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STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	**Translation of a Hyperinflationary Foreign Operation (IAS 21 and IAS 29)**		
Paper topic	Comment letters on Tentative Agenda Decision—Presenting Exchange Differences		
CONTACT(S)	Vincent Louis	vlouis@ifrs.org	+44 (0) 20 7246 6410
	Jawaid Dossani	jdossani@ifrs.org	+44 (0) 20 7332 2742

Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about the application of IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies*. The submitter asked how an entity—with a non-hyperinflationary presentation currency—presents any differences that arise on restating and translating the results and financial position of a hyperinflationary foreign operation. In September 2019, the Committee published a tentative agenda decision.

2. The objective of this paper is to:

   (a) analyse comments on the tentative agenda decision; and

   (b) ask the Committee whether it agrees with our recommendation to finalise the agenda decision.

Structure of the paper

3. This paper includes the following:

   (a) background (paragraphs 5–11);

(b) comment letter summary (paragraphs 12–16);

(c) staff analysis (paragraphs 17–57); and

(d) staff recommendation (paragraph 58).

4. There are three appendices to the paper:

(a) Appendix A—proposed wording of the agenda decision;

(b) Appendix B—comments on the usefulness of the information provided by the different methods; and

(c) Appendix C—comment letters.

Background

5. Paragraph 43 of IAS 21 requires an entity to restate the results and financial position of a hyperinflationary foreign operation applying IAS 29 before applying the translation method set out in paragraph 42 of IAS 21 (restate/translate approach). The application of the restate/translate approach may result in a change to the entity's net investment in the hyperinflationary foreign operation. This change would include two effects:

(a) a restatement effect resulting from restating the entity's interest in the equity of the hyperinflationary foreign operation as required by IAS 29; and

(b) a translation effect resulting from translating the entity's interest in the equity of the hyperinflationary foreign operation (excluding the effect of any restatement required by IAS 29) at a closing rate that differs from the previous closing rate.

6. The submitter asked how the entity presents the restatement and translation effects in its statement of financial position.

7. Paragraph 8 of IAS 21 defines an exchange difference as the difference 'resulting from translating a given number of units of one currency into another currency at different exchange rates'. The Committee concluded that, in the fact pattern described in the submission, either the translation effect alone meets the definition of an

exchange difference, or the combination of the restatement and translation effects meets that definition.

8. IAS 21 requires the recognition of exchange differences in profit or loss or OCI—with no reference to equity—because exchange differences meet the definition of income or expenses. Accordingly, the Committee concluded that an entity does not recognise exchange differences directly in equity.

9. Paragraph 41 of IAS 21 specifies why paragraph 39(c) of IAS 21 requires an entity whose functional currency is not the currency of a hyperinflationary economy to present in OCI—and not in profit or loss—any exchange difference arising when the entity's results and financial position are translated into a non-hyperinflationary presentation currency. The Committee observed that this explanation also applies if the functional currency is hyperinflationary. Accordingly, the Committee concluded that an entity presents in OCI any exchange difference resulting from the translation of a hyperinflationary foreign operation.

10. The Committee concluded that, in the fact pattern described in the submission, the entity presents:

    (a) the restatement and translation effects in OCI, if the entity considers that the combination of those two effects meets the definition of an exchange difference in IAS 21 (OCI method); or

    (b) the translation effect in OCI, if the entity considers that only this translation effect meets the definition of an exchange difference in IAS 21. In this case, consistent with the requirements in paragraph 25 of IAS 29, the entity would present the restatement effect in equity (split method).

11. In the light of its analysis, the Committee considered whether to add a project on the presentation of exchange differences resulting from the restatement and translation of hyperinflationary foreign operations to its standard-setting agenda. The Committee had not obtained evidence that a project would result in an improvement in financial reporting that would be sufficient to outweigh the costs. Consequently, the Committee tentatively decided not to add the matter to its standard-setting agenda.

Comment letter summary

12. We received 16 comment letters by the comment letter deadline. All comment letters received, including any late comment letters, are available on our website[1]. This agenda paper includes analysis of only the comment letters received by the comment letter deadline, which are reproduced in Appendix C.

13. Five respondents (Deloitte, Mazars, the Accounting Standards Committee of Germany, the Institute of Chartered Accountants of Nigeria and the National Board of Accountants and Auditors [Tanzania]) agree with the Committee's decision not to add the matter to its standard-setting agenda for the reasons outlined in the tentative agenda decision.

14. Other respondents disagree with the Committee's technical analysis and conclusions. For example:

    (a) KPMG, Santander, Banco Bilbao Vizcaya Argentaria (BBVA), MAPFRE and Telefonica say existing requirements in IFRS Standards allow an entity to recognise the restatement and translation effects directly in equity (direct equity method);

    (b) the Group of Latin American Accounting Standards Setters (GLASS) and David Hardidge say an entity should not apply the split method; and

    (c) the Accounting Standards Board of Japan (ASBJ) says requirements in IAS 1 *Presentation of Financial Statements* prevent the presentation of exchange differences arising on the translation of hyperinflationary foreign operations in OCI.

15. Several respondents suggest undertaking standard-setting to address the matter.

16. Respondents' comments, together with our analysis, are presented below.

[1] At the date of posting this agenda paper, there were no late comment letters.

Staff analysis

17. The following paragraphs analyse respondents' comments on:

    (a) the recognition of the restatement and translation effects directly in equity (paragraphs 18–36):

        (i) background (paragraphs 18–19);

        (ii) respondents' comments (paragraphs 20–25); and

        (iii) staff analysis, including

            1. both effects result from applying the restatement requirements in IAS 29 (paragraphs 26–29),

            2. IFRS Standards do not prohibit (and could be read to require) the direct equity method (paragraphs 30–32), and

            3. the reference to paragraph 41 of IAS 21 (paragraphs 33–36).

    (b) other aspects of the Committee's technical analysis and conclusions (paragraph 37).

    (c) requests for standard-setting:

        (i) respondents' comments (paragraphs 38–44); and

        (ii) staff analysis (paragraphs 45–55).

    (d) timing of publishing an agenda decision (paragraphs 56–57).

The recognition of the restatement and translation effects directly in equity

Background

18. As discussed in paragraphs 5–11 of this paper, the Committee concluded that, in the fact pattern described in the submission, the entity applies either the OCI method or the split method.

19. The Committee concluded that (a) an entity does not recognise exchange differences directly in equity and (b) in the fact pattern described in the submission, either the combined restatement and translation effects or the translation effect alone meet

IAS 21's the definition of an exchange difference. Accordingly, the Committee's analysis of existing IFRS Standards did not support the direct equity method.

Respondents' comments

20. Some respondents disagree with the Committee's conclusion. They say an entity can apply the direct equity method—in addition to the OCI and split methods—on the grounds that:

(a) both the restatement and translation effects result from applying the restatement requirements in IAS 29 (see paragraphs 22–23); and

(b) IFRS Standards do not prohibit (and could be read to require) the recognition of the translation effect in equity (see paragraphs 24–25).

21. Some respondents also say the reference to paragraph 41 of IAS 21 in the tentative agenda decision is inappropriate because that paragraph applies only to non-hyperinflationary foreign operations.

Both effects result from applying the restatement requirements in IAS 29

22. Some respondents say an entity can consider the translation effect to be part of the overall restatement required by IAS 29 and, accordingly, can recognise both the restatement and translation effects directly in equity. For example, KPMG says:

> …IAS 21 and IAS 29 require a comprehensive remeasurement of the financial statements of a hyperinflationary subsidiary and any adjustments to the measurement of the assets and liabilities of the subsidiary arising from that process are matched by equal and opposite adjustments to the components of equity of the subsidiary…

23. In KPMG's view, changes to an entity's equity that arise from applying the restate/translate approach could be considered to result from changes in the measuring unit applied to the net investment in the foreign operation and, thus, result from applying the restatement requirements in IAS 29. Applying paragraph 25 of IAS 29[2],

[2] Reproduced in paragraph 28 of this paper.

an entity would consider such changes to be adjustments to equity, and not exchange differences.

IFRS Standards do not prohibit (and could be read to require) the direct equity method

24. Some respondents note that IAS 21 does not explicitly specify how to recognise exchange differences arising from the translation of a hyperinflationary foreign operation. In their view, the lack of explicit requirements:

    (a) means that entities can present exchange differences (and thus, both the restatement and translation effects) directly in equity.

    (b) could be read to imply that IAS 21 prohibits the recognition of exchange differences on translating hyperinflationary foreign operations. Therefore, any difference that arises is not an exchange difference, and should be recognised directly in equity. These respondents say IAS 21's requirements for hyperinflationary foreign operations are different from those for non-hyperinflationary foreign operations (which explicitly specify how to recognise exchanges differences arising on translating the results and financial position of a non-hyperinflationary foreign operation). In their view, the requirements for hyperinflationary foreign operations could be seen as intentionally not contemplating or permitting the recognition of exchange differences—this is because doing so would not be meaningful. Because of the economic interrelationship between inflation and changes in exchange rates, any increase in the local currency amount of a foreign operation's equity is usually offset (at least to some extent) by devaluation of the exchange rate.

25. Some respondents say the fact that a number of entities apply the direct equity method provides evidence that the method is permitted by existing IFRS Standards.

Staff analysis

Both effects result from applying the restatement requirements in IAS 29

26. As noted above, paragraph 43 of IAS 21 requires an entity to restate the results and financial position of a hyperinflationary foreign operation applying IAS 29 before applying the translation method set out in paragraph 42 of IAS 21. The application of this restate/translate approach might result in a change to the entity's net investment that is made up of two effects—a restatement effect arising from the application of IAS 29 and a translation effect arising from the application of IAS 21. Accordingly, at least a portion (if not all) of the change results from using different exchange rates and, thus, is an exchange difference as defined in IAS 21[3].

27. We therefore disagree with respondents who say that an entity can recognise any change in its net investment that arises from the restate/translate approach directly in equity on the grounds that the change results *only* from changes in the measuring unit applied to that net investment and, consequently, results *only* from applying the restatement requirements in IAS 29.

28. We also disagree that, applying paragraph 25 of IAS 29, an entity would recognise any change in the net investment directly in equity. Paragraph 25 of IAS 29 states:

> At the end of the first period and in subsequent periods, all components of owners' equity are restated by applying a general price index from the beginning of the period or the date of contribution, if later. The movements for the period in owners' equity are disclosed in accordance with IAS 1.

29. That paragraph requires an entity to restate components of owners' equity to reflect changes in prices during the reporting period—it does not specify where an entity recognises the other side of that restatement. We note for example that, applying paragraphs 27–28 of IAS 29, a hyperinflationary foreign operation recognises in profit or loss a gain or loss on its net monetary position, which the entity also recognises in profit or loss.

[3] Paragraph 8 of IAS 21 defines an exchange difference as '…the difference resulting from translating a given number of units of one currency into another currency at different exchange rates…'.

IFRS Standards do not prohibit (and could be read to require) the recognition of the translation effect directly in equity

30. Paragraph 42 of IAS 21 does not explicitly specify how an entity recognises exchange differences arising when an entity's functional currency is hyperinflationary. However, this does not mean that:

    (a) such differences do not exist. Paragraphs 30–34 of Agenda Paper 4A for the Committee's September 2019 meeting (September paper) explain why, in our view, paragraph 42 does not explicitly discuss exchange differences. Paragraphs 46–48 of that paper explain why the translation effect—or the combined restatement and translation effects—meet IAS 21's definition of an exchange difference.

    (b) an entity can elect to recognise such differences directly in equity. Paragraphs 35–40 of the September paper explain that IAS 21 does not contemplate the recognition of exchange differences directly in equity because exchange differences meet the definition of income and expenses.

31. In our view, the absence of an explicit prohibition in IAS 21 regarding the recognition of exchanges differences directly in equity is *not* a basis to support that accounting treatment, particularly in this case when exchange differences meet the definition of income or expenses.

32. We therefore disagree with respondents who say entities can recognise exchange differences directly in equity when they relate to hyperinflationary foreign operations because IAS 21 does not explicitly prohibit (or could be read to require) that recognition.

The reference to paragraph 41 of IAS 21

33. The tentative agenda decision explains that IAS 21 requires the recognition of exchange differences in profit or loss or OCI—with no reference to equity—because exchange differences meet the definition of income or expenses. It then goes on to explain why an entity presents in OCI—and not in profit or loss—any exchange difference resulting from the translation of a hyperinflationary foreign operation. The tentative agenda decision states:

> Paragraph 41 of IAS 21 specifies why paragraph 39(c) of IAS 21 requires an entity whose functional currency is not the currency of a hyperinflationary economy to present in OCI—and not in profit or loss—any exchange difference arising when the entity's results and financial position are translated into a non-hyperinflationary presentation currency. The Committee observed that this explanation also applies if the functional currency is hyperinflationary. Accordingly, the Committee concluded that an entity presents in OCI any exchange difference resulting from the translation of a hyperinflationary foreign operation.

34. The tentative agenda decision therefore refers to paragraph 41 of IAS 21 in the context of assessing whether an entity presents exchange differences in OCI or profit or loss; the reference is not used in the context of assessing whether an entity can (or is required to) recognise exchange differences directly in equity.

35. We continue to think the agenda decision's reference to paragraph 41 is appropriate in the context in which it is used. We also note that paragraph 7 of IAS 1 supports the Committee's conclusion in this respect. That paragraph states:

> …The components of other comprehensive income include:..
>
> (c) gains and losses arising from translating the financial statements of a foreign operation (see IAS 21 *The Effects of Changes in Foreign Exchange Rates*)…'

36. Paragraph 7 of IAS 1 refers to the translation of foreign operations, without distinguishing between hyperinflationary and non-hyperinflationary foreign

operations. In our view, it would be helpful to amend the wording of the agenda decision to also include a reference to paragraph 7 of IAS 1 (in addition to paragraph 41 of IAS 21) in explaining the Committee's conclusion. Appendix A to this paper includes recommended wording in this respect.

Other aspects of the Committee's technical analysis and conclusions

37. The table below summarises respondents' comments on other aspects of the Committee's technical analysis and conclusions together with our analysis of those comments.

Respondents' comments	***Analysis***
1. The ASBJ notes that paragraph 88 of IAS 1 requires an entity to 'recognise all items of income and expense…in profit or loss unless an IFRS requires or permits otherwise'. It says paragraph 88 would require recognition of exchange differences relating to hyperinflationary foreign operations in profit or loss because there is no explicit requirement in IAS 21 that permits or requires an entity to present those exchange differences in OCI.	We disagree with the comment for the reasons set out in paragraphs 33–36 of this paper.
2. The GLASS says the change in an entity's net investment arising from the application of the restate/translate approach meets the definition of an exchange difference in its entirety. This is because the change arises from translating the balance of all items in the foreign operation's financial statements (after the restate step) into the presentation currency using different exchange rates. The FACPCE	As explained above, in our view the combined restatement and translation effects meet IAS 21's definition of an exchange difference, which would result in an entity applying the OCI method. However, given the definition of an exchange difference, we continue to

Respondents' comments	*Analysis*
(Argentina) says the OCI method is appropriate.	think an entity might also consider that *only* the translation effect meets that definition. In this case, the restatement effect is considered to result from applying IAS 29's restatement requirements, and not from applying different exchange rates to a given number of units of one currency.
3. David Hardidge suggests that the Committee prohibit the split method because the restatement effect is (a) part of the translation process and should be recognised together with the translation effect; and (b) not a transaction with owners in their capacity as owners and, therefore, should not be recognised in equity.	
4. We have been made aware that the following sentence in the tentative agenda decision (emphasis added) could be misleading: '…a restatement effect resulting from restating the entity's interest *in the net assets* of the hyperinflationary foreign operation as required by IAS 29'. It could be read to imply that IAS 29 requires the restatement of *all* assets and liabilities, whereas paragraph 12 of IAS 29 specifies that an entity does not restate monetary items.	We recommend updating the wording of the tentative agenda decision to remove references to 'net assets' and, instead, refer to 'equity'.

Requests for standard-setting

Respondents' comments

38. Several respondents suggest undertaking standard-setting. In particular:

(a) some respondents say the existing diversity in reporting provides evidence of a lack of clarity in IAS 21 and, therefore, confirms the need for standard-setting to address the matter.

(b) several respondents comment on the usefulness of the information provided by each of the presentation methods (see paragraphs 39–41).

(c) some respondents suggest a wider consideration of the interaction between IAS 21 and IAS 29 by the Board or Committee (see paragraphs 42–44).

Usefulness of information

39. Several respondents suggest performing additional outreach and research to determine which method provides the most useful information. Several of these respondents say (a) the direct equity method provides the most useful information to users of financial statements; and (b) the split method fails to provide useful information—this is because, in their view, the split method does not reflect the economic relationship between inflation and changes in exchange rates. Some of those respondents also provide additional information (for example, findings from their own research) in support of their view.

40. BBVA says we have not performed enough work on the matter because we have not analysed all possible scenarios, economic effects and possible asymmetries that may arise from each method. BBVA also provides examples that illustrate the differences in outcome that would result applying the different methods. Telefonica says our research[4] may have provided more relevant conclusions if it had linked the method used with each entity's experience with hyperinflationary economies, and the materiality of each entity's hyperinflationary foreign operations.

41. Appendix B to this paper provides further details about respondents' comments on the usefulness of each method.

A wider consideration of the interaction between IAS 21 and IAS 29

42. Some respondents suggest that the Committee consider more broadly a project on IAS 29, or the interaction between IAS 21 and IAS 29. These respondents say any lack of clarity on the matter relates to the complex interaction between those two Standards. Respondents note that those Standards were published at different times and, in their view, the interaction has not been adequately considered by the Board in

[4] Included in paragraphs 25–28 of Agenda Paper 4A for the September 2019 Committee meeting.

the past. Some of those respondents also say the matter described in the submission is too complex to be addressed in an agenda decision.

