IFRS Accounting

Staff paper

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IFRS® Interpretations Committee meeting

Date	**June 2023**
Project	**Consolidation of a Non-Hyperinflationary Subsidiary by a Hyperinflationary Parent (IAS 21 and IAS 29)**
Topic	**Possible solution**
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Purpose of the paper

1. This paper includes our analysis and preliminary views on a possible narrow-scope amendment to IFRS Accounting Standards (possible solution) to address:

   (a) the submitted fact pattern; and

   (b) the related matter.

2. This paper discusses only the key features of the possible solution. It does not discuss all aspects—for example, it does not discuss possible disclosure requirements that could accompany the possible narrow-scope amendment. Subject to the Committee agreeing with our recommendation in Agenda Paper 5B to refer the matter to the IASB, we will consider feedback from the Committee in refining the key aspects of the possible solution and will present it to the IASB at a future meeting together with any other aspects that may be necessary.

Structure

3. This agenda paper includes:

   (a) possible solution (paragraphs 4–27);

   (b) findings from Phase II (paragraphs 28–34);

   (c) staff preliminary view (paragraphs 35); and

   (d) an appendix—examples illustrating the possible solution.

Possible solution

The question

4. In the submitted fact pattern, the reporting entity’s subsidiary (foreign operation) has a non-hyperinflationary functional currency. Similarly, in the related matter, the reporting entity has a non-hyperinflationary functional currency. In both cases, the reporting entity presents financial statements in a hyperinflationary currency. Paragraph 39 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* (reproduced in Appendix A to Agenda Paper 5) applies to the translation of the results and financial position of an entity (or a foreign operation) that has a non-hyperinflationary functional currency. Consequently, in both situations, the reporting entity applies paragraph 39 of IAS 21 to translate the relevant results and financial position (including comparative information).

5. Paragraph 16 of Agenda Paper 5B notes that the question a narrow-scope standard-setting project would need to answer is whether applying only paragraph 39 results in useful information or whether the information would be more useful if it were expressed in terms of the current measuring unit.

Should the results and financial position be expressed in terms of the current measuring unit?

6. While IAS 29 applies only to an entity that has a hyperinflationary functional currency, paragraph 2 of IAS 29 says:

> In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.

7. Feedback from Phase I of our research (see paragraphs 14–16 of Agenda Paper 5A) suggests information provided by expressing amounts in terms of the current measuring unit for the submitted fact pattern could be useful. Based on our research and for the reasons noted in paragraph 2 of IAS 29, we think that expressing financial statements that are presented (or included within financial statements that are presented) in a hyperinflationary currency in terms of the current measuring unit would improve the usefulness of information.

8. In developing a possible solution, we need to consider that the reporting entity's *functional currency* is non-hyperinflationary—the possible solution should not have the effect of substituting a hyperinflationary currency for the functional currency. Paragraph BC16 of the Basis for Conclusions on IAS 21 states:

> The Board agreed that the translation method should not have the effect of substituting another currency for the functional currency. Put another way, presenting the financial statements in a different currency should not change the way in which the underlying items are measured. Rather, the translation method should merely express the underlying amounts, as measured in the functional currency, in a different currency.

9. Additionally, requiring an entity to apply the IAS 29 restatement methodology[1] to the related matter would be a significant change in the scope of IAS 29 which currently applies only to the financial statements of any entity whose functional currency is hyperinflationary.

10. The next section discusses a possible amendment to IAS 21 that:

    (a) in our view, would result in expressing financial statements that are presented (or included within financial statements that are presented) in a hyperinflationary currency in terms of the current measuring unit;

    (b) would not change the way underlying items are measured; and

    (c) would not require a change to the scope of IAS 29.

Possible solution—a narrow-scope amendment to IAS 21

Requirements in IAS 21

11. Paragraphs 38–49 of IAS 21 specify requirements for the use of a presentation currency other than the functional currency. [2] Those requirements apply when an entity:

    (a) presents its financial statements in a currency that is not its functional currency; or

    (b) translates the results and financial position of a foreign operation in preparing its consolidated financial statements.

12. Paragraph 39 of IAS 21 generally requires an entity to translate assets and liabilities at the closing rate at the date of the statement of financial position and income and expenses at exchange rates at the date of the transaction, except for an entity with a

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[1] IAS 29 requires an entity that has a hyperinflationary functional currency to restate its results and financial position in terms of the current measuring unit and includes requirements specifying how to do so. We refer to this as the 'IAS 29 restatement methodology'.

[2] Appendix A of Agenda Paper 5 of this meeting includes relevant extracts from IAS 21 and IAS 29.

hyperinflationary functional currency. In the latter case, paragraph 42 of IAS 21 requires an entity to generally translate all amounts (including comparatives) at the closing rate at the date of the most recent statement of financial position (most recent closing rate).

13. IAS 21, therefore, includes two translation methods. An entity's functional currency determines which of these two methods is applicable.

