Staff paper

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IASB® meeting

Date	**December 2023**
Project	**Use of a Hyperinflationary Presentation Currency by a Non-hyperinflationary Entity (IAS 21)**
Topic	**Recommended amendment to IAS 21**
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Purpose of the paper

1. As Agenda Paper 12A to this meeting explains, this paper includes our analysis and recommendations for the International Accounting Standards Board (IASB) to amend IAS 21 *The Effects of Changes in Foreign Exchange Rates* to address the presentation of financial statements in a hyperinflationary presentation currency by an entity whose functional currency is non-hyperinflationary.

Structure

2. This agenda paper includes:
   (a) staff analysis (paragraphs 3–24);
   (b) staff recommendations (paragraph 25);
   (c) question for the IASB; and
   (d) two appendices:
      (i) Appendix A—Why we do not recommend the View II as a solution; and

(ii) Appendix B—Examples illustrating the recommended solution.

Staff analysis

3. We continue to agree with the Committee's recommendation to develop a narrow-scope amendment to address the submitted fact pattern and the related matter for the reasons considered by the Committee (see paragraphs 19–20 of Agenda Paper 12A of this meeting).

4. This section of the paper considers:

   (a) objective of amending the Accounting Standards;

   (b) recommended solution;

   (c) benefits and costs of the recommended solution, including feedback on the recommended solution and project scope;

   (d) priority of the narrow-scope standard-setting project; and

   (e) next steps.

The objective of amending the Accounting Standards

5. In developing our recommended solution, we first considered the objective of any amendment to the Accounting Standards to address the submitted fact pattern and related matter.

6. In the submitted fact pattern, the reporting entity's subsidiary (foreign operation) has a non-hyperinflationary functional currency. Similarly, in the related matter, the reporting entity has a non-hyperinflationary functional currency. In both cases, the reporting entity presents financial statements in a hyperinflationary currency. Consequently, in both situations, the reporting entity applies paragraph 39 of IAS 21 to translate the relevant results and financial position (including comparative information). (See row 2 of the table in paragraph 6 of Agenda Paper 12A to this meeting).

7. As paragraphs 13–14 of Agenda Paper 12A note, feedback indicated that applying only paragraph 39 of IAS 21 to financial statements presented in a hyperinflationary currency (and thereby not restating current period income and expenses and all comparative information in terms of a current measuring unit) reduces understandability and comparability.

8. We agree with this feedback. Paragraph 2 of IAS 29 (see paragraph 13 of Agenda Paper 12A) explains why reporting operating results and financial position without restatement is not useful and paragraph 7 of IAS 29 states:

> In a hyperinflationary economy, financial statements, whether they are based on a historical cost approach or a current cost approach, are useful only if they are expressed in terms of the measuring unit current at the end of the reporting period…

9. Consequently, for both the submitted fact pattern and the related matter, we think the objective of any amendment to the Accounting Standards should be to express the results and the financial position in terms of a current measuring unit.

10. Of the three views applied in practice to the submitted fact pattern (see paragraphs 8 and 14 of Agenda Paper 12A), only View II results in expressing financial statements in terms of the current measuring unit. Consequently, we considered whether View II is a possible solution.[1] A few Committee members said the View II solution would be a good solution for the submitted fact pattern because it would result in restating amounts using an index as required by IAS 29 which, in their view, would appropriately reflect the economic effects of hyperinflation. Appendix A to this paper explains why we are not recommending the View II solution.

11. In considering other solutions that would meet the objective, we developed our recommended solution.

[1] We refer to this as the 'View II solution' throughout the rest of this paper.

Recommended Solution

12. Our recommended solution would amend IAS 21 to require an entity to translate all items (assets, liabilities, equity items, income and expenses, including comparatives) at the most recent closing rate if the entity:

    (a) has a non-hyperinflationary functional currency and presents its financial statements in a hyperinflationary presentation currency; or

    (b) translates the results and financial position of a foreign operation that has a non-hyperinflationary functional currency into a hyperinflationary presentation currency.

13. In our view, the recommended solution meets the objective in paragraph 9 of this paper. The recommended solution would result in an entity translating all items presented in a hyperinflationary currency using the closing rate. IAS 29 requires an entity to apply a general price index—ie a measure of inflation when restating amounts and consequently considers a general price index to represent a 'current measuring unit'. We think the closing rate also represents a measure of the current measuring unit.