43. For example, EY says:

> '…we note that IAS 29 is an old standard that has never been fully reconsidered by the IASB. In particular, IAS 29 is complex to apply by preparers, while the quality of the resulting information for users relies greatly on the reliability of the inflation statistics and an exchange rate that is not severely distorted. In addition, the interaction with IAS 21 is not fully defined and is prone to result in anomalous outcomes. We recommend that staff conduct further outreach to understand how investors use the information that results from the application of IAS 21 and IAS 29 and how the usefulness of the information compares to US GAAP, which applies a very different approach. In our view, the decision whether standard-setting is required should be left to the Board as this would involve a much broader project.'

44. The ASBJ says the Board decided not to revise its discussion of capital maintenance in the 2018 *Conceptual Framework for Financial Reporting* and, instead, to address matters related to capital maintenance when it undertakes research to decide whether to revise IAS 29. In the ASBJ's view, this implies the requirements in IAS 29 might be unclear and suggests that the Board research the need to revise IAS 29. BBVA identifies additional matters relating to the application of IAS 21 and IAS 29 that should be considered in any standard-setting project on hyperinflationary entities or foreign operations.

Staff analysis

45. We recommend not adding a narrow-scope standard-setting project on the matter submitted to the Committee on hyperinflationary foreign operations—instead, we recommend publishing an agenda decision with explanatory material because:

    (a) the explanatory material will improve consistency in the application of IAS 21 and IAS 29 (see paragraphs 47–49);

(b) the explanatory material is not expected to increase diversity in reporting (see paragraphs 50–51);

(c) diversity in reporting does not alone indicate a need for standard-setting (see paragraphs 52–53); and

(d) the expected benefits of narrow-scope standard-setting would not, in our view, outweigh the costs (see paragraph 54).

46. That said, the Board could consider a wider-scope project on hyperinflationary entities and foreign operations, or those that operate in high inflation economies (see paragraph 55).

Improving consistency in the application of IAS 21 and IAS 29

47. After considering respondents' comments on the tentative agenda decision, we continue to agree with the Committee's conclusion that, applying the existing requirements in IAS 21 and IAS 29, an entity either presents:

(a) the restatement and translation effects in OCI; or

(b) the translation effect in OCI, and the restatement effect in equity.

48. Explanatory material setting out this conclusion would improve consistency in the application of IAS 21 and IAS 29. This is because it would provide additional insights for some entities regarding the application of the restate/translate approach, and thus reduce the existing diversity in reporting.

49. Outreach responses, comment letters and our additional research has provided evidence that entities generally recognise the combined restatement and translation effects in OCI or directly in equity. Explanatory material similar to that in the tentative agenda decision would improve consistency in application by clarifying that recognising those effects directly in equity is not aligned with existing requirements. Entities that previously had applied, in good faith, the direct equity method would now be aware that they would need to implement an accounting policy change to apply the OCI method or the split method.

Not expected to increase diversity in reporting

50. Explanatory material in an agenda decision cannot add or change requirements in IFRS Standards. Accordingly, such explanatory material can neither permit an approach that existing IFRS Standards do *not* support nor rule out an approach that existing Standards support. For this reason, if the Committee concludes that an entity can apply the split method based on the requirements in IFRS Standards, the agenda decision cannot prohibit application of the split method on the basis that the method might not be viewed as providing useful information to users of financial statements.

51. Based on our analysis, we have concluded that the requirements in IAS 21 and IAS 29 permit both the OCI method and the split method—to rule out either would require a change to the Standards. Despite this, publishing an agenda decision that says both methods comply with the Standards would not be expected to create diversity in reporting. There is little evidence of entities applying the split method—that method is likely to be more complex and costly to implement than the OCI method and respondents have also indicated that, in their view, the split method may not provide useful information because it would not reflect the economic relationship between inflation and changes in exchange rates. There is therefore little incentive for entities to apply the split method.

Diversity in reporting alone does not indicate a need for standard-setting

52. Some respondents to the Due Process Oversight Committee's (DPOC) recent review of the *Due Process Handbook* suggested that the Committee's standard-setting criteria be changed so that identification of diversity in reporting would be considered evidence of the need for standard-setting. In response to that suggestion, Agenda Paper 2 of the DPOC's December 2019 meeting explained that one of the Committee's criteria for standard-setting is to assess whether the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine the required accounting (taking into consideration the principle-based nature of the Standards). Stakeholders commenting on a tentative agenda decision have the opportunity to highlight that particular requirements have been read differently. When that is the case, the Committee considers that feedback—importantly, including the reasons provided for those different readings—before reaching its conclusion on

whether the Standards provide an adequate basis. If there is diversity in reporting despite the Standards providing an adequate basis, then the appropriate way to help resolve that diversity is by publishing an agenda decision with explanatory material.

53. In December 2019, the DPOC decided not to change the Committee's standard-setting criteria as suggested by those respondents. Consequently, we continue to hold the view that diversity in reporting alone does not indicate a need for standard-setting.

Narrow-scope standard-setting

54. The respondents who disagree with the Committee's analysis generally recommend standard-setting on this matter and on the matters described in Agenda Papers 4B and 4C. Several respondents also highlight other questions that arise when applying IAS 21 and IAS 29, and some note the interdependencies between all those questions. Respondents that recommend standard-setting note the economic relationship between inflation and changes in exchange rates, and the fact that there may be short-term mismatches in that relationship when an economy has high inflation or is hyperinflationary. If the Board or Committee were to undertake standard-setting in relation to hyperinflationary entities or foreign operations, we agree with respondents that we would need to consider all possible scenarios, economic effects and possible asymmetries. In our view, there would be little benefit in attempting to address individual matters without undertaking more holistic research on both IAS 29 and its interaction with IAS 21. For this reason, we would not recommend a narrow-scope project on this matter—or the three matters described in the submission—in isolation of other aspects of the accounting for hyperinflationary foreign operations.

A wider-scope project

55. Undertaking a wider-scope research project on IAS 29—or the interaction between IAS 21 and IAS 29—is a decision for the Board. As part of its 2020 *Agenda Consultation*, the Board will publish a Request for Information (RFI) later in the year to seek formal public input on its strategy and 2022-2026 work plan. Respondents to this tentative agenda decision have provided thoughtful responses about the interaction between IAS 21 and IAS 29 in the context of hyperinflationary foreign

operations, and the economic considerations when presenting the results and financial position of those foreign operations. We would encourage those stakeholders to respond to the Board's Agenda Consultation and provide input to help the Board assess whether it should prioritise a project on IAS 29—or the interaction between IAS 21 and IAS 29—in determining its work plan for the coming years.

Timing of publishing an agenda decision

56. BBVA and MAPFRE say the timing of publishing an agenda decision on this matter could coincide with the closing process for entities' 2019 financial statements—in particular if the Committee were to finalise the agenda decision at its March 2020 meeting. In BBVA's view, this situation creates uncertainty and could add complexity to an entity's year-end closing process.

57. We note that the Board has considered the timing of application of agenda decisions. IFRIC® *Update* includes the Board's view in this respect—ie the Board's expectation that an entity would be entitled to sufficient time to determine whether to change an accounting policy as a result of an agenda decision and to implement any change.

Staff recommendation

58. On the basis of our analysis, we recommend finalising the agenda decision as published in IFRIC® *Update* in September 2019, subject to the changes discussed in paragraphs 36 and 37 of this paper. Appendix A to this paper sets out the proposed wording of the final agenda decision.

Question for the Committee
Does the Committee agree with our recommendation to finalise the agenda decision set out in Appendix A to this paper?

Appendix A—proposed wording of the agenda decision

A1. We propose the following wording for the final agenda decision (new text is underlined and deleted text is struck through).

Translation of a Hyperinflationary Foreign Operation—Presenting Exchange Differences (IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies*)

The Committee received a request about the application of IAS 21 and IAS 29. In the fact pattern described in the request, the entity:

(a) has a presentation currency that is not the currency of a hyperinflationary economy as defined in IAS 29;

(b) has a foreign operation with a functional currency that is the currency of a hyperinflationary economy as defined in IAS 29 (hyperinflationary foreign operation); and

(c) translates the results and financial position of the hyperinflationary foreign operation into its presentation currency in preparing its consolidated financial statements.

Paragraph 43 of IAS 21 requires an entity to restate the results and financial position of a hyperinflationary foreign operation applying IAS 29 before applying the translation method set out in paragraph 42 of IAS 21 (restate/translate approach). The application of the restate/translate approach may result in a change to the entity’s net investment in the hyperinflationary foreign operation. This change would include two effects:

(a) a restatement effect resulting from restating the entity’s interest in the equity ~~net assets~~ of the hyperinflationary foreign operation as required by IAS 29; and

(b) a translation effect resulting from translating the entity’s interest in the equity ~~net assets~~ of the hyperinflationary foreign operation (excluding the effect of any restatement required by IAS 29) at a closing rate that differs from the previous closing rate.

To illustrate using a simple example, assume at the beginning of the reporting period an entity has a 100% interest in a hyperinflationary foreign operation that has a non-monetary asset of 1,000 in local currency (LC), no other assets and no liabilities. Therefore, the foreign operation has net assets (and equity) of LC1,000. The change in the general price index of the hyperinflationary economy during the reporting period is 200%. The entity could, for example, calculate:

(a) the restatement effect as (LC1,000 × 200% – LC1,000) × closing exchange rate. This calculation reflects the entity’s interest in the equity ~~net assets~~ of the hyperinflationary foreign operation of LC1,000, restated applying IAS 29, and reported in the entity’s presentation currency; and

(b) the translation effect as (LC1,000 × closing exchange rate) – (LC1,000 × opening exchange rate). This calculation reflects the entity’s interest in the equity ~~net assets of~~ the hyperinflationary foreign operation of LC1,000 (excluding the effect of any restatement required by IAS 29) multiplied by the difference between the opening and closing exchange rates.

The request asked how the entity presents the restatement and translation effects in its statement of financial position.

Do the restatement and translation effects meet the definition of an exchange difference?

Paragraph 8 of IAS 21 defines an exchange difference as the difference ‘resulting from translating a given number of units of one currency into another currency at different exchange rates’. The Committee concluded that, in the fact pattern described in the request, either the translation effect alone meets the definition of an exchange difference, or the combination of the restatement and translation effects meets that definition.

How does an entity present any exchange difference arising from translating a hyperinflationary foreign operation?

The Committee observed that all requirements in IAS 21 that specify the recognition (or presentation) of exchange differences require an entity to recognise (or present) exchange differences in profit or loss or other comprehensive income (OCI).

IAS 21 requires the recognition of exchange differences in profit or loss or OCI—with no reference to equity—because exchange differences meet the definition of income or expenses. Accordingly, the Committee concluded that an entity does not recognise exchange differences directly in equity.

Paragraph 7 of IAS 1 *Presentation of Financial Statements* specifies that components of OCI include gains and losses arising from translating the financial statements of a foreign operation. Paragraph 41 of IAS 21 specifies why paragraph 39(c) of IAS 21 requires an entity whose functional currency is not the currency of a hyperinflationary economy to present in OCI—and not in profit or loss—any exchange difference arising when the entity's results and financial position are translated into a non-hyperinflationary presentation currency. The Committee observed that this explanation also applies if the functional currency is hyperinflationary. Accordingly, the Committee concluded that an entity presents in OCI any exchange difference resulting from the translation of a hyperinflationary foreign operation.

Applying the requirements in IFRS Standards to the restatement and translation effects

The Committee concluded that, in the fact pattern described in the request, the entity presents:

(a) the restatement and translation effects in OCI, if the entity considers that the combination of those two effects meets the definition of an exchange difference in IAS 21; or

(b) the translation effect in OCI, if the entity considers that only this translation effect meets the definition of an exchange difference in IAS 21. In this case, consistent with the requirements in paragraph 25 of IAS 29, the entity ~~would~~ presents the restatement effect in equity.

In the light of its analysis, the Committee considered whether to add a project on the presentation of exchange differences resulting from the restatement and translation of hyperinflationary foreign operations to its standard-setting agenda. The Committee has not ~~[yet]~~ obtained evidence that a project with that scope—undertaken in isolation of other aspects of the accounting for hyperinflationary foreign operations—would result in an improvement in financial reporting that would be sufficient to outweigh the costs.

Consequently, the Committee ~~[~~decided~~]~~ not to add the matter to its standard-setting agenda.

Appendix B––comments on the usefulness of the information provided by the different methods

B1. As noted in paragraph 41 of this paper, several respondents commented on the usefulness of the information provided by the different methods. This appendix summarises respondents' comments in this respect.

The split method

B2. Some respondents say the split method does not faithfully represent the economic relationship between inflation and changes in exchanges rates[5]. These respondents observe that few (if any) entities apply the method, indicating that it does not provide useful information. In addition:

(a) MAPFRE says it previously applied this method but stopped in 2016. This is because the method (i) resulted in amounts that did not reflect the contribution of its hyperinflationary foreign operations to the group; and (ii) could potentially provide misleading information.

(b) BBVA says, if the foreign operation has a positive net monetary position[6], applying this method could result in an entity recognising twice the effect of the loss in purchasing power of the hyperinflationary currency.

(c) EY says the frequency of financial reporting could affect the cumulative amounts of the restatement and translation effects applying this method.

(d) Santander acknowledges that existing requirements in IAS 21 and IAS 29 may support this method. However, it says if an entity were to apply the method, it would also need to provide additional information to help users understand how the method affects its financial statements.

[5] Paragraph 47 of Agenda Paper 4A for the September 2019 Committee meeting outlines this economic relationship.

[6] A positive net monetary position exists when the total of an entity's monetary assets exceeds the total of its monetary liabilities. BBVA includes in its comment letter an example that illustrates this observation.

The OCI method

B3. The Consejo Mexicano de Normas de Información Financiera supports the OCI method—it says the method complies with IFRS Standards and was successfully used in Mexico for several years. Other respondents however say the method might not provide useful information. In particular,

(a) some respondents say this might be the case when changes in exchange rates do not fully reflect inflation—ie when the devaluation of the foreign operation's functional currency does not fully reflect inflation in the foreign operation's jurisdiction[7]. BBVA says its experience is that, in those circumstances, the method fails to present the real contribution of a hyperinflationary foreign operation to the group. MAPFRE also says the method results in presenting any mismatch in inflation and changes in exchange rates as an exchange difference, which in its view is misleading.

(b) Telefonica says the method appropriately presents the combined effects of inflation and changes in exchange rates on a net basis. However, it says recognising the combined effects of inflation and changes in exchange rates directly in equity provides more useful information.

(c) MAPFRE says the method results in presenting the effects of inflation in separate places—this is because an entity accumulates gains or losses on a foreign operation's net monetary position[8] in retained earnings whereas it presents the amounts related to the restatement effect in OCI.

The direct equity method

B4. Some preparers say they apply the direct equity method because it provides useful information, or more useful information than the other methods. In their view, this

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[7] Several respondents comment on the fact that changes in exchange rates often do not fully reflect inflation in the short-term—those respondents note that the exchange rate of a hyperinflationary currency often does not devaluate immediately (because of exchange restrictions) in response to changes in prices.

[8] Paragraphs 27–28 of IAS 29 require an entity whose functional currency is hyperinflationary to compute and present in profit or loss a gain or a loss on its net monetary position.

method (a) is understood by users of financial statements and faithfully reflects the economic relationship between inflation and changes in exchange rates; and (b) appropriately avoids distortions from any temporary mismatch between inflation and changes in exchange rates.

B5. Telefonica and BBVA say entities with significant hyperinflationary foreign operations apply this method, indicating that the method provides useful information. Telefonica says Spanish entities that apply the method are those that have significant experience in managing foreign operations in hyperinflationary economies.

Appendix C—comment letters

KPMG IFRG Limited
15 Canada Square
London E14 5GL
United Kingdom

Tel +44 (0) 20 7694 8871
chris.spall@kpmgifrg.com

Ms Sue Lloyd
International Accounting Standards Board
Columbus Building
7 Westferry Circus
London
E14 4HD

Our ref CS/288

20 November 2019

Dear Ms Lloyd

Tentative agenda decisions: Translating a Hyperinflationary Foreign Operation (IAS 21 and IAS 29)

We appreciate the opportunity to comment on the following tentative agenda decisions (TADs) of the IFRS Interpretations Committee (the Committee):

— Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences

— Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary

— Presenting Comparative Amounts when a Foreign Operation First becomes Hyperinflationary

We have consulted with, and this letter represents the views of, the KPMG network.

We do not support finalising the TADs as currently drafted. Below, we first set out our comments on the technical analysis in relation to each of the three TADs and the current requirements of IFRS standards. We then set out our recommendation for a long-term solution to clarify the issues and to promote consistent application of IFRS standards.

Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences

With respect to the first tentative agenda decision, we support the Committee's tentative conclusion that, in the fact pattern described in the request, an entity could either present:

— the restatement and translation effects in other comprehensive income (OCI), or

— the translation effect in OCI and the restatement effect directly in equity.

However, we also believe that it would be permissible for an entity to present the combination of the restatement effect and the translation effect directly in consolidated equity and we disagree with the Committee's apparent tentative view that such an approach is not permitted. The arguments for allowing this alternative approach are as follows:

— The TAD makes reference to the requirements in IAS 21.41 and says that 'the Committee observed this explanation also applies if the functional currency is hyperinflationary.' However, IAS 21.41 does not apply when the functional currency of the foreign operation is hyperinflationary. IAS 21.41 is expanding on IAS 21.39 which states that it applies when the functional currency of the foreign operation is not hyperinflationary. Extending the mandatory applicability of IAS 21.41 to a hyperinflationary environment, when it clearly is focused solely on a non-hyperinflationary environment, seems to be an interpretation rather than a matter to be resolved through an agenda decision.

