 Restatements in Consolidated Financial Statements when the group entity is not hyperinflationary

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- Request

- Suggests that the IASB consider revising IAS 21 and IAS 29 to allow for more flexibility in the presentation of hyperinflationary adjustments in group consolidated financial statements. One potential solution could involve recognising IAS 29 restatements directly in equity or other comprehensive income, rather than in profit or loss. This approach would help mitigate the earnings volatility that currently arises from the combined application of IAS 29 and IAS 21.

Conclusion

- The challenges outlined in this submission are not unique to SBG, South Africa or Africa but are relevant to all IFRS preparers operating partially or wholly in hyperinflationary economies.
- We believe that by addressing these issues via the next agenda consultation would enhance the consistency, comparability, and reliability of financial reporting in hyperinflationary contexts, thereby providing more meaningful and relevant information to investors and other stakeholders.

THANK YOU

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CONNECT WITH US

17 Fricker Rd, Illovo, Sandton, Johannesburg,
2196 Private Bag X32, Northlands, 2116

Head Office
T: +27 (0) 86 107 2422

SAICA International
T: +27 (0) 86 107 2422

For more information
visit www.saica.org.za

CA(SA) AGA(SA) AT(SA)

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