14. We acknowledge closing rates may not fully reflect the effects of inflation. Exchange rates typically do not fully reflect differing price levels between the two economies to which they relate at a given point in time. Nonetheless, IFRS Accounting Standards and stakeholders already consider the closing rate as a measure of the current measuring unit:

    (a) paragraph 17 of IAS 29 (see Appendix A of Agenda Paper 12A) allows entities to estimate a general price index using changes in movements in the exchange rate between the functional currency and a relatively stable foreign currency when a general price index is not available.

    (b) paragraph BC22 of the Basis for Conclusions on IAS 21 says the IASB, when developing IAS 21, decided not to adopt an approach that would require translating comparatives for an entity whose functional currency is the currency of a hyperinflationary economy, and for which the comparative amounts are being translated into a presentation currency of a non-hyperinflationary economy. One of the reasons is that if exchange rates fully reflect differing price levels between the two economies to which they relate, translating comparatives will result in the same amounts for the comparatives as were reported as current year amounts in the prior year financial statements. The IASB's decision, therefore, appears to be based on an assumption that there is a link between changes in a price index and changes in exchange rates.

(c) entities in the submitted fact pattern that apply view II and restate their financial statements after applying paragraph 39 of IAS 21, translate assets and liabilities at the closing rate without further restatement (see first row of the table in paragraph 6 and the View II column in the table in paragraph 8 of Agenda Paper 12A). Current practice would therefore suggest stakeholders accept the closing rate as a measure of the current measuring unit for assets and liabilities. We have not identified a conceptual argument that suggests the current measuring unit for income and expenses and comparative periods needs to be different from the current measuring unit for assets and liabilities.

15. Many Committee members agreed with our recommended solution and said it is the best and most practical solution. Some members asked us to consider specific points on the details related to the recommended solution. Paragraph 19 lists those comments together with our analysis of these comments.

16. Appendix B to this paper illustrates the application of our recommended solution.

Benefits and costs of the recommended solution

Benefits

17. In addition to meeting the objective in paragraph 9 our recommended solution:

(a) would improve the usefulness and comparability of financial statements. In particular, it would:

(i) remove diversity in practice for the submitted fact pattern.

(ii) improve comparability of financial statements presented in a hyperinflationary local currency. Currently, entities that have the hyperinflationary local currency as their functional currency restate their results and financial position applying IAS 29 while entities that have a non-hyperinflationary functional currency but present financial statements in that hyperinflationary local currency do not restate their results and financial position.

(iii) generally allow for easy translation back into the non-hyperinflationary functional currency or another currency—a user of financial statements (investors) would need to know only the closing exchange rate and the relevant financial statement measure. Investors we spoke with during our outreach said they prefer to translate amounts back into the non-hyperinflationary functional currency for their analysis.

(b) would be simple to apply for preparers. The closing exchange rate would be applied to all items in the current and comparative periods. Closing rates are either observable or, applying *Lack of Exchangeability* (Amendments to IAS 21), can be estimated when a currency lacks exchangeability.

(c) would apply a translation method that already exists in IAS 21 (see row 3 of the table in paragraph 6 of Agenda Paper 12A—the 'closing rate' method). Consequently, the recommended solution would not introduce a fundamental change to the underlying principles in IAS 21 or add new complexities. The closing rate method: [2]

(i) does not change the way underlying items are measured.

(ii) does not generate new exchange gains and losses. The current application of paragraph 39 of IAS 21 (see row 1 and 2 of the table in paragraph 6 of Agenda Paper 12A) results in exchange differences that

[2] See paragraphs BC15–BC23 of the Basis for Conclusions on IAS 21 (reproduced in Appendix A of Agenda Paper 12A) which explain the rationale for the closing rate method and other translation methods.

are recognised in other comprehensive income and accumulated in a separate component of equity. Stakeholders we spoke to questioned the usefulness of this 'currency translation adjustment' particular when an entity translates its own results and financial position. In this situation, the amounts accumulated in equity never recycle to profit or loss. Some stakeholders said that when a currency is hyperinflationary, substantial amounts of exchange differences can accumulate in equity given the level of inflation and resulting devaluation of the local currency.

(iii) does not change ratios such as return on assets.

(d) requires no amendments to IAS 29. In our view, amendments to IAS 29 risks unintended consequences for a broad range of entities and not only those in the submitted fact pattern and the related matter.

Costs

18. Our recommended solution:

(a) would require all entities in both the submitted fact pattern and the related matter to change their current accounting treatment. Entities in the related matter apply paragraph 39 of IAS 21 and not the closing rate method. Entities in the submitted fact pattern apply either View I, View II or View III which are currently applied in practice. Therefore, all affected entities will incur initial implementation costs. However, we do not expect entities to incur significant initial or ongoing costs because, as explained in paragraph 17(b), the recommended solution is simple to apply.