— Because of the economic interrelationship between the changes in exchange rate and inflation, the hyperinflation and translation effects are interlinked and generally presented together (i.e. as prices measured in the hyperinflationary currency increase, its value against other currencies tends to decrease at a rate that reflects the excess of price inflation in the hyperinflationary currency compared to price inflation in other currencies). Specifically, IAS 21.43 states: "When an entity's functional currency is the currency of a hyperinflationary economy, the entity shall restate its financial statements in accordance with IAS 29 before applying the translation method set out in paragraph 42 [i.e. all amounts translated at the closing rate at the end of the current period], except for comparative amounts that are translated into a currency of a non-hyperinflationary economy." The language and guidance does not contemplate computation of any exchange differences or their separate presentation as a gain or loss in comprehensive income. Proponents of this approach argue that it would not be economically meaningful to provide a split since the remeasurement process under IAS 29 will generally give rise to large increases in the local currency amount of net assets which usually are offset by devaluation in the exchange rate. Indeed, this is why IAS 21 requires all amounts to be translated at year-end exchange rates. Accordingly, proponents argue that IAS 21 does not permit computation of any exchange differences based on first retranslating the current year local-currency IAS 29 financial statements at last year's exchange rate. This approach is quite different from identifying exchange differences arising from remeasurement of foreign currency transactions (which IAS 21 explicitly requires to be included in profit or loss) and identifying those arising from retranslation of the financial statements of a non-hyperinflationary operation (which IAS 21 explicitly requires to be included in other comprehensive income).

— IAS 21 and IAS 29 require a comprehensive remeasurement of the financial statements of a hyperinflationary subsidiary and any adjustments to the measurement of the assets and liabilities of the subsidiary arising from that process are matched by equal and opposite adjustments to the components of equity of the subsidiary. In effect, it may be argued that the changes in equity result from changes in the measuring unit applied to the net investment in the foreign operation. IAS 29 does not view these changes as giving rise to gains or losses, but instead treats them as adjustments to the corresponding equity balances (as per IAS 29.25).

— Also, as corroborated by the staff's research, it seems that there are a number of entities that present both the restatement effect and the translation effect directly in consolidated equity in practice.

Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary

With respect to the second tentative agenda decision, we would support the Committee's conclusion that in the fact pattern described in the request the entity could retain the pre-hyperinflation foreign currency translation reserve as a separate component of equity until disposal of the foreign operation. However, we believe that the so-called "reclassification" within equity of the pre-hyperinflation translation reserve could also be an acceptable approach and we disagree with the Committee's tentative view that it is not acceptable. We believe that "reclassification" would be an acceptable alternative approach if the entity has adopted a policy to present the restatement effect and the translation effect directly in consolidated equity, as discussed above. In this case, the foreign currency translation reserve is not simply reclassified but rather it is remeasured as nil as a result of retrospective application of the new policy. The arguments for allowing this alternative approach are as follows:

— IFRIC 7.3 and IFRIC 7.BC17 clearly state that the amounts presented at the date of initial application of IAS 29 are calculated as if the currency had always been hyperinflationary, similar to retrospective application of a change in accounting policy. Indeed, the "as if" terminology comes from IAS 8.22 which is the core statement in IFRS as to what retrospective application means. It seems entirely reasonable for an entity to conclude that this retrospective approach would apply also to recalculation of the previous foreign currency translation reserve, just as an entity would apply IAS 21 to changes to foreign currency balances arising on retrospective adoption of other requirements.

— The requirements in IAS 21.39(c) and 41 are not applicable to hyperinflationary economies. In addition, IAS 29.24 states that: "[…] at the beginning of the first period of application of the Standard, the components of owners' equity, except retained earnings and any revaluation surplus, are restated […] any revaluation surplus that arose in previous periods is eliminated. Restated retained earnings are derived from all other amounts in the restated statements of financial position." Consequently, the first application of IAS 29 generates an overall restatement of the opening equity components of the foreign operation whose functional currency becomes hyperinflationary during the financial year. This restatement is relevant also in determining opening equity in the group financial statements, even if the comparatives presented for the prior period are not restated.

— Furthermore, as corroborated by the staff's research, it seems that there are a number of entities that have reclassified within equity the pre-hyperinflation translation reserve in practice.

Presenting Comparative Amounts when a Foreign Operation First becomes Hyperinflationary

With respect to the third agenda decision, we note that the TAD does not provide any technical analysis or insights. The mere fact that the Committee has not observed significant diversity with respect to presentation of comparatives on first application does not mean that the requirements of IFRS standards are clear.

We believe that it is unclear in the current IFRS standards whether on first application of hyperinflationary accounting an entity should restate its comparatives for price changes in prior periods if its presentation currency is not hyperinflationary. In our view, an entity should choose an accounting policy, to be applied consistently, on whether it restates its comparatives in these circumstances. If the entity chooses to restate its comparatives in these circumstances, then they are measured in purchasing power in the functional currency at the previous reporting date and translated into the presentation currency at the closing exchange rate at the previous reporting date.

Also, we believe that an entity would be required to restate comparative amounts in its interim financial statements in the year after the foreign operation becomes hyperinflationary, if the foreign operation was not hyperinflationary during the comparative interim period. This is because:

— IAS 29 is required to be applied from the start of the annual period in which hyperinflation is identified (see IAS 29.4).

— So, for example, if hyperinflation was identified in Q3 of the comparative year, then IAS 29 should have been applied from the start of Q1 of the comparative year. Indeed IAS 29 would have been applied on this basis in the annual financial statements for the comparative year.

— It is therefore reasonable in this example to expect that any re-presentation of information for Q1 or Q2 of the previous year would be prepared on a consistent basis using IAS 29. In any event, calculating IAS 29 amounts for Q1 and Q2 of the comparative year would have been necessary in order to prepare IAS 29 information for Q3 of the comparative year.

Recommendation to the Committee

Overall, it appears that the IFRS standards are not clear on the issues under discussion. Given that the issues are narrow in scope, we believe that they would be most efficiently resolved through an interpretation or amendment of IAS 21 and/or IAS 29.

If the Committee decides not to proceed with developing an interpretation or amendment of IAS 21/ IAS 29, then we recommend the Committee amends the TADs consistent with our substantive comments on the technical analysis set out above.

Please contact Chris Spall on +44 (0) 20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited

cc: Brian O'Donovan, KPMG

Deloitte Touche Tohmatsu Limited
Hill House
1 Little New Street
London
EC4A 3TR

Phone: +44 (0)20 7936 3000
Fax: +44 (0)20 7583 0112
www.deloitte.com/about

Direct phone: +44 20 7007 0884
vepoole@deloitte.co.uk

25 November 2019

Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
United Kingdom
E14 4HD

Dear Ms Lloyd

Tentative agenda decision – Translating a Hyperinflationary Foreign Operation—Presenting Exchange Differences (IAS 29 *Financial Reporting in Hyperinflationary Economies*)

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the September 2019 IFRIC Update of the tentative decision not to take onto the Committee's agenda the request for clarification on how an entity presents the restatement and translation effects from translating the financial statements of a hyperinflationary foreign operation into the entity's presentation currency that is not the currency of a hyperinflationary economy.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

Mrs Sue Lloyd

IFRS Interpretations Committee

Columbus Building,
7 Westferry Circus, Canary Wharf

London E14 4HD
United Kingdom

Paris, 25 November 2019

Tentative Agenda Decisions – IFRIC Update September 2019

Dear Sue,

MAZARS is pleased to comment on the various IFRS Interpretations Committee Tentative Agenda Decisions published in the September 2019 IFRIC Update.

We have gathered all our comments as appendices to this letter, which can be read separately and are meant to be self-explanatory.

We would like to draw your attention to the issue of training costs to fulfil a contract. While we agree that IAS 38, because its scope explicitly includes training costs, leads to expense those costs when incurred, we question the relevance of this outcome when the training costs are specific to a contract with a customer (they are not general training and cannot be useful to contracts with other customers), are essential for the entity to provide the promised goods or services, and are explicitly chargeable to the customer.

In that situation we believe that the 3 criteria for capitalization of costs in IFRS 15.95 are met, and we do not find it relevant to expense them on the basis of an old standard that probably needs to be revisited.

We therefore believe that the Committee should refer this issue to the Board for further analysis.

61, rue Henri Regnault - 92075 - Paris La-Défense Cedex
Tel: +33 (0)1 49 97 60 00 - Fax: +33 (0)1 49 97 60 01 - www.mazars.fr

MAZARS

Should you have any questions regarding our comments on the various tentative agenda decisions, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully

Michel Barbet-Massin

Financial Reporting Advisory

Edouard Fossat

MAZARS

Appendix 1

Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences (IAS 21 and IAS 29)

https://www.ifrs.org/projects/work-plan/translation-of-a-hyperinflationary-foreign-operation-presenting-exchange-differences/comment-letters-projects/tad-translation-of-a-hyperinflationary-foreign-operation-presenting-exchange-differences/

We agree with the Committee's conclusion that any exchange difference resulting from the translation of a foreign operation shall be presented in OCI, irrespective of whether the currency of the foreign operation is that of a hyperinflationary economy.

We also agree with the Committee that IAS 21 is not clear as to whether the exchange difference relating to the hyperinflationary foreign operation corresponds to the translation effect alone, or also encompasses the IAS 29 restatement effect.

On that basis, the presentation in the statement of financial position of the IAS 29 restatement effect and the translation effect should be consistent with the analysis made by an entity of what encompasses exchange differences:

- If the entity considers that only the translation effect meets the definition of an exchange difference, then the restatement effect shall be recognized through equity and the translation effect in OCI;
- If the entity considers that the combination of restatement and translation effects meets the definition of an exchange difference, both effects shall be recognized in OCI.

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

https://www.ifrs.org/projects/work-plan/cumulative-exchange-differences-arising-before-a-foreign-operation-becomes-hyperinflationary/comment-letters-projects/tad-cumulative-exchange-differences-arising-before-a-foreign-operation-becomes-hyperinflationary/

We agree with the Committee that pre-hyperinflation exchange differences shall not be reclassified within equity at the beginning of the period during which the foreign operation becomes hyperinflationary. The only reclassification of pre-hyperinflation exchange differences will arise on disposal of the foreign operation according to IAS 21 paragraph 48.

Some consider that such a reclassification is needed because pre-hyperinflation exchange differences and the effect of the IAS 29 restatement when the foreign operation first becomes hyperinflationary are of similar nature and should therefore be offset in the financial statements. That analysis should lead to consider that the combination of the restatement effect and the translation effect meets the definition of an exchange difference. In that case, the entity will present the first IAS 29 restatement effect within exchange differences in a separate component of equity.

Presenting Comparative Amounts when a Foreign Operation First becomes Hyperinflationary

https://www.ifrs.org/projects/work-plan/presenting-comparative-amounts-when-a-foreign-operation-first-becomes-hyperinflationary/comment-letters-projects/tad-presenting-comparative-amounts-when-a-foreign-operation-first-becomes-hyperinflationary/

Considering the outcome of the outreach conducted by the staff on that issue, we agree with the Committee's decision not to add this matter to its standard-setting agenda.

Building a better working world

Ernst & Young Global Limited
6 More London Place
London
SE1 2DA
Tel: +44 [0]20 7980 0000
Fax: +44 [0]20 7980 0275
ey.com

INVESTOR IN PEOPLE

International Financial Reporting Standards
Interpretations Committee
IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London
E14 4HD

5 November 2019

Dear IFRS Interpretations Committee members,

Tentative agenda decision (*IFRIC Update* September 2019) –

- ***Translating a Hyperinflationary Foreign Operation—Presenting Exchange Differences (IAS 21 The Effects of Changes in Foreign Exchange Rates and IAS 29 Financial Reporting in Hyperinflationary Economies)—Agenda Paper 4A***
- ***Cumulative Exchange Differences before a Foreign Operation becomes Hyperinflationary (IAS 21 and IAS 29)—Agenda Paper 4B***
- ***Presenting Comparative Amounts when a Foreign Operation first becomes Hyperinflationary (IAS 21 and IAS 29)—Agenda Paper 4C***

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the above tentative agenda decisions of the IFRS Interpretations Committee ('Committee') published in the September 2019 *IFRIC Update*.

The Committee received a request about several aspects of the application of IAS 21 and IAS 29. The Committee concluded in each of the three resulting tentative agenda decisions 'not to add the matter to its standard-setting agenda'. However, we note that IAS 29 is an old standard that has never been fully reconsidered by the IASB. In particular, IAS 29 is complex to apply by preparers, while the quality of the resulting information for users relies greatly on the reliability of the inflation statistics and an exchange rate that is not severely distorted. In addition, the interaction with IAS 21 is not fully defined and is prone to result in anomalous outcomes. We recommend that staff conduct further outreach to understand how investors use the information that results from the application of IAS 21 and IAS 29 and how the usefulness of the information compares to US GAAP, which applies a very different approach. In our view, the decision whether standard-setting is required should be left to the Board as this would involve a much broader project.

Tentative Agenda Decision – Paper 4A
The Committee concluded that '… either the translation effect alone meets the definition of an exchange difference, or the combination of the restatement and translation effects meets that definition'. In our experience, not combining the restatement and translation effects results in problematic outcomes. As illustrated in the Appendix, when calculated separately,

the cumulative restatement effect and the cumulative translation effect depend on the frequency of financial reporting. This effect is exceptionally strong when the exchange rate is not free floating and the devaluations lag the incidence of local inflation. The Committee should explicitly consider this issue before reaching a final conclusion on the separation of the translation effect.

We would be happy to meet with you at your convenience to discuss this issue and other matters related to the concepts and mechanics underlying the standard.

Tentative Agenda Decision – Paper 4B
With respect to the treatment of the cumulative exchange differences before a foreign operation becomes hyperinflationary, the Committee concluded that '... the entity retains the cumulative pre-hyperinflation exchange differences as a separate component of equity ... until disposal of the foreign operation'. In the fact pattern described, we agree with the conclusion that the difference should not be reclassified within equity or to profit or loss. However, we note that the Committee does not address the equally important and related questions:

- Where an entity should report the retrospective IAS 29 restatement effect; and
- Whether and where an entity should report the retrospective IAS 21 translation effect on the retrospective IAS 29 restatement effect (i.e., the application of IAS 29 retrospectively changes the profile of the net foreign investment in the past).

A true retrospective application of IAS 21 is even more complex as it would involve determining the impact on assets that are no longer owned and also the need to disentangle it from the closely intertwined IAS 29 effect (see Appendix).

In our view, the Committee should consider whether it might be appropriate to require the combined restatement and translation effect to be accounted for as part of the currency translation component of equity.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully

Ernst + Young Global Limited

Appendix – Impact of frequency of reporting on IAS 21 and IAS 29 calculations

The two tables below illustrate the following fact pattern:

- The local currency (LCU) is hyperinflationary
- The reporting currency (RCU) is not hyperinflationary
- The LCU/RCU exchange rate is managed by local authorities and moves as follows:
  - 31 December 2018 1.00 LCU = 1.00 RCU
  - 30 June 2019 1.00 LCU = 1.00 RCU
  - 31 December 2019 1.50 LCU = 1.00 RCU
- The Consumer Price Index (CPI) in the hyperinflationary economy moves as follows:
  - 31 December 2018 CPI = 100
  - 30 June 2019 CPI = 135
  - 31 December 2019 CPI = 150
- The subsidiary in the hyperinflationary economy owns a single non-monetary asset with a carrying amount of LCU 1,000 on 31 December 2018
- Comparing Tables 1 and 2, it is clear that the cumulative restatement effect and the cumulative translation effect depend on the frequency of financial reporting
- This also means that a catch-up effect calculated for, say, a single two-year period would differ from the cumulative effect calculated over eight quarters covering the same period

Table 1

	Fx rate LCU/RCU	*CPI*	*Asset local currency*	*Asset reporting currency*	*Effect IAS 21*	*Effect IAS 29*
31/12/2018	1.00	100	1,000	1,000		
30/06/2019	1.00	135	1,350	1,350	0	350
31/12/2019	1.50	150	1,500	1,000	-450	100
				Total	-450	450

Table 2

	Fx rate LCU/RCU	*CPI*	*Asset local currency*	*Asset reporting currency*	*Effect IAS 21*	*Effect IAS 29*
31/12/2018	1.00	100	1,000	1,000		
31/12/2019	1.50	150	1,500	1,000	-333	333
				Total	-333	333

October 31, 2019

Ms. Sue Lloyd
Chair of the IFRS IC
International Financial Reporting Standards Board
Columbus Building, 7 Westferry Circus
Canary Wharf, London E14 4HD
United Kingdom

Dear Ms. Lloyd,

We have read the Tentative Agenda Decision of the IFRS Interpretations Committee held on September 17, 2019, dealing with *Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences*. We believe that we are able to provide input based on our experience with this matter, since Mexico suffered high inflation from 1973 to 2001, and exceeded the cumulative 100% hyperinflation threshold from the end of 1981 through 1990, and again in 1996 and 1997, which was subsequently reduced after significant efforts of the Mexican Government.

Inflation accounting, following the Mexican inflation accounting standard was recognized from 1984 to 2008, after which it was discontinued following a sustained period of reduced inflation. In accordance with our local standard, inflation must be recognized when figures are distorted by inflation, which our studies show occurs when the cumulative three-year inflation as of the beginning of the year exceeds 26%. Recognition of inflation under the Mexican standard follows the same procedures as the ones prescribed by IAS 29, *Financial Reporting in Hyperinflation Economies*.

Our experience over those inflationary years was that devaluations of the Mexican peso vis a vis the US dollar (the currency of our neighbor) were a direct result of the differences of inflation between the two currencies. They did not run in parallel, since due to political decisions the devaluation was artificially restrained until it was impossible to ignore the cumulative effect and the devaluation occurred. This phenomenon prompted the Mexican standard setter to create the concept of "Comprehensive financing result" in the statement of income, which comprises interest expense (or income), exchange gains or losses and monetary gain or loss on monetary assets and liabilities due to inflation.

The presentation of this comprehensive financing result is well accepted by Mexican preparers and users of financial statements, since it clearly presents the interaction of these items. Interest includes an inflation effect which is compensated by the monetary gain. Also, exchange gains or losses are compensated by the monetary gain or loss.

Accordingly, the Mexican standard setter has reached the conclusion that, when translating the financial statements of a foreign subsidiary, both the foreign currency translation and the restatement effects should be recognized in Other Comprehensive Income (OCI) and recycled to profit and loss upon partial or total disposal of the investment.

To avoid divergence in practice, we strongly prefer the first of the two alternatives included in the Tentative Agenda Decision, since we believe it has more technical support and has been successfully tested in an inflationary economy for several years.

Regarding the Tentative Agenda Decision on *Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary*, we agree that the amount presented in OCI of any exchange differences arising before a foreign operation becomes hyperinflationary should be retained in such account and not be reclassified to another component of equity. Also, the effect of the first restatement due to inflation shall affect such account, since it is a catch-up of the inflation not recognized in prior years. In subsequent years both the exchange differences from translation and the restatement effect shall be recognized in such OCI account. Proper disclosure of annual and cumulative amounts for each concept should be made.

We do not have any comment on the Tentative Agenda Decision on *Presenting Comparative Amounts when a Foreign Operation First becomes Hyperinflationary*.

Should you require additional information on our comments listed above, please contact Juan Gras at (52) 55 5596 5633 ext. 105 or me at (52) 55 5596 5633 ext. 103 or by e-mail at jgras@cinif.org.mx or fperezcervantes@cinif.org.mx, respectively.

Kind regards,

C.P.C. Felipe Pérez Cervantes
President of the Mexican Financial Reporting Standards Board
Consejo Mexicano de Normas de Información Financiera (CINIF)

Cc: Mr. Tadeu Cendon

Grupo Latinoamericano
de Emisores de Normas
de Información Financiera

Group of Latin American
Accounting Standard Setters

November 22, 2019

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

RE: Tentative Agenda Decision—Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences (IAS 21 and IAS 29)

Dear members of the IFRS Foundation:

The "Group of Latin American Accounting Standard Setters" – GLASS welcomes the opportunity to comment on the Tentative Agenda Decision Project — Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences (IAS 21 and IAS 29) (the Project).

This response summarizes the views of the directors of the different country's members of the GLASS Board[1] , in accordance with the following due process.

Our position arises from a **general conceptual analysis** of the interaction between IAS 21, IAS 19 and other standards serves as the basis for answering the three points presented as "Tentative Agenda Decisions":

- Tentative Agenda Decision—Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary (IAS 21 and IAS 29) -

- Tentative Agenda Decision—Presenting Comparative Amounts when a Foreign Operation First becomes Hyperinflationary

- Tentative Agenda Decision—Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences (IAS 21 and IAS 29)

The document presenting the aforementioned analysis is attached as part of this response.

Due process

Discussions regarding the modifications proposed in the project were held within a specific Technical Working Group (GTT) created in October 2019, basically formed by GLASS directors representing 9 countries, taking the experience produced in those countries that are experiencing hyperinflation processes.

The GTT discussed the different views included in the summary through teleconferences. In these calls, the GTT developed a final document based on the consensual responses and technical views of all its members. Finally, the GTT document was submitted to and approved by the GLASS Board.

[1] The overall objective of the Group of Latin American Accounting Standard Setters (GLASS) is to present technical contributions with respect to all Exposure Drafts issued by the IASB. Therefore, GLASS aims to have a single regional voice before the IASB. GLASS Board is constituted by: Argentina (Chairman), Mexico (Vice Chairman), Brazil, Chile, Colombia, Costa Rica, Peru, Uruguay and Venezuela.

Grupo Latinoamericano
de Emisores de Normas
de Información Financiera

Group of Latin American
Accounting Standard Setters

General comment

We have read the Decision of the Tentative Agenda of the IFRS Interpretations Committee held on September 17, 2019, which deals with "the project".

We believe that we can provide useful information based on our experience with this matter, taking into account that many countries in the region had, and some have, high inflation for prolonged periods related to the presentation of financial information in hyperinflationary environments.

Our technical group has developed a study document (attached) related to the application of IFRS in the described context, identifying what we consider the appropriate application of IFRS in its entirety and the accounting treatment that will be applied in the circumstances.

We agree with the analysis that paragraphs 41 and 48 of IAS 21 requires the entity to present the cumulative pre-hyperinflation exchange differences in a separate component of equity 'until disposal of the foreign operation' and to reclassify the cumulative pre-hyperinflation exchange differences from equity to profit or loss (as a reclassification adjustment) on disposal of the foreign operation, and therefore the application of IAS 29 by the controlled entity doesn't require any reclassification but, as you can observe in the enclosed study paper, the requirement of IAS 29 to retrospective application implies, in our opinion, the re-measurement of the accumulated amounts previously recorded in the mentioned separate component of equity for the reasons expressed in the paper.

Accordingly, because of our conclusions on the matter we ask the IFRS IC to include the submission in its agenda because we consider it is a very relevant issue, with widespread effect and with severe difficulties of understanding in economic environments where hyperinflation never exists or at least doesn't exist for the last 40 years.

We offer our collaboration with the staff or the committee in the development of the future interpretation in order to produce the input you consider necessary

Contact

If you need to ask some questions about our comments, please contact glenif@glenif.org

Kind regards

Jorge Gil
Chairman
Group of Latin American Accounting Standard Setters (GLASS)

Grupo Latinoamericano de Emisores de Normas de Información Financiera

Group of Latin American Accounting Standard Setters

ANEXX – STUDY PAPER

Measurement of the participation in a Subsidiary

The case raised has the following characteristics:

- The controlling entity has a presentation currency that is not the currency of a hyperinflationary economy as defined in IAS 29;
- The controlling entity has a foreign operation with a functional currency that is the currency of a hyperinflationary economy as defined in IAS 29 (hyperinflationary foreign operation); and
- The controlling entity translates the results and financial position of the hyperinflationary foreign operation into its presentation currency in preparing its consolidated financial statements.

Applicable standards:

- The wright application of IFRS requires that all the applicable standards to a particular event or situation have to be considered, and that they have to be applied in its entirety in order to meet the requirements for application of IFRS.
- Measurement of assets, liabilities, income and expense of the period and OCI of the period of the subsidiary for the purpose of consolidation - IFRS 10 *Consolidated Financial Statements*
- Restatement of the measurements of assets, liabilities, income and expense of the period, OCI of the period and Equity, in a hyperinflationary economic environment - IAS 29 *Financial Reporting in Hyperinflationary Economies*
- Translation of the functional currency of the subsidiary (hyperinflationary – i.e. Argentine Peso) to the presentation currency of the controlling entity (not hyperinflationary – i.e. US Dollar) - IAS 21 *The Effects of Changes in Foreign Exchange Rates*

Analysis:

- IFRS 10 doesn't include in its text much details on the consolidation mechanism, which is substantially consistent with the one used for the measurement of participations in other entities using the equity method, contemplated and developed by IAS 28.
- The consolidation mechanism consists basically in incorporating the assets and liabilities of a subsidiary into the consolidated statements, replacing the recognized amount of the participation in the said entity as investment in its separate statements. This also implies the recognition of the causes that generate variations in the investment in the subsidiary, that is to say the variations originated in results of the period, OCI of the period, contributions from and dividends to the stockholders.
- It is also sometimes necessary to modify the amount of participation on the subsidiary recognized, for reasons other than those mentioned, which is the case of changes in equity of the subsidiary due to the recognition of errors from previous periods or retrospective changes in equity because of changes in accounting policies.

- Paragraph 3 of IAS 28 describes the applicable method to the measurement of participation in other entities: *The* equity method *is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.* This expression is complemented by the statements included in paragraph 26 of the same standard that are transcribed below: *26. Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.*
- The transcribed definitions do not contemplate all the causes of the variations, but they are complemented with paragraph 10 of that standard that states: *10. Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. The investor's share of the investee's profit or loss is recognised in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised in the investor's other comprehensive income (see IAS 1 Presentation of Financial Statements).*
- It can be concluded that IAS 28 requires that all variations that do not arise from reciprocal transactions between the subsidiary and other companies of the group (those that must be eliminated) must be recognized with counterpart in the same concept that gave rise to their recognition in the subsidiary. Thus, the participation in profit or loss for the period must be done under the same concept in the consolidated statements (or in the separate statements of the controlling entity) and the same occurs with all other causes of variations that are recognised, among which can be found retrospective modification of the subsidiary equity that must be recognized, by analogy, as retroactive changes in equity of the controlling entity.
- In that sense, it is clear that the treatment in profit or loss of the period, OCI of the period and other items of Equity must be similar whether it is a subsidiary that must be consolidated or an associate or joint venture that must be recognised using the equity method. Although it is not explicitly established in IAS 28, we can conclude by analogy with the underlying logic in its mechanics that, in case the investee retroactively corrects the magnitude of its assets, for example by the recognition of an error or a change In accounting policy, the controlling entity must make a retrospective correction in the measurement of the book value of the participation in the subsidiary in a similar manner, and its reflection in its equity in the same manner adopted by the investee.

- In the case under analysis, we observe that although the application of IAS 29 for the first time is considered a "change in circumstances", the mechanics described by said standard require that the restatement of the values of assets, liabilities and equity of the entity must be carried out retroactively at the beginning of the oldest period presented, which indicates that the way of recognition have to be identical to that required for cases of errors and changes in accounting policies described in IAS 8.
- Continuing with the previous reasoning, an investor must reflect the change in the magnitude of the equity of the investee at the beginning of the comparative period that is presented, in the same way as the investee, that is to say, modifying the value of the participation in the subsidiary proportionally at the same date, in order to coincide with its equivalent participation in the equity of the investee.
- In the subsidiary, the change in equity results from changes in:

  a) the measurement of the contributions by the stockholders,

  b) the measurement of the items that reflect the accumulated OCI, and

  c) the measurement of the accumulated income.

  Therefore, the controlling entity should reflect the change in the measurement of its participation in the investee with counterpart in the equivalent concepts.

- An additional complexity arises when the controlling entity, as is the case, has a functional or presentation currency that is different, and it is not hyperinflationary (for example, US Dollar). In that case, the net effect arising from the impact of inflation on the economic environment of the investee and the change between the exchange rates of the hyperinflationary currency of the investee and that of the non-hyperinflationary currency of the controlling entity
- This situation generates an exception to the described treatment, which occurs as a result of having to recognize changes in the participation on the subsidiary that have no effect on the investee's equity, which is the one that arises from the need to convert to the presentation currency of the controlling entity (or the functional currency of the entity that has joint control or significant influence), which does not match the functional currency of the investee. This is because at the level of the investee, said situation does not generate any effect on the measurement of its equity, but it does affect the measurement of the investment of the parent in the investee, made in the presentation currency of the group or in the functional currency of the controlling entity in its separate financial statements

Conclusion:

- In the case presented, the wright and comprehensive application of IFRS requires that it proceed as follows:

  a) The investee must correct its financial statements retrospectively <u>at the</u> <u>beginning</u> of the comparative period of the year in which the existence of hyperinflation was identified. Said restatement will result in changes in the measurement of its assets, in the measurements of contributions of owners, in the accumulated OCI and in Accumulated Income by application of the procedures provided in IAS 29.

b) The new measurements of the equity components at that date must be translated at the historical exchange rate with the presentation currency of the controlling entity or the functional currency of the investment entity. The exchange rate is the same as the one used for the measurement of these concepts at the time of recognition, prior to the identification of the existence of hyperinflation in the functional currency of the subsidiary or investee.

a) The differences that arise in the accumulated OCI and in Accumulated Income of the investee at said date, measured in the presentation currency of the controlling entity or the functional currency of the investing entity, will be recognized in the controlling or investing entity respectively in the participation on the OCI of subsidiaries or associates accumulated and in accumulated income and those corresponding to the contributions of owners in accumulated translation differences.

b) The investee must correct its financial statements retrospectively at the closing date of the comparative period of the year in which the existence of hyperinflation was identified. Said restatement will result in changes in the measurement of its assets, in the measurements of contributions of owners, in the accumulated OCI and in Accumulated Income by application of the procedures provided in IAS 29.

c) The measurements of the items must be translated using the closing exchange rate of the period between the investee's hyperinflationary functional currency and the presentation currency of the controlling entity or the functional currency of the investment entity.

d) The difference in the equity measurement at the closing date determined in d) and the equivalent measurement of the initial equity determined in b) corrected by the changes measured in d) must be recognized in the OCI of the period in the item that reflects the difference in translation between currencies..

e) The same procedure has to be applied for the period in which the existence of hyperinflation is identified.

- A simple example of application of the concepts described here is attached, where they are identified at the beginning of the period of application of IAS 29 in Argentina (01/01/2017) and their subsequent recognition both in profit and loss and in OCI.

Grupo Latinoamericano de Emisores de Normas de Información Financiera

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APPLICATION EXAMPLE OF THE PREVIOUS CONCEPTS

Argentine Subsidiary (Amounts in nominal AR$)				
	01/01/17	31/12/17	31/12/18	31/12/19
Items	AR$	AR$	AR$	AR$
Monetary Assets	100,00	349,00	674,00	1.051,00
Non Monetary Assets	900,00	855,00	810,00	765,00
Liabilities	0,00	-120,00	-260,00	-410,00
Contributed Capital	-1.000,00	-1.000,00	-1.000,00	-1.000,00
Retained earnings	0,00	0,00	-84,00	-224,00
Profit & Loss of the period	0,00	-84,00	-140,00	-182,00
Control	0,00	0,00	0,00	0,00
Revenue		-600,00	-1.000,00	-1.600,00
Cost of sales (Except depreciation)		375,00	665,00	1.155,00
Depretiation of NM Assets		45,00	45,00	45,00
Other expenses		60,00	90,00	140,00
Income Tax		36,00	60,00	78,00
P&L of the period	0,00	-84,00	-140,00	-182,00

CPI Index Closing date	100,00	130,00	210,00	300,00
CPI Index Period average		115,00	170,00	255,00
US$ Exchange rate Closing date	10,00	11,00	17,00	25,00
US$ Exchange rate Period average		10,50	14,00	21,00
Net investment in Arg Subs	100,00	98,55	72,00	56,24
Net income (expense) from Arg Subs	0,00	7,64	8,24	7,28
Accumulated income (expense) for inv foreign operation	0,00	7,64	15,87	23,15
OCI for inv in foreign operation - income (expense)	0,00	-9,09	-34,78	-23,04
Accumulated OCI for inv foreign operation - income (expense)	0,00	-9,09	-43,87	-66,91

Grupo Latinoamericano de Emisores de Normas de Información Financiera

Group of Latin American Accounting Standard Setters

Argentine Subsidiary (Amounts in restated AR$)				
	01/01/17	31/12/17	31/12/18	31/12/19
Items	AR$	AR$	AR$	AR$
Monetary Assets	100,00	349,00	674,00	1.051,00
Non Monetary Assets	900,00	1.111,50	1.701,00	2.295,00
Liabilities	0,00	-120,00	-260,00	-410,00
Contributed Capital	-1.000,00	-1.300,00	-2.100,00	-3.000,00
Retained earnings	0,00	0,00	-65,42	-21,43
Profit & Loss of the period	0,00	-40,50	50,42	85,43
Control	0,00	0,00	0,00	0,00
Revenue		-678,26	-1.235,29	-1.882,35
Cost of sales (Except depreciation)		423,91	821,47	1.358,82
Depretiation of NM Assets		58,50	94,50	135,00
Other expenses		67,83	111,18	164,71
Inflation effect (Gain) Loss		46,83	184,45	217,49
Income Tax		40,70	74,12	91,76
P&L of the period	0,00	-40,50	50,42	85,43

Net investment in Arg Subs	100,00	121,86	124,41	117,44
Net income (expense) from Arg Subs	0,00	3,86	-3,60	-4,07
Accumulated income (expense) for inv foreign operation	0,00	3,86	0,26	-3,81
OCI for inv in foreign operation - income (expense)	0,00	18,01	6,15	-2,90
Accumulated OCI for inv foreign operation - income (expense)	0,00	18,01	24,16	21,25
Previously reported Investment (Nominal amounts)	100,00	98,55	72,00	56,24
Previously reported Accumulated OCI (Nominal amounts)	0,00	-9,09	-43,87	-66,91
Previously reported Accumulated Income (Nominal amounts)	0,00	7,64	15,87	23,15

Accumulated difference in Investment measurement	0,00	23,32	52,41	61,20
Accumulated difference in OCI	0,00	27,10	68,03	88,16
Accumulated difference in Profit or loss of the period	0,00	-3,78	-15,62	-26,96

Application of IAS 21 in conjunction with IAS 29

Comments on issues raised by ESMA to IFRS IC

Background

1. On April 17, 2019, the European Securities and Markets Authority (ESMA) sent a note to the IASB IFRS IC chairwoman, Mrs. Sue Lloyd, suggesting that the IFRS IC consider clarifying certain practical applications of IAS 29 *Financial Reporting in Hyperinflationary Economies* in conjunction with IAS 21 *Effects of Changes in Foreign Exchange Rates.*

2. More specifically, the problems identified by the ESMA refer to the case of groups that prepare their consolidated financial statements using a presentation currency not considered hyperinflationary, but which have had to include businesses in Argentina that have the Argentine peso as functional currency (AR$), which is considered the currency of a hyperinflationary economic environment under the terms of IAS 29, and therefore have previously applied the requirements of IAS 29 to measure all the elements related to its financial position, income and expenses and cash flows expressing them in the purchase power at the closing date of the period, reported in AR$.

3. The issues identified by ESMA and on which it has requested clarification are the following:

(a) Scope of the application of paragraph 42 (b) of IAS 21 in the first period in which the functional currency of the foreign operation becomes hyperinflationary and its interaction with paragraph BC17 of IFRIC 7. This includes the presentation of the information of the comparative figures for Q1 and Q2 2019 in the interim financial statements.

(b) The presentation of the combined effects of hyperinflation and the conversion of foreign currency of a foreign operation whose functional currency is the currency of a hyperinflationary economy to a stable presentation currency.

(c) The accounting treatment for the previously accumulated balance of exchange differences in a separate component of equity related to a foreign operation whose functional currency has become hyperinflationary, after the application for the first time of IAS 29 by the foreign operation.