(b) for the submitted fact pattern, the parent will apply IAS 29 and restate its own income and expenses and comparative information by using an inflation index, while using closing exchange rates to present the income and expenses and comparative information of its foreign operation. This could pose some challenges when consolidating the foreign operation. Feedback from a preparer that is a hyperinflationary parent said even with the above-mentioned challenge the recommended solution would be simple to apply.

Feedback on the recommended solution and project scope

19. As noted previously, many Committee members said the recommended solution was the best and most practical solution. In considering the recommended solution, a few Committee members asked us to consider specific points of detail. The table below lists those comments together with our analysis of those comments:

#	Comment	Staff analysis
1	One Committee member asked whether the IASB should address how an entity would translate the statement of cash flows.	In our view, the IASB does not need to address this question as part of this narrow-scope standard-setting project. Paragraph 7 of IAS 21 states that IAS 21 does not apply to the translation of cash flows of a foreign operation. This is the reason why the translation methods in IAS 21 refer only to the translation of results and financial position. As discussed previously, our recommended solution makes use of the 'closing rate' translation method in paragraph 42 of IAS 21—consequently, we think the solution should not create new challenges for entities in respect of translating the statement of cash flows.
2	One Committee member asked how an entity would determine the closing rates when a currency is not observable.	In our view, no further action is required as part of this project. The IASB recently issued *Lack of Exchangeability* (Amendments to IAS 21) which address how an entity determines the closing rate when a currency lacks exchangeability.

#	Comment	Staff analysis
3	One Committee member asked whether a different solution might be necessary for foreign operations based in the same country as the reporting entity and those based in another country.	In our view, no further action is required as part of this project. IAS 21 is based on an entity's functional currency and does not have different accounting requirements for foreign operations based on their geographical location. The recommended solution would not—and should not—change the principles upon which IAS 21 is based.
4	One Committee member said applying the closing rate method to a subsidiary's results and financial position could result in elimination differences upon consolidation (for example, for intra-group transactions (IFRS 10 paragraph B86(c)).[3]	In our view, no further action is required as part of this project. Similar types of elimination differences already arise under current requirements (because different entities might apply different translation methods depending on their facts and circumstances). Our recommended solution would use the closing rate method already in paragraph 42 of IAS 21 and consequently does not create any new accounting challenges.
5	One Committee member suggested considering transition requirements	We will consider transition requirements at a future meeting—see paragraph 24 of this paper which discusses next steps.

20. Some stakeholders in our outreach raised other application matters related to IAS 29. We considered whether the matters raised related to the interaction between IAS 21 and IAS 29 (ie the subject of the submitted fact pattern) and whether they could be addressed concurrently as part of this project without requiring a fundamental change

[3] 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.'

to the principles and requirements in IAS 21 and IAS 29. Other than the related matter, we did not identify any other matter that could efficiently be addressed within the scope of this project. In particular, the matters raised:

(a) did not relate to new application questions about the interaction of IAS 21 and IAS 29;

(b) were not sufficiently narrow in scope for the IASB or the Committee to address it in an efficient manner; and/or

(c) have been considered as part of its *Third Agenda Consultation*.

Priority of the narrow-scope standard-setting project

21. As Agenda Paper 8 to this meeting notes, staff is working on developing a prioritising framework to help the IASB make decisions about agenda project prioritisation and timing in between the IASB's five-yearly agenda consultation. To help the IASB assess the priority of this narrow-scope standard setting project, and in the absence of a prioritisation framework, we used the considerations used to determine the priority of narrow-scope standard setting projects resulting from the post-implementation review (PIR) process.

22. As part of its *Third Agenda Consultation*, the IASB decided to leave unchanged the level of its resource allocation to maintenance and consistent application of IFRS Accounting Standards at 15-20%.[4] Considering the nature and stage of other projects that would fall within this allocation (both on the work plan and in the pipeline), we are of the view this project can be efficiently progressed to an Exposure Draft in 2024.

[4] See pages 10–11 of the Feedback Statement on the IASB's *Third Agenda Consultation*.