4. The Argentine Federation of Professional Councils of Economic Sciences (FACPCE) knowledge about the concerns related to the application of IAS 29 by Argentine entities that are consolidated in the financial statements of European groups. For this reason, created a technical working group (TWG) to analyze these issues and convey his views on the matter to IFRS IC.

5. The TWG considers that, in order to adequately understand the effect of using the restatement process of IAS 29, the concept of “unit of measure” must be taken into account. Financial information in non-hyperinflationary environments use the functional currency of the entity as a unit of measure according to the parameters of IAS 21. The restatement process in hyperinflationary contexts involves replacing the legal tender in the hyperinflationary economy with a “virtual” currency based on the nominal currency corrected of the distortion produced by inflation on it and converts it into an ideal currency with zero inflation.
In the described context, the variations in the prices of currencies have two components that can be easily identified, which are the change in the purchasing power of the hyperinflationary

currency and the change in the market variables that determine a change in the exchange rate between the hyperinflationary currency and the rest of the currencies with which transactions are made or are used as a presentation currency.
Both variables are highly interdependent in high inflation contexts, so the economic and financial analyzes are made on the devaluations / appreciations of the exchange rate above / below the inflation of the period.
Therefore, in this context it is not useful information to make a separate analysis of the inflation and exchange rate effects since the magnitude of one is substantially determined by the magnitude of the other.
That is why in the solutions that the TWG proposes to the treatment of exchange rates differences related to investments in a foreign operation, is only to separate the cumulative effect at the beginning of the period of application of IAS 29, of the effect that occurs during the reporting period.
Although the application of IAS 29 arises from a change in circumstances and does not represent a change in accounting policy, the requirement of retroactive application as if the environment had always been hyperinflationary, requires that the mechanisms provided for changes in accounting policies be used in relation to the determination of the accumulated effects at the beginning of the comparative period and the subsequent effects.

Issue 1 - Scope of the application of paragraph 42 (b) of IAS 21 in the first period in which the functional currency of the foreign operation becomes hyperinflationary and its interaction with paragraph BC17 of IFRIC 7

1A - The requirements of not changing the comparative figures also apply for the first year in which the foreign operation begins to apply accounting for hyperinflationary economies

6. The TWG has reviewed the relevant paragraphs of the corresponding standards, and has reached the following conclusions:

(a) The use of the term “subsequent changes” in paragraph 42 (b) of IAS 21 could not be construed as a restriction not to keep comparative figures in the presentation currency in the first year in which the foreign business goes on to report under the IAS 29 criteria for a hyperinflationary economy.

(b) However, at the beginning of the first year of application, the entity that includes in its consolidated financial statements a foreign operation whose functional currency is to be considered that of a hyperinflationary economic environment, shall recognize in a cumulative manner directly in the equity, in the item that reflects the accumulated balance of the exchange rates differences of the foreingn operation, the effect of the initial application of IAS 29, in the first day of the year of initial application (see example in paragraph 9).

(c) The point of view of the TWG indicated in 5 (b) is based on the joint application of the requirements of paragraphs 42 (b) and BC22 of IAS 21, where it is clearly established that the objective of the IASB in determining the approach for comparative figures in presentation currency, previously determined in a currency to which accounting for hyperinflationary economies is applied, is consistent with paragraph BC17 of IFRIC 7.

1B - Presentation of financial information in the interim consolidated financial statements that include a foreign operation that began to applying accounting for a hyperinflationary economy

7. When preparing the consolidated financial statements for Q1 and Q2 2019, the comparative figures shall be considered as indicated in the following paragraphs of IAS 34:

(a) Paragraph 28 of IAS 34 states the following:
The entity must apply, in the interim financial statements, the same accounting policies that it applies in its annual financial statements, except as regards the changes in accounting policies carried out after the closing date of the annual financial statements plus recent, which will be reflected in the next to present. (...)

(b) Additionally, paragraph 36 of IAS 34 clarifies that the amounts of income and expenses, which are presented in each interim period, will also reflect all changes in the estimates of the items that have been presented in previous intermediate periods within the same annual period.

(c) However, the same paragraph 36 adds:
(…) The amounts reflected in the intermediate information of previous periods will not be subject to any retroactive adjustment. Paragraphs 16A (d) and 26 require, however, that the entity disclose information about the nature and amount of any significant change in the estimates previously made (...). ……..

8. Therefore, the TWG concludes that the comparative figures for Q1 2019 and Q2 2019 should not be affected in order to recognize the effects of the application of the change in the circumstances that affected the Argentine peso as of July 1, 2018. Comparative information which, from the point of view of the TWG, respects the requirements of IAS 34, follows the following approach:

Q2019	Q2018	Was IAS 29 applied to the comparative figures before its translation to presentation currency?	Application of paragraph 36 of IAS 34
Q12019	Q12018	No	• Use the unrestated amounts of Q12018. • Disclose the information required by IAS 34.16(d) and 26
Q22019	Q22018	No	• Use the unrestated amounts of Q12018. • Disclose the information required by IAS 34.16(d) and 26

9. As of any intermediate closing date after July 1, 2019, the comparative figures shall be those expressed in the purchasing power of the closing month of the comparative year, and then converted using the closing exchange rate of the month corresponding to the end of the comparative intermediate period.

Issue 2 - Presentation of the combined effects of hyperinflation and the translation of foreign currency of a foreign operation whose functional currency is the currency of a hyperinflationary economy to a stable presentation currency

10. The TWG considers that:

(a) In the first year, the cumulative effect of inflation recognized due to the first year of the application of accounting for hyperinflationary economies directly in equity must be determined, based only in the first year effects, the point of view followed by The IFRIC is that similar treatment should be given to the retroactive application of a standard as a change in accounting policy described in IAS 8, although with the limitations of doing so without modifying the comparative figures in the presentation currency when it is a stable currency.

(b) When converting foreign operations that uses accounting for hyperinflationary economies, the OCI for translation to presentation currency of the fiscal year will highlight the combined effect of the currency translation and the loss in the purchasing power of the functional currency of the foreign operation.

Example

	AR$	US$
Net investment in foreign operation to December 31, 2017 (a)	100	5.56
Net investment in foreign business to December 31, 2017 (b)	350	19.44

(a) Expressed in AR$ before applying IAS 29 - relevant exchange rate: US $ 1 = AR$ 18.
(b) AR$ expressed in purchasing power of December 2018 - relevant exchange rate: US $ 1 = AR$ 18.

The group will present directly in equity US $ 13.89 (US $ 19.44 - US $ 5.56), which arises from the initial application of accounting for hyperinflationary economies in foreign operations.

	AR$	US$
Net investment in foreign operation to December 31, 2017 (c)	518	-
Corresponding result by year 2018 (c)	10	0.25
Net investment in foreign business at December 31, 2017 (c)	528	13.20

(c) AR$ expressed in purchasing power of December 2018 - - relevant exchange rate: US $ 1 = AR$ 40.

The entity will present the following information from the foreign operation (in presentation currency):

Source:	Presentation	Currency
Net investment in foreign business at		
December 31, 2017 (b)	5.56	IAS 21.42
Effect by initial application IAS 29 on		
Foreign operation (Exchange differences in equity)	13.89	IFRIC 7.FC17
Results for the year 2018 (a)	0.25	IAS 21.42
OCI for the year convertion	(6.49)	
Net investment in foreign business at		
December 31, 2018 (a)	13.20	IAS 21.42

The OCI of the year per translation to presentation currency is explained as follows:

		US $
Net investment in foreign business at		
December 31, 2017 - base restated		19.44
Inter-annual inflation 2018:	48,00%	
Exchange rate variation between currencies, 2018:	122.22%	
Difference in variations [(1 + 48%) / (1 + 122.22%)] - 1:	(33.40%)	
OCI per year conversion:		(6.49)

The OCI of the year per translation to presentation currency reflects the combined effect of the inter-annual inflation of the foreign currency and the variation in the inter-annual exchange rate between the functional currency and the presentation currency.

Issue 3 - The accounting treatment of the balance of the account for translation to presentation currency previously accumulated in a separate component of equity, related to a foreign operation whose functional currency has become hyperinflationary, after the application for the first time of accounting for hyperinflationary currencies by the foreign operation

11. In accordance with paragraph 48 of IAS 21, an entity shall reclassify any balance previously accumulated in equity from the conversion of a foreign operation to presentation currency, when it occurs:

(a) a total disposition of a foreign operation; or

(b) a partial disposition of a foreign operation.

12. Given that none of the events provided for in paragraph 48 of IAS 21 occurs in this case, the TWG considers that the entity should not review the balances for conversion previously accumulated in equity related to a foreign operation, for the sole fact that its functional currency has become considered one of a hyperinflationary economic environment.

13. In accordance with the provisions of 5 (b) above, the amount previously accumulated in equity from the conversion of a foreign operation will be modified at the beginning of the period of initial application of IAS 29. The new amount determined, with more modifications that will occur in the following periods will be the amounts to be reversed at the time that some of the conditions provided for in paragraph 48 of IAS 21 referred to above are verified.

Accounting Standards Board of Japan (ASBJ)
Fukoku Seimei Building 20F, 2-2, Uchisaiwaicho 2-Chome, Chiyoda-Ku Tokyo 100-0011, Japan
Phone +81-3-5510-2737 Facsimile +81-3-5510-2717 URL https://www.asb.or.jp/en/

21 November 2019

IFRS Interpretations Committee
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Comments on three Tentative Agenda Decisions relating to
IAS 21 *The Effects of Changes in Foreign Exchange Rates* and
IAS 29 *Financial Reporting in Hyperinflationary Economies*

1. The Accounting Standards Board of Japan (the "ASBJ") welcomes the opportunity to comment on the following three IFRS Interpretation Committee's (the "Committee") tentative agenda decisions relating to IAS 21 *The Effects of Changes in Foreign Exchange Rates* ("IAS 21") and IAS 29 *Financial Reporting in Hyperinflationary Economies* ("IAS 29"), proposed in the September 2019 IFRIC Update.

   - Translating a Hyperinflationary Foreign Operation—Presenting Exchange Differences
   - Cumulative Exchange Differences before a Foreign Operation becomes Hyperinflationary
   - Presenting Comparative Amounts when a Foreign Operation first becomes Hyperinflationary

Translating a Hyperinflationary Foreign Operation—Presenting Exchange Differences

2. The Committee's tentative agenda decision rejects only one view related to the exchange differences that arise from translating the financial performance and financial position of a foreign operation whose functional currency is the currency of

a hyperinflationary economy into a presentation, that is, to present the entire difference in equity. As a result, the tentative agenda decision explains that all or part of the difference will be presented in other comprehensive income (“OCI”).

3. However, to resolve this issue comprehensively, we think the Committee should not publish this agenda decision rejecting a certain interpretation but rather research on the needs for a project to revise IAS 29 should first be undertaken. Then, consideration should be given as to where to proceed to standard-setting activities for the following reasons:

    (a) While the issue is related to the concept of capital maintenance, the IASB noted in the course of revising the Conceptual Framework that the issues associated with capital maintenance should be addressed when the IASB undertakes research to determine whether to revise IAS 29. The issue implies that IAS 29 is not necessarily clear.

    (b) IAS 21 and IAS 29 do not provide specific guidance regarding (1) whether the restatement effect and the translation effect should be presented separately; nor (2) where to present the amounts of these effects.

    (c) Although the submitter expressed concerns related to presenting the effects of inflation and the changes in exchange rate separately because of the economic interrelationship between the two, no analysis regarding this concern has been performed.

    (d) Given that the two views that are considered to be acceptable in the tentative agenda decision have different accounting consequences, we think the Committee should consider which view is appropriate.

    (e) Paragraph 88 of IAS 1 requires an entity to include all items of income and expense in profit or loss unless IFRS requires or permits otherwise. In the context of this issue, there is no explicit requirement in IFRS and, therefore, we think that an entity cannot interpret existing guidance to conclude that the difference should be presented in OCI.

~~Cumulative Exchange Differences before a Foreign Operation becomes Hyperinflationary~~

4. In light of the existing requirements in IFRS standards, we can accept the analysis in the tentative agenda decision as one interpretation. However, we are of the view that the accounting may change depending on how the issue of "Translating a Hyperinflationary Foreign Operation—Presenting Exchange Differences" above (hereinafter referred to as "presenting exchange differences") is analysed. Accordingly, we are of the view that the Committee should consider this issue together with the issue of the presenting exchange differences.

<u>Presenting Comparative Amounts when a Foreign Operation first becomes Hyperinflationary</u>

5. Given that diversity in practice has not been identified, we agree with the analysis not to add this issue to the standard-setting agenda.

6. We hope our comments are helpful for the Committee's and the IASB's consideration in the future. If you have any questions, please feel free to contact us.

Yours sincerely,

A. Kogasaka

Atsushi Kogasaka
Chair
Accounting Standards Board of Japan

Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

DRSC

ASCG • Zimmerstr. 30 • 10969 Berlin

Sue Lloyd
Chair of the IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH

United Kingdom

IFRS Technical Committee
Phone: +49 (0)30 206412-12
E-Mail: info@drsc.de

Berlin, 11 November 2019

Dear Sue,

IFRS IC's tentative agenda decisions in its September 2019 meeting

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the tentative agenda decisions taken by the IFRS Interpretations Committee (IFRS IC) and published in the September 2019 *IFRIC Update*.

We fully agree with all **tentative agenda decisions**. However, we suggest that one detail in the reasoning for the tentative agenda decision on IFRS 16 be made more prominent: As the main conclusion (see fourth paragraph) appears to be that the "customer's right of use" (i.e. the right to direct how and for what purposes an asset is used) mainly depends on whether or not "the customer has the right to make all *relevant* decisions" – which the customer seems to have in this fact pattern –, it should be underlined in this context that "*relevant*" connotes to "*affect[ing] the economic benefits to be derived from the use*".

~~In respect of the **final agenda decision on IFRS 15**, we reiterate our concern that we had already addressed upon the respective tentative decision, i.e. not addressing the follow-up question of how to account for compensations that exceed the transaction price. We take the view that this question deserves being addressed by the IFRS IC or the IASB, as, in many cases, the answer on this question could affect the answer on the main question.~~

If you would like to discuss our views further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Andreas Barckow

President

Contact:
Zimmerstr. 30 ·D-10969 Berlin ·
(via Markgrafenstr.19a)
Phone: +49 (0)30 206412-0
Fax: +49 (0)30 206412-15
E-Mail: info@drsc.de

Bank Details:
Deutsche Bank Berlin
IBAN-Nr.
DE26 1007 0000 0070 0781 00
BIC (Swift-Code)
DEUTDEBBXXX

Register of Associations:
District Court Berlin-Charlottenburg, VR 18526 Nz
President:
Prof. Dr. Andreas Barckow
Executive Director:
Prof. Dr. Sven Morich

I C A N

ACCURACY & INTEGRITY

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF NIGERIA
(Established by Act of Parliament No. 15 of 1965)

PLOT 16, IDOWU TAYLOR STREET,
VICTORIA ISLAND,
P.O BOX 1580, MARINA
LAGOS NIGERIA.

Tel: 09053847510-1
Email: info.ican@ican.org.ng, rce@ican.org.ng
Website: www.icanig.org

Registrar/Chief Executive
JOHN I. EVBODAGHE, MBA, FCA

November 23, 2019
ICAN/SP/R&T/NOV/2019

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Sir,

RE: IAS 21 AND IAS 29 – TRANSLATING A HYPERINFLATIONARY FOREIGN OPERATION | PRESENTING EXCHANGE DIFFERENCES WHEN A FOREIGN OPERATION IS HYPERINFLATIONARY (AGENDA REF 4A)

The Institute of Chartered Accountants of Nigeria (ICAN) has considered the above Staff Paper and is pleased to submit its comments as follows:

Question1:
Does the Committee agree with our analysis and conclusion, set out in paragraphs 29–60 of this paper, that, depending on its view of whether all or part of the consolidation difference meets the definition of an exchange difference in IAS 21, the reporting entity presents the consolidation difference either in:

(a) Consolidated OCI, or

(b) Separately, with one component presented in consolidated OCI (translation effect) and the other component in consolidated equity (restatement effect)?

We agree with the analysis and conclusion, set out in paragraphs 29–60 of the paper that the reporting entity presents the consolidation difference either in:

a. Consolidated Other Comprehensive Income (OCI), or

b. Separately, with one component presented in consolidated OCI (translation effect) and the other component in consolidated equity (restatement effect)

Question 2:

Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda?

We agree with the Committee's recommendation not to add this to its standard-setting agenda.

Question 3:

Does the Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

We have no comments on the proposed wording of the tentative agenda decision.

We thank you for giving our Institute the opportunity to contribute to the work of IFRS Foundation.

Yours faithfully,

For: Registrar/Chief Executive

Ben Ukaegbu, PhD, ACA
Deputy Registrar, Technical Services

(NBAA)

THE NATIONAL BOARD OF ACCOUNTANTS AND AUDITORS

TANZANIA

TEL NOS: +255 26 2963318-9
E-MAIL: info@nbaa.go.tz
WEBSITE: www.nbaa.go.tz

NATIONAL AUDIT OFFICE "AUDIT HOUSE",
8TH FLOOR, 4 UKAGUZI ROAD,
P. O. BOX 1271,
41104 TAMBUKARELI,
DODOMA, TANZANIA

Our Ref: CCD.562/573/01

21st November, 2019

Chief Executive Officer,
IFRS Foundation
Columbus Building
7 West ferry Circus
Canary Wharf
London E14 4HD

Dear Sir/Madam

RE: TRANSLATION OF A HYPERINFLATIONARY FOREIGN OPERATION: PRESENTING EXCHANGE DIFFERENCES (IAS 21 AND IAS 29)

Refer to the heading above.

NBAA support the conclusion reached by the IFRS Interpretation Committee on the request asked how the entity presents the restatement and translation effects in its statement of financial position by describing that, the entity presents:

a. the restatement and translation effects in OCI, if the entity considers that the combination of those two effects meets the definition of an exchange difference in IAS 21; or

b. the translation effect in OCI, if the entity considers that only this translation effect meets the definition of an exchange difference in IAS 21. In this case, consistent with the requirements in paragraph 25 of IAS 29, the entity would present the restatement effect in equity.

As far as there is no clear evidence that a project would result in an improvement in financial reporting that would be sufficient to outweigh the costs, NBAA is supportive with the decision of not adding a project on the presentation of exchange differences resulting from the restatement and translation of hyperinflationary foreign operations to committee's standard-setting agenda.

If you require any clarification on our comments, please contact the undersigned.

Thank you in advance for your cooperation.

Yours sincerely,

CPA Angyelile V. Tende
For: EXECUTIVE DIRECTOR

BBVA
Creando Oportunidades

Ms Sue Lloyd
Chair of the IFRS IC
International Accounting Standards Board
Columbus Building, 7 Westferry Circus
London E14 4HD

22 November 2019

Tentative Agenda Decision: Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences (IAS 21 & IAS 29)

Dear Ms Lloyd,

Banco Bilbao Vizcaya Argentaria (BBVA) thanks you for the opportunity to respond to the IFRS Interpretations Committee's (IFRS IC) publication of the tentative agenda decision related to the translation of a hyperinflationary foreign operation - presenting exchange differences (IAS 21 & IAS 29) in the September 2019 IFRIC Update. We acknowledge and appreciate the interest, effort and analysis performed about a complicated matter that is relevant for our Financial Statements as BBVA have significant interests in hyperinflationary economies (Venezuela and Argentina).

However, we do believe that this matter should be addressed through a change in the Standards. The current interaction between IAS 29 (*Financial Reporting in Hyperinflationary economies) and IAS 21 (The effects of changes in Foreign Exchange Rates*) is not correctly addressed in the Standards and currently leads to significant problems and challenges when preparing the Consolidated Financial Statements of entities with foreign operations in hyperinflationary countries that use a non-hyperinflationary presentation currency. In particular, we notice that IAS 29 does not explicitly specify how the entity should present any exchange difference that arise from the restate/translate process to a Group non-hyperinflationary currency and think that this lack of clarity cannot be solved just with an Agenda Decision and without performing a deeper analysis. Moreover, we think that if this tentative agenda decision is published as definitive, many different accounting outcomes of the same economic phenomenon could occur. This fact does not help to achieve the IFRS Foundation goal of producing high-quality global accounting standards.

Therefore, we do not agree with the IFRS IC's tentative agenda decision. Consequently, we are pleased to provide you with further information about a complex topic that is relevant for multinational companies with interests in hyperinflationary countries.

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General Comments

The Group experience applying IAS 29 in our subsidiaries allows us to confirm the high complexity of applying the accounting mechanism of inflation together with the historical movements of the exchange rates in a way that the outcomes are economically understandable.

BBVA applies the so-called View C (accounting for both restatement and translation effects in Equity) to its foreign operations in Venezuela and Argentina. In this regard, we support that:

- our accounting policy is compliant with IFRS, taking into account the lack of any specific guidance in the Standards and the economic inter-relationship between inflation and exchange rates, and that
- it offers and provides reliable and relevant information about our interests in foreign operations in hyperinflationary economies. We think that the so-called View A and B options lead to a distorted financial information (especially View A). We present the arguments along this comment letter.

Our analysis performed to adopt this accounting policy includes both IFRS technical and economic criteria.

- From a technical point of view, we notice that the Committee observed in the Tentative Agenda Decision that IAS 21.41 and 39 c) also apply if the functional currency is hyperinflationary. However, the Standard is clear that those paragraphs only apply to non-hyperinflationary environment entities. Therefore, we think that extending this criteria to entities in hyperinflationary economies would require standard-setting. Additionally, IAS 21 in general, and paragraph 42 of IAS 21 in particular, do not address how an entity should present any exchange differences that may arise from the restatement of foreign operations in hyperinflationary economies when preparing the Consolidated Financial Statements of a Group of entities that have a stable presentation currency.
- From an economic point of view, we think it is relevant to consider aspects such the inter-relationship of inflation and exchange rates in economies with high inflation rates, both in the long run and in intermediate periods (where distortions often exist due to governmental interventions), or the fact that entities with balance sheets with a high component of monetary items recognise the purchasing power loss of the currency due to inflation in the Income Statement (IAS 29.28) (and depending on the accounting policy option chosen for translation, a duplicity of impacts in the Income Statement could arise).

These aspects are further explained in the following sections of this comment letter. However, we note that the analysis performed by the Committee to reach the conclusion of the tentative agenda decision was narrow, simple and did not consider any of those relevant economic aspects.

We notice that the outreach and research performed by the Staff bring to light that there is currently diversity in practice with respect to this matter. In this regard,

- We find significant that just few entities currently uses the so-called View A (presenting the restatement effect in Equity and translation effect in OCI) although some parties defend that it is the literal interpretation of the Standards. In our view, the main reason for not being a widespread used approach is that it lacks of economic sense. Applying View A does not faithfully represent the economic phenomena it purports to represent. It separates the effects of two highly correlated macroeconomic variables on financial reporting and, therefore, not only would it be a very complex and costly process but also it could harm the usefulness of the financial statements when this topic is relevant for the financial statements of an entity. Therefore, we understand that only entities with non-relevant foreign operations in hyperinflationary economies could have chosen that approach.

- The analysis performed by the Staff shows that both View B (both effects in OCI) and View C (both effects in Equity) are generally used. We understand that entities with relevant foreign operations in hyperinflationary economies have chosen any of those methods.

We have added a section in this comment letter to address other concerns related to the current accounting method for hyperinflation under IAS 29 and its interaction with IAS 21 when translating local hyperinflationary financial statements into the Group non-hyperinflationary presentation currency when preparing the consolidated financial statements.

In conclusion, we believe that the translation of a hyperinflationary foreign operation into the presentation currency of a non-hyperinflationary economy is a complex matter where the Standards are not clear enough providing the necessary relevant criteria. Therefore, taking into account that the IAS 29/IAS 21 do not provide an adequate basis for entities to account for this topic, we think that the Committee cannot solve this topic through an Agenda Decision and should recommend standard setting to the IASB.

On the other hand, we are concerned about the timing coincidence of our formal decision making process for 2019 year-end Financial Statements (involving the Audit Committee and Board of Directors) and the foreseeable IFRS IC meetings where the deliberations on this topic would take place (ie expected for 21 January 2020 or 3-4 March 2020). This timing coincidence generates additional uncertainty and complicates the decision making process in a relevant topic. We understand this problem would be common for many multinational companies that prepare their annual Financial Statements in 1Q. We encourage the Committee to be sensitive to this concern for planning the due process of this matter.

The following sections discuss with further details our previous statements of this General Comments section.

1. Discussion about View A not faithfully representing the economic phenomena

If an entity recognises translation effect in OCI (applying IAS 21) and restatement effect in Equity (applying IAS 29.25), it will be separating the effects of two macroeconomic variables that are part of the same economic phenomena (hyperinflation). Beyond macroeconomic theories, population in economies with hyperinflation or with high rates of inflation have real awareness of the negative effect of inflation over the purchasing power of the local currency. The strong devaluation of the local currency of a hyperinflationary economy in relation to the currency of a non-hyperinflationary economy is the reflection of purchasing power loss due to inflation.

Having in mind this economic inter-relationship most entities with foreign operations in hyperinflationary countries do not apply View A because it would directly result in an asymmetric presentation of the elements that are part of the Total Equity of the entity. The increase in the Equity due to the hyperinflation restatement (high nominal growth in local currency) would be compensated with a decrease in OCI due to the devaluation of the exchange rates.

Moreover, when a reporting entity has a balance sheet with a majority of monetary items and presents an excess of monetary assets over monetary liabilities (common situation for financial and insurance entities balance sheets) and applies View A, it could end recognising its purchasing power loss twice in the Income Statement.

This fact is easy to explain using a numerical example. For that purpose, we present the same simplified example used in the Staff Paper 4A for discussion in the Committee's meeting on 25 September but changing the non-monetary asset in local currency by a monetary asset (no other assets and no liabilities).

<u>Consolidated statement of financial position at 1 January 2017</u> (initial step)

01/01/2017	Entity P	Entity S					Adjustments	Consolidated
	GBP	LC	Inflaction factor	LC restated for IAS 29	exchange rate	GBP	GBP	GBP
Assets	400	1.000		1.000		400	-400	400
investment in S	400						-400	-
Asset		1.000	1	1.000	0,4	400		400
Equity and liabilities	400	1.000		1.000		400	-400	400
Share capital - Entity P	400							400
Share capital - Entity S		1.000	1	1.000	0,4	400	-400	-
Retained earnings								-
Exchange difference (CTA)								-
Net income								-

Applying the steps described in the Staff Paper 4A (inflation factor = 3; exchange rate = 0.25 at 31 December 2017), we compare two situations:

Case A: 100% non-monetary asset (IFRS IC Staff example)

Case B: 100% monetary asset

Case A - 100% non-monetary asset (Staff Paper 4A example)

<u>Consolidated statement of financial position at 1 January 2017</u>

31/12/2017	Entity P	Entity S					Adjustments	Consolidated
	GBP	LC	Inflaction factor	LC restated for IAS 29	exchange rate	GBP	GBP	GBP
Assets	400	1.000		3.000	0,25	750	-400	750
investment in S	400						-400	-
Non Monetary asset		1.000	3	3.000	0,25	750		750
Equity and liabilities	400	1.000		3.000	0,25	750	-750	750
Share capital - Entity P	400							400
Share capital - Entity S		1.000	3	3.000	0,25	750	-750	-
Retained earnings								-
Exchange difference (CTA)								-
Consolidation diference:								**350**
restatement								500
conversión								-150
Net income								-

Case B - new example with 100% monetary asset

<u>Consolidated statement of financial position at 1 January 2017</u>

31/12/2017	Entity P	Entity S					Adjustments	Consolidated
	GBP	LC	Inflaction factor	LC restated for IAS 29	exchange rate	GBP	GBP	GBP
Assets	400	1.000		1.000	0,25	250	-400	250
investment in S	400						-400	-
Monetary asset		1.000	3	1.000	0,25	250		250
Equity and liabilities	400	1.000		1.000		250	-750	250
Share capital - Entity P	400					-		400
Share capital - Entity S		1.000	3	3.000	0,25	750	-750	-
Retained earnings						-		-
Exchange difference (CTA)					0	-		-
Consolidation diference								**350**
restatement								500
conversión								-150
Net income				-2.000	0,25	-500		**-500**

The table below illustrates how the three views apply to the consolidation difference of GBP350 under the two cases.

	100% non-monetary asset			**100% monetary asset**		
	View A	View B	View C	View A	View B	View C
Assets	**750**	**750**	**750**	**250**	**250**	**250**
investment in S	-	-	-	-	-	-
Asset	750	750	750	250	250	250
Equity and liabilities	**750**	**750**	**750**	**250**	**250**	**250**
Share capital - Entity P	400	400	400	400	400	400
Share capital - Entity S	-	-	-	-	-	-
Retained earnings	500	-	350	500	-	350
Exchange difference (CTA)	-150	350	-	-150	350	-
	350	350	350	350	350	350
Net income	-	-	-	-500	-500	-500

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It can be observed that under the "100% monetary asset" case, the consolidation difference due to the hyperinflation restatement is recognised in the Income Statement as a purchasing power loss (ie loss on the net monetary position).

In this example there is an imperfect inter-relationship between inflation and exchange rate: the devaluation of exchange rates is not being deep enough to absorb the rise of inflation. So, the exchange difference effect is not negative enough to compensate the positive nominal increase of the Equity of the subsidiary due to changes in index price.

In case of disposal of the foreign operation, having chosen View A, the entity would be required to reclassify to profit or loss the cumulative amounts of exchange differences recognised in OCI (ie. GBP 150). Accordingly, the same concept (ie. the purchasing power loss of the currency due to inflation) would be recognised twice in the Income Statement (total loss GBP 650):

- First, when applying IAS 29 for restatement of the statement of financial position (loss of GBP 500).
- Second, when applying IAS 21 for disposal of the foreign operation (loss of GBP 150).

On the other hand,

- If View B is applied, on disposal a positive impact of GBP 350 will be recognised in the Income Statement, resulting in a total loss in P&L of GBP 150.
- If View C is applied, none additional impact in the Income Statement will be recognised when disposal (total loss in P&L GBP 500).

Leaving apart the discussion about View C, we think that this example brings to light the high diversity of outcomes that the conclusion of the tentative agenda decision could produce for reflecting the same economic phenomena (View A total loss in P&L GBP 650; View B total loss in P&L GBP 150). We think this fact is far from the goal of having high-quality global accounting standards.

This situation is more graphic when using an example of perfect correlation of inflation and exchange rate (inflation factor=3; exchange rate=0.13):

Perfect correlation and 100% non-monetary asset

31/12/2017	Entity P	Entity S					Adjustments	Consolidated
	GBP	LC	Inflaction factor	LC restated for IAS 29	exchange rate	GBP	GBP	GBP
Assets	400	1.000		3.000	0,13	400	-400	400
investment in S	400						-400	-
Non Monetary asset		1.000	3	3.000	0,13	400		400
Equity and liabilities	400	1.000		3.000	0,13	400	-400	400
Share capital - Entity P	400							400
Share capital - Entity S		1.000	3	3.000	0,13	400	-400	-
Retained earnings								-
Exchange difference (CTA)								-
Consolidation diference:								-
restatement								267
conversión								-267
Net income								-

Perfect correlation and 100% monetary asset

31/12/2017	Entity P	Entity S					Adjustments	Consolidated
	GBP	LC	Inflaction factor	LC restated for IAS 29	exchange rate	GBP	GBP	GBP
Assets	400	1.000		1.000	0,13	133	-400	133
investment in S	400						-400	-
Monetary asset		1.000	3	1.000	0,13	133		133
Equity and liabilities	400	1.000		1.000		133	-400	133
Share capital - Entity P	400					-		400
Share capital - Entity S		1.000	3	3.000	0,13	400	-400	-
Retained earnings						-		-
Exchange difference (CTA)					0	-		-
Consolidation diference								-
restatement								267
conversión								-267
Net income				-2.000	0,13	- 267		-267

The table below illustrates how the three views apply under the two cases.

	100% non-monetary asset			100% monetary asset		
	View A	View B	View C	View A	View B	View C
Assets	**400**	**400**	**400**	**250**	**250**	**250**
investment in S	-	-	-	-	-	-
Asset	400	400	400	250	250	250
Equity and liabilities	**400**	**400**	**400**	**250**	**250**	**250**
Share capital - Entity P	400	400	400	400	400	400
Share capital - Entity S	-	-	-	-	-	-
Retained earnings	267	-	0	267	-	0
Exchange difference (CTA)	-267	0	-	-267	0	-
	0	**0**	**0**	**0**	**0**	**0**
Net income	-	-	-	-267	-267	-267

In case of 100% non-monetary assets, if View A is used, even though there is not a purchasing power loss, the entity would be required to recognise a loss of GBP 267 in case of disposal. However, Equity due to hyperinflation would remain at the same amount. However, if View B or View C is used, none impact would be recognised in the Income Statement.

In case of 100% monetary assets, if View A is used, even though there is not a consolidation difference, in case of disposal the entity would be required to recognise twice a loss of GBP 267 due to the purchasing power loss of the currency. However, if View B or View C is used, the purchasing power loss would be recognised just once in according to the reality of the economic phenomena.

In conclusion, separating the recognition of translation effect in OCI and restatement effect in Equity implies dividing the effects of two macroeconomic variables that are part of the same economic phenomena and could lead to undesirable and incorrect consequences in financial reporting. Therefore, we think that View A does not allow to faithfully represent the economic phenomena in the financial statements.

2. Discussion about the circumstances in which View B could result in an inappropriate presentation of Equity

Taking into account that View B implies a joint presentation of hyperinflation restatement and translation effects in OCI, we think that it could be a more reasonable accounting policy option. However, our experience applying accounting for hyperinflation under IAS 29 for our foreign interests in Venezuela and Argentina and preparing consolidated financial statements in euros under IAS 21, allows us to affirm that this option is not good enough, especially when there are temporary asymmetries between inflation and foreign exchange rates.

Economies with high inflation rates are characterised by high correlation between inflation and exchange rates in the long run. However, as a result of the attempt of the fiscal or monetary authorities to influence any of those economic variables, relative long periods of inconsistency often exist although they finally converge. A typical situation would be the following:

- First, existence of one or several years with very high inflation rates and increased interest rates and nominal growth, where foreign exchange rates remain relatively stable due to the monetary policy or foreign exchange controls. The Income Statement of the foreign operations translated to the Group non-hyperinflationary presentation currency (for example, euro) is high. Assuming that those results are not distributed as dividends to the parent company (restrictions normally exist in these countries), the Reserves of the Group remain at very high level at the historical exchange rate.

- Some years later a strong devaluation occur. Then, high exchange rate differences arise.

When View B is applied, the resulting situation is the consolidated Financial Statements having high Reserves for accumulated results, compensated with high exchange differences in OCI. Our experience shows that this presentation of the composition of the Equity of the subsidiaries is not well understood by the users of the financial statements and raise numerous questions. The economic rationale behind is that the real contribution of the subsidiary is only understood on a net basis: the high accumulated results in the non-hyperinflationary presentation currency are questioned due to being generated in an economic context of foreign exchange control.

Therefore, any distortion that has occurred over time between exchange rates and inflation and that is finally corrected lead to an asymmetric presentation of the consolidated Group Equity. Therefore, we think that View B can lead to an asymmetric composition of Equity that hinders the real contribution of the foreign subsidiaries in hyperinflationary countries.

3. Interaction IAS 29 & IAS 21: Presenting exchange differences on hyperinflationary foreign operations

We understand the logic of the analysis of the Committee tentative agenda decision. However, we don't share the view that such a complex topic can be solved just with a literal reading of the Standards, using a very simple example and without deepening in the underlying economic reality. We think that the analysis performed by the Committee so far lack of an economic substance reasoning.