23. The table below sets out the PIR prioritisation framework and our analysis of that framework:

PIR framework	Staff analysis
Does the matter have substantial consequences?	**Yes—**the submitted fact pattern and the related matter are common in hyperinflationary economies and the effect can be material. There is diversity for the submitted fact pattern. There is no diversity for the related matter. However, in both situations, feedback suggests applying the requirements in paragraph 39 of IAS 21 does not result in useful information. Therefore, there are substantial consequences not only for preparers, but also for users of financial statements. The recommended solution would, amongst other things, enhance the understandability and comparability of financial statements presented in a hyperinflationary currency. Some Committee members said this would improve the opportunity for entities within hyperinflationary economies to attract much needed investment.
Is the matter pervasive?	**Yes—**the submitted fact pattern and the related matter are common in hyperinflationary economies and the effect can be material. As noted above, the number of hyperinflationary economies has been increasing and anecdotal feedback suggests this trend is expected to continue.
Does the matter arise from a financial reporting issue that can be effectively addressed by the IASB in a timely manner?	**Yes—**considering the work already performed as part of the Committee's process, the additional resources required to progress this project to an Exposure Draft (if the IASB agrees with the solution) will not be substantial (see paragraph 24 for next steps). We emphasise that if, as a consequence of feedback on the Exposure Draft, the IASB becomes aware of matters we have not identified through our research to date that change the cost-effectiveness of the recommended solution, the IASB can reconsider this project's prioritisation at that stage.

PIR framework	Staff analysis
Are the benefits of any action expected to outweigh the costs? To determine this, the IASB considers the extent of disruption and operational costs from change and the importance of the matter to users of financial statements.	**Yes—**the recommended solution makes use of a translation method that already exists in IAS 21, is well understood and simple to apply. While entities will incur costs to implement the solution, we think the implementation and ongoing costs will not be substantial. In our view, stakeholders will also not incur significant costs in reviewing and commenting on an Exposure Draft that proposes the solution because the translation method already exists in IAS 21. Investors we spoke to during our research said they typically prefer translating figures back to a non-hyperinflationary currency for purposes of their analysis and were supportive of a solution that made this translation easier.

Next steps

24. If the IASB agrees with our recommendation, we expect the next steps to be:

    (a) a discussion at a future IASB meeting about possible disclosure and transition requirements. At that meeting we plan to also assess the due process requirements for developing an Exposure Draft and to ask the IASB for permission to start the balloting process.

    (b) drafting, balloting and publishing an Exposure Draft.

Staff recommendation

25. Based on our analysis, we recommend that the IASB:

    (a) add a maintenance project to its work plan to develop a narrow-scope amendment to address the submitted fact pattern and the related mater; and

    (b) proposes to amend IAS 21 to require a reporting entity to translate all items (assets, liabilities, equity items, income and expenses, including comparatives) at the most recent closing rate when the entity:

(i) has a non-hyperinflationary functional currency and presents financial statements in a hyperinflationary presentation currency (related matter); or

(ii) translates the results and financial position of a foreign operation that has a non-hyperinflationary functional currency (submitted fact pattern).

Question for the IASB

Question for the IASB
Does the IASB agree with our recommendations to: (a) add a maintenance project to the workplan to develop a narrow-scope amendment to address the submitted fact pattern and the related matter, and (b) propose to amend IAS 21 as set out in paragraph 25(b)?

Appendix A—Why we do not recommend the View II Solution

A1. A few Committee members said requiring entities to apply View II—set out in paragraph 8 of Agenda Paper 12A—would be a better solution than the recommended solution—particularly for the submitted fact pattern—because restating amounts using an index as required by IAS 29 would, in their view, better reflect the economic effects of hyperinflation. Some stakeholders in our outreach meetings also suggested View II as a solution to address the submitted fact pattern.

A2. We considered but rejected the View II solution because:

(a) the recommended solution would apply to both the submitted fact pattern and the related matter. View II could work for the submitted fact pattern but applying it to the related matter would be complex. As paragraph 12 of Agenda Paper 12A to this meeting explains, entities in the situation described in the related matter are not in the scope of IAS 29. Therefore, using View II as a solution would require the IASB to either: (i) expand the scope of IAS 29 which, in our view, would be beyond the scope of this project; or (ii) introduce an arbitrary rules-based amendment to the scope of IAS 29.

(b) applying the View II solution to the submitted fact pattern and our recommended solution to the related matter would be arbitrary and rules-based and result in having two different translation methods for similar situations. IAS 21 requires an entity to apply the same translation method when translating its own results and financial position to a different presentation currency or when translating a foreign operation.

(c) the recommended solution gives a consistent translation method for all items in the financial statements. In View II and View III applied in practice for the submitted fact pattern (see paragraph 8 of Agenda Paper 12A), the statement of financial position is translated using the closing rate while the income statement and comparative information are translated at spot exchange rate and then, in some cases, restated applying a general price index—following some of the principles in IAS 29. There are no clear conceptual basis for having different approaches for translating assets and liabilities and income, expenses and comparative information.