Moreover, we notice that IAS 29 was issued in 1989 and IAS 21 in 2001 and their interactions have not been revised afterwards. In this regard, we notice that IAS 29 is very focused on the local financial statements under hyperinflation and does not deepen in the real casuistry that affects the consolidated financial statements where the presentation currency is not hyperinflationary. And it should be taken into account that the users of financial information normally have greater interest in these consolidated financial statements than in the local ones.

We would like the Committee to understand that the financial presentation of the consequences of the previous described characteristics of the hyperinflationary economies together with the fact that paragraph 42 of IAS 21 does not explicitly specify how a reporting entity must present any exchange difference that may arise from the restate/translate process, have led to many multinational companies to apply the so-called View C. The tentative agenda decision accepts View B because you are assuming that the restatement effect is part of the exchange difference and then it can go to OCI. We think that View C is acceptable because the exchange difference could be seen as part of the restatement effect that IAS 29 sets that must be recognised in Equity (IAS 29.25) and taking into account that it contributes to better reflect economic reality of hyperinflationary subsidiaries and provide more reliable and relevant information.

On the other hand, as it is explained in Section 1, we think that View A should never be seen as a possible accounting option because it does not allow to faithfully represent the economic phenomena in the financial statements. However, we understand that a literal reading of the Standards, without deepen in the economic substance, can lead to that conclusion.

In conclusion, we think that this matter should be addressed through a change in the Standards that clarify the accounting and presentation treatment for interactions between hyperinflation and translation to non-hyperinflationary currency, taking into account the underlying economic reality.

4. Other considerations in relation to the interaction between IAS 21 and IAS 29

Our experience with interests in countries with high rates of inflation or hyperinflation have allowed us to identify other challenges when applying together IAS 29 & IAS 21.

We acknowledge the Committee decided to recommend that the Board propose narrow-scope amendments to IAS 21 to address a significant topic: situations in which exchangeability between two currencies is lacking. We will be happy to share our experience about adequate ways to determine the spot exchange rate in these situations with you.

In addition, we share other relevant improvements that the Standards need in this section with the aim of providing more information for the Committee to reflect on the need to recommend the IASB a comprehensive standard-setting project:

- An earlier application of some restatement for inflation could be needed for economies high rates of inflation (non hyperinflationary). Accounting for hyperinflation generally applies too late.
- The current requirement of IAS 29.4 that it is preferable that all entities that report in the currency of the same hyperinflationary economy apply the Standard from the same time could have sense when comparing local financial statements in a specified economy. However, when dealing with multinational companies with interests in different countries, the comparison is done at global level and more flexibility should be needed to enhance comparison.

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- The prohibition in IAS 21 to restate comparatives when restated financial statements are translated to a non-hyperinflationary presentation currency causes a clear lack of comparability between periods.

- IAS 29 should recognise that holdings of stable currencies (dollar, for example) help to preserve the purchasing power. Consequently, a restatement mechanism should be allowed for these holdings.

As a conclusion, we do not agree with the IFRS IC's tentative agenda decision. Also, we notice that not enough work has been performed by the staff and not all scenarios and economic impacts and asymmetries have been analyzed. Therefore, we think standard setting is needed to address correctly the interaction between IAS 29 & IAS 21 for such a complex topic that is relevant for many multinational companies with significant interests in economies with high rates of inflation.

If you have any questions or wish to amplify our comments, please do not hesitate to contact Maria Ángeles Peláez, Global Head of Accounting and Regulatory Reporting in BBVA Group (apelaez@bbva.com - phone +34 91 537 3764) or María Erviti, Accounting & Prudential Policies Director (maria.erviti@bbva.com - phone +34 94 487 6302).

Yours sincerely

María

María Erviti
Accounting and Prudential Policies Director
BBVA Group

Santander

IFRS Interpretations Committee
Sue Lloyd
IFRS Interpretations Committee Chair

Tentative Agenda Decision—Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences (IAS 21 and IAS 29)
Tentative Agenda Decision—Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary (IAS 21 and IAS 29)

Dear Mrs. Lloyd:

We appreciate the opportunity to comment in detail Tentative Agenda Decision -Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary and Tentative Agenda Decision - Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences and, published by IFRS Interpretations Committee meeting on September 17, 2019.

First Application IAS 29- Tentative Agenda Decision—Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary

We appreciate the IFRIC efforts to clarify first application of IAS 29 to a foreign operation on a hyper-inflationary economy, which requires to restate the financial statement of this subsidiary before consolidation process.

We are aware that restatement is a complicated process, which depends on economic variables that are strongly correlated, inflation and exchange rates, that reflects the same economic event, loss of purchasing power in a country's economy, which finally become hyperinflationary. Although there is such a correlation between the two variables, this correlation is not perfect and includes temporary mismatches, mainly due to decisions taken by local governments based on their monetary and fiscal policy actions.

Considering the above, before an economy becomes hyperinflationary, there is a progressive devaluation of the currency, which is reflected in a debit to Other Comprehensive Income (OCI) in consolidation process of the foreign operation, in order to recognize the devaluation of net assets of foreign operation, whether monetary or non-monetary, in group's functional currency. However, this devaluation does not reflect the same reality between these two categories of assets; in case of monetary assets there is a real loss, but not in non-monetary assets.

On first application of IAS 29, the restatement, whereby non-monetary assets are revaluated, implies a credit to Equity. At this stage, we do not believe that consolidated financial statements reflect faithful image of economic situation, because the underlying economic event, loss of purchasing power, started by a currency devaluation followed by high inflation rates, and is reflected as a first part in OCI and subsequent in Equity, and therefore, it's dispersed in consolidated financial statements.

Ciudad Grupo Santander, Amazonia Building.
28660 Boadilla del Monte, Madrid, Spain
Tel. +34. 91.289.88.08
e-mail: david.pena@gruposantander.com

In our opinion, the impact in OCI arising from the first devaluation of the currency must be leveled to Equity, implying that:

1. The impact of this economic event would not be spread in two lines of the consolidated financial statements, but only in Equity.
2. In terms of monetary assets, as there is a real loss of this assets, it should imply a debit in Equity, achieved through the proposed reclassification.
3. As for non-monetary assets, reclassifying the impact of first currency devaluation from OCI to Equity and subsequently carrying out the restatement, that neutralize the impact in Equity, which is in accordance with the absence of an actual loss mentioned above.

We would suggest the Committee to consider the analysis carried out previously and propose a levelling between OCI and Equity in order to correct both undesired effect.

Tentative Agenda Decision— Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences (IAS 21 and IAS 29)

We support the IFRIC efforts to respond the accounting challenges related to application of IAS 29 and 21 to a translation of a foreign operation on a hyperinflationary economy, in our opinion, a robust guide is needed due to the diversity shown in practice;

- Committee outreach, where five respondents express different applications from View A, B and C,
- Additional research performed by IASB staff, where 10 entities presented both effects in OCI and five entities in Equity,
- Committee debate during the meeting on September 17, and,
- Other publications of Big Four Audit Firms, who consider there is an accounting policy choice between recognizing the restatement effect directly in equity and in other comprehensive income as a translation adjustment.

The restatement of a foreign operation on a hyperinflationary economy and posterior translation to the group's functional currency is a complex process, and due to diversity in practice and the depth of the issue, we consider a tentative agenda decision is not enough and we would invite the Committee to evaluate the possibility of include it into standard setting agenda.

According to the Committee's analysis based on IAS 21-The Effects of Changes in Foreign Exchange Rates, and IAS 29 - Financial Reporting in Hyperinflationary Economies, there are three different options to show restatement and the translation effect of a foreign operation on a hyperinflationary economy:

View A: presenting both effects separately, restatement in Equity and translation in OCI, due to only translation effect is considered as exchange difference.

View B: presenting both effects together, restatement and translation, in OCI, considering both as exchange differences.

View C: present both the restatement and translation effect in Equity.

We would like to share our view with Committee members about these three options.

Ciudad Grupo Santander, Amazonia Building.
28660 Boadilla del Monte, Madrid, Spain
Tel. +34. 91.289.88.08
e-mail: david.pena@gruposantander.com

Santander

View A

The segregation in two lines of consolidated financial statements between restatement in OCI and translation in Equity does not reflect, in our opinion, a faithful image, because there is a strongly correlation between inflation and exchange rates, as mentioned above. These economic event, loss of purchasing power of a foreign operation, should not be dispersed in the consolidated financial statements.

However, in a tight application of IAS 21 and IAS 29, it may be understood that it should be recorded in that way, that's the reason why, considering a faithful image of consolidated financial statements, we understand it requires a robust and explicit accounting guide in order to explain it to financial statements preparers.

View B

Although this option is better than View A in order to represent a faithful image, because we avoid dispersion of loss of purchasing power of local economy, including restatement and translation in OCI, View B is not still good enough to represent faithful image. Assuming first application of IAS 29 has been performed, unifying both impacts finally reflected in Equity, there are still mismatches between inflation and exchange rates after the local economy becomes hyperinflationary. Therefore, the dispersion of this economic event on the consolidated financial statements could be easily occur again.

View C

In our view, presenting both mentioned effects in Equity is the best option to give faithful image of entity's financial position, due to:

- A single line in financial statements that includes the impact of these correlated economic variables, inflation and exchange rate.

- As mentioned in staff paper discussed in the Committee, IAS 21 does not explicitly prohibit the recognition of the exchange difference in equity, although Committee considers that this fact alone does not justify the recognition of this difference in equity. In our opinion, the effects mentioned above are not merely reflecting an exchange difference.

- It is consistent with the first application of IAS 29, which impact on Equity, and it is consistent with the reclassification of the currency devaluation impacts that we request in our analysis of the tentative decision "First Application IAS 29- Tentative Agenda Decision—Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary".

- In the long-term, we consider this is the way to correct the temporary mismatches between inflation and currency devaluation.

Up to date, we have considered View C the best option in order to give a faithful image of Group's financial position. In our experience, View C application has been well understood by users of our financial information, nevertheless we have included specific disclosures in our statements detailing the impact.

Ciudad Grupo Santander, Amazonia Building.
28660 Boadilla del Monte, Madrid, Spain
Tel. +34. 91.289.88.08
e-mail: david.pena@gruposantander.com

Santander

Following the analysis of these views carried out, in our opinion, accounting treatment of loss of purchasing power effect, composed of currency and inflation effect, for a foreign operation in a hyperinflationary economy, is not clearly defined in IAS 21 and IAS 29, and therefore, our suggestion is to include the issue into standards setting agenda.

We would be pleased to discuss any of the issues raised in this letter, nevertheless for any further insight to these comments please contact, David Peña Ortega on +34.91.289.88.08 or Aranzazu Leo Abad +34.91.289.30.46

Yours faithfully,

David Peña Ortega
Head of Accounting Regulation
Santander Group

Ciudad Grupo Santander, Amazonia Building.
28660 Boadilla del Monte, Madrid, Spain
Tel. +34. 91.289.88.08
e-mail: david.pena@gruposantander.com

Madrid, 25 November 2019

IFRS Interpretation Committee
Columbus Building
7 Westferry Circus
Canary Wharf, London E14 4HD
United Kingdom

Re: Committee's tentative agenda decision on Translating a Hyperinflationary Foreign Operation (IAS 21 and IAS 29) – Agenda Paper 4

Dear Sirs,

I am writing on behalf of Telefónica, S.A. one of the world's largest telecommunications companies by market cap and number of customers. Further information about the Telefónica Group and its activities is available on our website: www.telefonica.com

Telefónica appreciates the opportunity to provide comments to the IFRS Interpretations Committee on its Project *Translating a Hyperinflationary Foreign Operation (IAS 21 and IAS 29).*

Our comments to the specific issues raised in the aforementioned document covering agenda papers 4A and 4B are included in the Appendix attached to this letter. We have decided to write our comments in a single letter although the IFRS IC has published three separate projects for comment. We ask the Committee to consider our comments herein to the different sub projects, as applicable.

If you would like to discuss any of the issues described herein, please do not hesitate to contact Marta Soto, Head of Accounting Practice, at +34.914.828.534 or by e-mail to marta.sotobodi@telefonica.com.

Yours sincerely,

Marta Soto

Head of Accounting Practice

Telefónica, S.A

Appendix

Telefónica's comments on ***Translating a Hyperinflationary Foreign Operation (IAS 21 and IAS 29) – Agenda Paper 4***

Telefónica appreciates the Staff's attention to such a complex and relevant issue for its group. We are also grateful for the opportunity to respond to the preliminary decisions on the issues analysed, which are the following:

- Presenting exchange differences when a foreign operation is hyperinflationary;
- Cumulative exchange differences arising before a foreign operation becomes hyperinflationary; and
- Presenting comparative amounts when a foreign operation first becomes hyperinflationary.

The history of the Telefónica Group is linked to Latin America, where it is present in 8 countries, including Venezuela and Argentina, which are currently considered as hyperinflationary economies.

The Group's experience dealing with the accounting issues of hyperinflationary economies is extensive. Venezuela, which has represented a very important operation, has fulfilled this condition since 2009. At the same time, the effects on the consolidated financial statements of the Group have been very relevant, both from the equity and from the income statement points of view.

From the point of view of economic theory, the inflation and exchange rates are two sides of the same coin, i.e. their movements are correlated. In fact, perfect economic logic would imply full compensation between both effects. However, from the point of view of financial standards, hyperinflation scenarios are regulated by two independent and poorly correlated standards. This lack of integrity leaves undefined questions that requires Management to make their best interpretation.

Therefore, and based on our experience in the application and analysis of the standards and their impacts in hyperinflationary environments, we do not agree with the Staff's decisions.

Telefónica understands that the problem regarding the consolidation of subsidiaries in hyperinflationary economies is complex and deep. However, there are groups such as Telefónica for whom its effects have been and still are very relevant. It is from this experience that we wish to express our disagreement with the Committee's tentative decisions on agenda papers 4A and 4B based on the considerations set out below.

- **Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences when a Foreign Operation is Hyperinflationary – Agenda paper 4A**

The Staff analysed three views on how a reporting entity with a presentation currency of a non-hyperinflation currency presents the consolidation differences for their subsidiaries in hyperinflationary economies:

- View A- present the restatement effect and translation effect separately, in OCI and equity, respectively.
- View B- present both restatement and the translation effects in consolidated OCI.
- View C- present both the restatement and the translation effects in consolidated Equity.

The Staff concluded that only the two first views were acceptable approaches for presenting consolidation differences.

In our opinion, the analysis developed by the Staff is not complete in relation to View C. We support that it is an accounting policy choice compliant with current standards, which should not be excluded from the accounting policy options available for the entities.

Major audit firms supported this opinion, which was a fundamental reference for the adoption of this accounting policy in Telefónica.

Regarding diversity in practice, we agree that there might be a need to review the relevant standards to address the issue of hyperinflation from an integral point of view, which is what we propose as a response to the conclusion of the Staff.

The choice of View C as the accounting policy for the presentation of the effects of hyperinflation is not residual according to the outreach carried out by the Staff. According to their data, from the review of 15 companies that explicitly describe their accounting policy, 5 out of 15 follow view C. In any case, in order to obtain more relevant conclusions from the analysis of the results of the study, it would be interesting to weigh each alternative taking into account the experience of the entities in its application and the weight of the impact in their accounts (not only in the current financial year, but also in previous years).

Telefónica and other Spanish entities that have followed View C, with the agreement of their external auditors, are examples of companies with a long history of managing subsidiaries in hyperinflationary economies, which have represented a significant weight in their financial statements. From the perspective of the consolidated financial statements, the application of International Financial Reporting Standards for situations of hyperinflation has presented different challenges over time, and therefore the analysis has been evolving and recurrent and finally ended up applying View C.

As stated in the document prepared by the Staff, the measurement of the impact of hyperinflation is affected by two standards, independent from each other:

- IAS 29, which describes the restatement of the subsidiary's financial statements, resulting in a change in its equity, which is presented within consolidated Retained earnings.
- IAS 21, specifically par. 42, in relation to the translation of the financial statements of the hyperinflationary subsidiary, adjusted for inflation, to the presentation currency of its parent company, for the preparation of the consolidated financial statements. In this case, it describes a differentiated process and does not specify the nature of the resulting effect.

Therefore, a first simple approach to the presentation in Group accounts of the impact of subsidiaries in hyperinflationary economies would be View A, which derives from the application of both standards independently: in Equity for the restatement of IAS 29 and in OCI for analogy to the treatment of translation differences for non-hyperinflationary subsidiaries. However, this way of accounting for the impacts does not reflect the underlying economic reality, because as we have commented above, both effects are correlated and must be understood together as the best expression of the fair view. There is broad consensus on a net presentation of both impacts as derived from the Staff analyses.

This is the starting point for Views B and C.

View B, which is supported by the Staff, considers the adjustment for hyperinflation according to IAS 29 to be an exchange difference by analogy. In its opinion, the consolidation difference arising from the change in the assets of the subsidiary at the closing exchange rate with respect to the initial exchange rate falls within the definition of exchange difference, despite the fact that the initial and final amounts are different in local currency. In our opinion, this is a valid approach from a perspective of presenting both effects on a net basis. However, at the same time, the Standards are silent on where to classify the net impact taken as whole, therefore other approaches could be considered. In particular, we believe that presenting the net impact in equity is the most appropriate and it is not prohibited by the standards.

IAS 21 explains in its par. 42 that the process of translating the financial statements of hyperinflationary subsidiaries is different from that of any other foreign subsidiary. The application of a single closing exchange rate to all amounts in the financial statement is a consequence, and not an origin, of the primary hyperinflation situation. The result of applying a different criterion to the general one is that the nature of the impact is equally different from the translation differences arising in the consolidation of the other foreign subsidiaries. Therefore, we believe that the presentation requirements of par. 39 y 41 for non-hyperinflationary subsidiaries should not be considered as a reference for a different situation, which is the one of a hyperinflationary subsidiary.

In that sense, being the restatement and translation impacts closely related, in our selection of the View C we gave priority to the nature of the cause, which is hyperinflation, over that of the consequence, which is a specific translation methodology.

As the Staff explains, the net of both would be zero in a perfect market, and the fact of not being so gives rise to an impact of a mixed nature, and not necessarily unequivocally identifiable with only one of the parts of the equation.

In addition, we consider that the combined effects of the changes in equity result from changes in the measuring unit applied to the net investment in the foreign operation. Considering the guidance in paragraph 25 of IAS 29, such changes do not give rise to gains and losses, but instead are to be treated as adjustments to the respective balances.

As we mentioned at the beginning, the years affected by this situation have meant that the analysis has been continuous and has evolved, based on the observation of the real evolution of the economy, the difficulties of obtaining solid references and the objective of achieving the most aligned with the fair view. In this sense, there have been other considerations in the process:

- The variables involved (inflation index and exchange rate) are not affected at the same time or to the same extent throughout the hyperinflation period, although over time their behaviour tends to converge according to economic logic. This exposes companies to a vulnerability beyond their management capacity, which the market penalises without understanding its cause in depth, and which must be considered.
- Impact on results: the net monetary position and the adjustment for inflation of the items in the local company's income statement already generates an impact on its results that is included in the consolidated profit and loss account. That is, the consolidated income statement is already strongly affected by hyperinflation.

On the other hand, the Staff also mentions IFRIC 16 "Hedges of a Net investment in a Foreign Operation" to provide another argument in favour of its conclusion. This interpretation (IFRIC 16, p1) describes the process of translating a foreign subsidiary into a presentation currency other than its functional currency, with the recognition of exchange differences in OCI until disposal. The Staff presents this generic description as a valid reference that fills the obvious silence in IAS 21 on presenting exchange differences of hyperinflationary subsidiaries.

In our experience, net investment hedges are not common in hyperinflationary environments, although the development of the interpretation does not exclude the possibility. As we have been remarking, the uncertainty on the evolution of inflation that conditions the exchange rate expectation (one of the characteristics of hyperinflation is the irregularity in the increase of prices), makes them practically unviable not only in terms of cost but also in terms of effectiveness requirements.

Finally, and as a substantial support to View C, it should be noted that the major audit firms published during 2018 regulatory updates presenting the three views as valid accounting policies, which undoubtedly endorses their compliance with IFRSs.

Considering all the arguments set out above, we believe that there are no sufficient arguments to remove View C as a valid accounting policy. We kindly suggest the Committee to reassess its decision, as we believe that this issue would be better resolved through a standard setting process.

- **Tentative agenda decision- Cumulative exchange differences arising before a foreign operation becomes hyperinflationary– Agenda paper 4B**

We disagree with the Staff position on this matter, as explained below.

According to the Staff's opinion, when the foreign operation becomes hyperinflationary, the reporting entity does not reclassify within equity the pre-hyperinflation translation reserve relating to that foreign operation. Instead, it retains the pre-hyperinflation translation reserve as a separate component of equity.

This is its conclusion even if the accounting policy chosen by the entity for the presentation of the net effect of the restatement and translation were View C, i.e. in equity.

Its main reasons refer to the fact that IAS 21 does not contemplate the retrospective effect indicated by IAS 29 and IFRIC 7 ("as if the economy had always been inflationary").

We understand that there is another approach, again in agreement with the opinion of major international audit firms, who consider that the issue is not clearly dealt with in IFRS and therefore the interpretation of different standards could lead to different responses.

The analysis supporting this opinion is based on the first application of IAS 29 in the local entity subject to high inflation rates. IFRIC 7 concludes that *the entity shall apply the requirements of IAS 29 as if the economy had always been hyperinflationary.* This means a full retrospective application of IAS 29 in the foreign operation and then a translation of the resulting balances into the non-hyperinflation currency at the closing exchange rate. Due to the full retrospective adjustment on net assets and the requirements to use the closing exchange rates to the restated amounts, translation differences would have never arisen. Therefore, the amount of any translation difference generated prior to the classification of the economy as hyperinflationary should be derecognised by reclassifying any previous cumulative amount to the same heading where the effect of inflation is recognised, i.e. "Retained earnings".

We kindly suggest the Committee to reconsider its decision, together with the presentation issue as suggested above in a standard setting process.

MAPFRE

Majadahonda, November 22, 2019

International Financial Reporting Standards
Interpretations Committee
IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London
E14 4HD

Dear IFRS Interpretations Committee members,

With regard to the IFRIC meeting held on September 17, 2019, in which said body agreed that the Standards “IAS 21 – The Effects of Changes in Foreign Exchange Rates” and “IAS 29 – Financial Reporting in Hyperinflationary Economies” were not sufficiently relevant to be included in the standard setting agenda, at MAPFRE we would like to make it clear that we do not agree with the IFRIC’s tentative agenda decision regarding “Translation on a hyperinflationary foreign operation - presenting exchange differences (IAS 21 & IAS 29)” and “Cumulative Exchange Differences arising before A Foreign Operation becomes Hyperinflationary”. As such, we request that their inclusion in the standard setting agenda be reconsidered, in order to have a firm and homogeneous financial framework across all listed companies operating in hyperinflationary countries and that use a non-hyperinflationary presentation currency, both at present as well as in the future. In our opinion, the treatment of such a highly complex problem as the interaction of the exchange rate and inflation in accounting cannot be deduced from the wording of the current standard.

When a listed company has a subsidiary whose functional currency is from a hyperinflationary economy, the financial statements of said subsidiary must be restated to correct for inflation, in addition to translating them to the functional currency of the Group financial statements once they have been restated, which produces the following effects:

A. **Restatement of financial statements:**

- **Changes in non-monetary items.** As per paragraph 25 of IAS 29, it is understood that they should be recorded in reserves.

- **Results from the net monetary position.** As per IAS 29, paragraph 9, they must be included in the income statement.

B. Translation of restated financial statements to the functional currency of the Group:

- **Currency conversion differences.** In line with paragraph 32 of IAS 21, they must be recorded in "Other Comprehensive Income" (hereinafter, OCI).

This accounting treatment (View A from the IFRIC analysis documents), which was used by MAPFRE until 2016, implies that, by translating to euros the already restated financial statements of a subsidiary with a functional currency from a hyperinflationary economy, there is an increasingly negative conversion difference from the increase in equity coming from the restatement for inflation (the increases in reserves primarily originate, not in real results from the companies, but from the pure accounting restatement for inflation of retained earnings). If this information were presented separately, both the reserves for restatement as well as the negative conversion differences would increase progressively in line with inflation and currency depreciation/devaluation, which could lead to an asymmetry in these figures with regard to the rest of the subsidiary's and the Group's financial statements, in scenarios of unchecked inflation and severe currency depreciation/devaluation, which would be misleading for users of the financial statements.

This was demonstrated with the real data from 2017 from the financial statements of MAPFRE Group and its subsidiaries operating in Venezuela, which led to a change of accounting policy in said year, explained in the following paragraphs. Below is the data from 2017:

ITEM	Subsidiaries in Venezuela		Rest of Group		TOTAL	
	Amount	%	Amount	%	Amount	%
ASSETS	59.7	0.09	67,509.8	99.91	67,569.5	100
LIABILITIES	21.6	0.04	57,035.2	99.96	57,056.8	100
EQUITY	38.1	0.36	10,474.6	99.64	10,512.7	100
WRITTEN PREMIUMS	11.7	0.06	19,970.6	99.94	19,982.3	100
ATTRIBUTABLE RESULT	(9.0)	--	709.5	--	700.5	100
RESERVES FOR RESTATEMENT	517.3	100	--	--	517.3	100
CONVERSION DIFFERENCES	(889.9)	55.60	(710.7)	44.40	(1,600.6)	100

Information in million euros

As can be seen in the chart above, the separate presentation of both effects leads to the previously mentioned situation in which the amounts of reserves and conversion differences are unrealistically magnified, from having generated elevated restatement and translation differences, which both come from the same economic reality of hyperinflation, and which could be misleading for users of the financial statements. Further, the disproportionate amount of these items is clear in comparison to the rest of the balance sheet figures, both for said subsidiaries as well as for the rest of the Group, which does not give a true and fair view of the relative importance of said subsidiaries within MAPFRE Group.

As a result of the above, and with the aim of improving the true and fair view of the Group consolidated economic information, we firmly believe that these two effects (restatement for inflation and currency conversion differences) must be shown together in order to best reflect the reality of the subsidiaries operating in hyperinflationary economies, avoiding separating the impacts from exchange rates and hyperinflation, as well as the confusion that this separation can cause for users of the financial statements, thus proceeding in 2017 to the change in accounting policy, as explained below.

It is worth pointing out here that numerous listed companies do not currently use the accounting treatment used by MAPFRE until 2016 (View A from the IFRIC analysis documents), given how illogical its results are in the current environment, which shows that this View does not appropriately handle the interaction between IAS 29 and IAS 21. In our view, the Standards do not appropriately reflect these interactions, in part as a consequence of the different times of issuance (1989 vs 2001), and specifically from not establishing the treatment of exchange differences as a gain or loss in OCI. IAS 21.41, which deals with the recognition of exchange differences, is clearly linked to the paragraph 39 that is applicable to entities “whose functional currency is not the currency of a hyperinflationary economy”, and as such the Standard does not define the treatment for hyperinflationary economies. This issue becomes even more relevant considering that IAS 21.42 establishes the use of closing rates for both profit and loss and balance sheet items, and also that the comparative figures are not restated after applying IAS29.

Although IFRIC has given the option of presenting the two mentioned effects together in OCI, with the aim of improving the true and fair view of the financial situation and of the consolidated equity that must be stated in the financial statements, we believe it would be more appropriate to present them in the reserves statement, given that:

- The reserve for restatement is an equity caption and, as established in paragraph 25 of IAS 29, the nature of the adjustments included therein are equity movements.
- Paragraph 3 of the interpretation, IFRIC 7 “Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies”, indicates:

*"In the reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, not having been hyperinflationary in the prior period, **the entity shall apply the requirements of IAS 29 as if the economy had always been hyperinflationary**. Therefore, in relation to non-monetary items measured at historical cost, the entity's opening statement of financial position at the beginning of the earliest period presented in the financial statements shall be restated to reflect the effect of inflation from the date the assets were acquired and the liabilities were incurred or assumed until the end of the reporting period."*

The application of this standard would comply with the definition of retroactive application established in IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors". In this regard, paragraph 110 of IAS 1 "Presentation of Financial Statements" establishes that the retroactive restatements and adjustments are not changes in equity but are opening balance adjustments of accumulated earnings.

Considering the accounting treatment described for the first period in which hyperinflation exists, we believe that for the sake of homogeneity, the most appropriate treatment is to recognize the effect of hyperinflation in a reserves caption in the following periods as well.

- The logical interaction between significant price increases and devaluation of exchange rates becomes especially relevant in hyperinflationary economies, and it must be duly noted that, as we have seen historically in Venezuela and Argentina, it is possible that political decisions influence said variables (inflation and exchange rates), which causes distortions for long periods of time. Although logic ultimately leads to a correlation between said variables, these distortions influence all calculations during this period and, through accumulation, in the financial statements of the subsequent closing. Using View B from the IFRIC analysis documents would lead to the conclusion that all historical imbalances between inflation and exchange rate should be considered conversion differences and recycled in the future, which is not logical and leads to distortions in accounting treatment.

  The above case is especially relevant in the case of Venezuela, where there are such relevant distortions between inflation and exchange rates that it has been necessary to use a synthetic exchange rate treatment. Here it is important to highlight that this option was not explicitly contemplated in the Standard, but the economic reality made it necessary in order to avoid significant accounting distortions.

- The results from the net monetary position are included in each period in the income statement, and therefore retained earnings (reserves) include all results for this item from previous periods. As a result, if OCI included the rest of the hyperinflation effects, the impacts of such would remain separate, therefore lacking homogeneity in accounting treatment for the effects of one single economic event of hyperinflation, and thus be misleading for users of the financial statements.

In order to avoid the distortion this caused, MAPFRE changed the accounting policy in 2017, recording all the above-mentioned effects of hyperinflation (restatement for inflation and currency conversion differences) in one single reserves caption (View C from the IFRIC analysis document). In this regard, the argument is once again to avoid distortions. An economy begins to be treated as hyperinflationary after several years of high price increases (a cumulative ratio greater than 100 percent for 3 years), recognizing the historic effects in reserves once said requirement is met, given that restating comparative statements is not permitted. With this treatment, once again, there is a distortion between the amounts to be recognized in reserves and those recognized in previous OCIs, which are inconsistent with the recognition of assets and liabilities when applying IAS 29 historically.

With Argentina considered to be a hyperinflationary economy in 2018, this experience has reaffirmed that the current accounting is more reliable and relevant than the one previously followed, as presenting all effects of hyperinflation in equity, in a single reserves caption, avoids the separation of the impacts from the exchange rate depreciation and the loss of purchasing power from hyperinflation. Equity remains unchanged and the effects of the restatement of the net monetary position continue to be recorded in the Income Statement in each period.

Further, it is noteworthy that, with the approval of the external auditors, the criteria for presenting all effects of hyperinflation in a single reserves caption has been followed, in recent years, by MAPFRE and other listed Spanish companies, which is leading to differences in criteria between the different listed companies, and thus in the comparison of the information.

With all of this in mind, and because neither IAS 21 nor IAS 29 establish precise criteria for the problematic conversion differences for hyperinflationary economies, we believe that this issue should be included in the standard setting agenda, so that the problem of translating financial statements from hyperinflationary economies is clearly regulated, specifying its accounting treatment and presentation in financial statements considering the abovementioned points, and thus unifying the different approaches used until now by the listed companies.

In this regard, given the proximity of the close of the 2019 accounting year and its expected impact for numerous listed companies, we request that IFRIC be sensitive to this in terms of deadlines in its deliberations, in order for MAPFRE Group governing bodies to be able to make appropriate decisions with respect to the accounting criteria at the close of 2019.

Please do not hesitate to contact us with any questions you might have.

Sincerely,

Fernando Mata Verdejo
Chief Financial Officer

PO Box 1411
Beenleigh QLD 4207
25 November 2019

Ms Sue Lloyd
Chair IFRS Interpretations Committee
International Accounting Standards Board
Columbus Building, 7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Online submission: https://www.ifrs.org/projects/work-plan/translation-of-a-hyperinflationary-foreign-operation-presenting-exchange-differences/

Dear Sue

Tentative agenda decisions — Translating a Hyperinflationary Foreign Operation (IAS 21 and IAS 29)

- **Translating a Hyperinflationary Foreign Operation—Presenting Exchange Differences (IAS 21 and IAS 29)**
- **Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary (IAS 21 and IAS 29)**
- **Presenting Comparative Amounts when a Foreign Operation First becomes Hyperinflationary (IAS 21 and IAS 29)**

I am pleased to make this submission on the above Tentative Agenda Decisions (TADs) relating to Translating a Hyperinflationary Foreign Operation.

I have extensive experience in accounting advice on International Financial Reporting Standards across a wide range of clients, industries and issues in the for-profit, not-for-profit, private and public sectors.

My clients have included listed companies, unlisted and private companies, charitable and not-for-profit organisations, federal, state and local government departments and agencies in the public sector, and government owned corporations (government business enterprises). I also have some commercial, standard setting and academic experience.

Overall

I do not support issuing the TADs as drafted.

Translating a Hyperinflationary Foreign Operation—Presenting Exchange Differences (IAS 21 and IAS 29)

The draft TAD permits a separate restatement adjustment to be recognised directly in equity. I disagree with that option in the absence of an explanation by the Committee of why the restatement adjustment is a direct to equity item on consolidation. Because the adjustment is not a transaction with owners as owners, the adjustment would appear to meet the definition under IAS 1 of total comprehensive income:

> ***Total comprehensive income* is the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.**

What is the restatement adjustment?

While adjusting equity of an entity reporting in a hyperinflationary currency to a current purchasing power concept makes sense, such an adjustment to equity makes less sense when the results are being reported in a stable currency of the consolidated group.

If the Committee permits an accounting policy choice as to whether a separate restatement adjustment is recognised, it needs to explain what this restatement adjustment represents in respect of the consolidated group. When preparers make a choice, they need (under IAS 8) to understand whether the separate recognition of a restatement adjustment represents fairly the "transaction, other event or condition".

Should the restatement adjustment be separately recognised?

Under principle-based accounting standards, the restatement adjustment should represent something, and not just be based on an interpretation that separate recognition is permitted because the standards do not prohibit it.

I could not identify any intention in IAS 21 and IAS 29 that would require the complexity of recycling part of the translation process and not the remainder. This indicates to me that any restatement adjustment is part of the translation process and not something to be separately recognised.

Other related matters

If the Committee permits the separate recognition of a restatement adjustment, it should explain how the requirement of IAS 29 paragraph 24 and the elimination of the revaluation surplus is presented in the consolidated statement of comprehensive income. This is important, as the requirements of IAS 21 prohibit restatement of comparatives.

The Committee should also acknowledge the effects of equity accounting and whether there is any flow-through of the restatement adjustment of an associate or jointly-controlled entity to the consolidated group.

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

There is an issue under of IAS 29 paragraph 24 on first application of IAS 29 in relation to that part of the consolidated revaluation surplus that is eliminated. If the Committee permits the separate recognition of a restatement adjustment, the Committee needs to explain how this elimination is treated.

If the Committee decided that all IAS 29 adjustments are part of the translation process, then I would support this TAD.

Similar to my comments above on the complexity of recycling part of the translation process and not the remainder, I could not identify any intention in IAS 21 and IAS 29 that would require the complexity of separately accounting for the pre-hyperinflation exchange difference. This indicates to me that such accounting is not required under a principles-based approach.

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

I do not believe that the Committee has sufficiently analysed the issue in relation to quarterly reporting.

The Committee should undertake such analysis if it permits a separate restatement adjustment to be recognised. The analysis should consider how this restatement adjustment is determined and accounted for, particularly in relation to quarterly reporting.

Yours sincerely,

David Hardidge
https://www.linkedin.com/in/davidhardidge/