(d) from a cost perspective, View II would be costlier to apply for preparers and more difficult to understand for investors. This is because it is a two-step process that would requires the use of both an exchange rate and a general price index. The recommended solution makes it easier for investors to translate financial statements to a non-hyperinflationary currency and, thereby, reducing cost for investors.

Appendix B—Examples illustrating the recommended solution

B1. The objective of the examples is to illustrate the application of the recommended solution for the submitted fact pattern and the related matter.

The related matter

Facts

B2. Entity A has a non-hyperinflationary functional currency (NHC) but presents its financial statements in a hyperinflationary currency (HC).

B3. Entity A:

(a) was established on 1 January 20X2 with a share capital of NHC1,000;

(b) used the proceeds to buy a non-depreciable non-monetary asset for NHC1,000 on 1 January 20X2;

(c) generated cash sales of NHC50 on 1 January 20X2 and 1 January 20X3; and

(d) has a current reporting date of 31 December 20X3.

B4. The exchange rates between the currencies are:

(a) 1 January 20X2: NHC1: HC1

(b) 31 December 20X2: NHC1: HC2

(c) 31 December 20X3: NHC1: HC3

B5. Applying the recommended solution to its financial statements for the year ended 31 December 20X3, Entity A translates all amounts (including comparative information) in its financial statements at closing exchange rate of NHC1: HC3.

31 December	20X3		20X2	
DR / (CR)	**NHC**	**HC**	**NHC**	**HC**
Income and expenses				
Revenue	(50)	(150)	(50)	(150)
Assets				
Non-monetary asset	1,000	3,000	1,000	3,000
Cash	100	300	50	150
Equity				
Share Capital	(1,000)	(3,000)	(1,000)	(3,000)
Retained earnings	(100)	(300)	(50)	(150)

B6. Applying the recommended solution does not result in any new exchange differences.

Submitted fact pattern[5]

Facts

B7. Entity P (a parent) has a hyperinflationary functional and presentation currency (HC). Entity P owns 100% of the equity of Entity S (a subsidiary).

B8. Entity S:

(a) has a non-hyperinflationary functional currency (NHC);

(b) was established on 1 January 20X2 through an investment of HC1,000 by Entity P. Entity S used the capital to acquire a non-depreciable non-monetary asset for NHC1,000.

B9. Entity S generates cash sales of NHC50 on 1 January 20X2 and 1 January 20X3.

B10. The exchange rates between the currencies are:

(a) 1 January 20X2: NHC1: HC1

(b) 31 December 20X2: NHC1: HC2

[5] For simplicity we do not illustrate all the consolidation procedures the hyperinflationary parent applies after translating the financial statements of its non-hyperinflationary subsidiary.

(c) 31 December 20X3: NHC1: HC3

B11. The Consumer Price Index of the hyperinflationary economy in which Entity P operates are[6]:

(a) 1 January 20X2: 100

(b) 31 December 20X2: 200

(c) 31 December 20X3: 300

Solution

B12. Applying the recommended solution to its financial statements as at, and for the year ended, 31 December 20X3, Entity P translates all amounts (including comparative information) in the financial statements of Entity S at closing exchange rate of NHC1: HC3.

Excerpts of Entity S's financial statements				
31 December	**20X3**		**20X2**	
DR / (CR)	**NHC**	**HC**	**NHC**	**to HC**
Income and expenses				
Revenue	(50)	(150)	(50)	(150)
Assets				
Non-monetary asset	1,000	3,000	1,000	3,000
Cash	100	300	50	150
Equity				
Share Capital	(1,000)	(3,000)	(1,000)	(3,000)
Retained earnings	(100)	(300)	(50)	(150)

B13. After Entity P translates the financial statements of Entity S, it includes these financial statements in its consolidated financial statements by:

[6] While this is not usually the case, for simplicity we assume that that the exchange rates fully reflect differing price levels between the two economies to which they relate.

(a) combining like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of the subsidiary; and

(b) eliminate the carrying amount of its investment in Entity S as at 31 December 20X3 (HC1,000 × (change in general price index of: 300 ÷ 100) = HC3,000) and the Entity P's 100% interest in the share capital of Entity S at that same reporting date (HC3,000).[7]

[7] If the exchange rates do not fully reflect differing price levels between the two economies to which they relate, the carrying amount of the investment reported in the statement of financial position of Entity P, restated applying IAS 29, will not equal the carrying amount of the parent's interest in the share capital of Entity S as reported, after applying the recommended solution, in the subsidiary's statement of financial position. See row 4 in paragraph 19 of this paper for further discussion about this challenge.