14. Paragraph 42(b) of IAS 21 includes one exception to the translation method applicable to entities with a hyperinflationary functional currency. This exception is based on an entity's *presentation currency*. If an entity that has a hyperinflationary functional currency presents financial statements in a non-hyperinflationary presentation currency, the entity does not adjust comparative information—comparative amounts are those that were presented as current year amounts in the prior year financial statements. Paragraph BC22 of the Basis for Conclusions on IAS 21 explains:

(a) if exchange rates fully reflect differing price levels between the two economies to which they relate, applying the normal translation method (after applying IAS 29) will result in the same amounts for the comparative information as were reported as current year amounts in the prior year financial statements.

(b) the relevant amounts had been already expressed in the non-hyperinflationary presentation currency and there was no reason to change them.

15. The table below summarises which paragraphs in IAS 21 apply to translating an entity's (or its foreign operation's) results and financial position:

	Functional currency	Presentation currency	Paragraph in IAS 21
1	Non-hyperinflationary currency	Non-hyperinflationary currency	39
2	Non-hyperinflationary currency	Hyperinflationary currency	39
3	Hyperinflationary currency	Non-hyperinflationary currency	42*
4	Hyperinflationary currency	Hyperinflationary currency	42

*Paragraph 42(b) includes an exception for comparative information.

Amending the translation requirements in IAS 21

16. In both the submitted fact pattern and the related matter, the functional currency is non-hyperinflationary and the presentation currency is hyperinflationary (row 2 in the table in paragraph 15 above). Although an entity's functional currency generally determines which translation method in IAS 21 applies, an entity's presentation currency can affect the applicable translation method (see paragraph 14). We therefore considered whether we could develop a specific translation methodology applicable to the submitted fact pattern and the related matter.

17. We think an entity should translate all items (assets, liabilities, equity items, income and expenses, including comparatives) at the most recent closing rate when the entity:

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

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

18. Applying this translation method all items would, in our view, be expressed in terms of the current measuring unit and doing so would improve the usefulness of information (see paragraph 10(a)). We note that:

    (a) respondents from Phase I of our additional research are of the view that assets and liabilities translated at the most recent closing rate (for example, when applying paragraph 39 of IAS 21) are expressed in terms of the current measuring unit. In their view, no further adjustment is required.

    (b) even though exchange rates do not generally fully reflect differing price levels between the two economies to which they relate, paragraph 17 of IAS 29 states that movements in the exchange rate between the functional currency and a relatively stable foreign currency can be used to estimate changes in a general price index for periods for which a general price index may not be available.

19. As paragraph 12 of this paper notes, IAS 21 already requires an entity that has a hyperinflationary functional currency to translate all amounts (including comparative information) at the most recent closing rate (paragraph 42(a) of IAS 21). Paragraph BC17 of the Basis for Conclusions on IAS 21 explains the practical and conceptual advantages of such a translation approach. That paragraph highlights that this translation method:

    (a) does not change the way underlying items are measured (see paragraph 10(b));

    (b) is simple to apply;

    (c) does not generate any new gains and losses; and

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

20. Amending IAS 21 would also not result in a change to the scope of IAS 29 (see paragraph 10(c)).

21. Investors we spoke with in Phase I of our additional research say it would be useful to receive information in the non-hyperinflationary functional currency. An additional benefit, in our view, of requiring an entity to use a single exchange rate (the most recent closing rate) in the submitted fact pattern and the related matter is that doing so would simplify a conversion back to the non-hyperinflationary functional currency for such investors. The investor would need to know only the exchange rate used and the relevant amounts in the hyperinflationary presentation currency.

22. We acknowledge that in developing IAS 21, the IASB decided not to adopt a translation methodology that would require *all* entities translating financial statements to a different presentation currency to use the most recent closing rate—for the reasons explained in paragraphs BC18–BC19 of IAS 21. However, we see no reason to not apply the most recent closing rate to the submitted fact pattern and the related matter—in particular, as paragraphs 6–10 of this paper explain, we think that in these situations, the results and financial position should be expressed in terms of the current measuring unit.

23. Appendix A includes two examples that illustrate the application of the possible solution to the submitted fact pattern and the related matter.

Other considerations

Comparative information in the submitted fact pattern

24. Applying our possible solution to the submitted fact pattern, an entity that has a hyperinflationary functional currency would apply the most recent closing rate to the comparative results and financial position of the foreign operation that has a non-hyperinflationary presentation currency but apply the IAS 29 restatement methodology to its own comparative results and financial position—this could add complexity. We considered whether, in this situation, an entity should be required or permitted to apply the IAS 29 restatement methodology to the comparative information of the foreign operation. However:

    (a) permitting or requiring an entity to apply the IAS 29 restatement methodology for comparative information of the foreign operation in this situation would add more complexity and result in a foreign operation's results and financial position for the current year being translated at the most recent closing rate but a general price index being applied to the foreign operation's comparative period results and financial position.

    (b) feedback to our possible solution (see paragraph 34) suggests this would not be a significant practical challenge.

    (c) the complexity would not be new or unique—similar complexity exists in the case of a reporting entity that has a hyperinflationary functional currency that translates the results and financial position of a foreign operation that also has a hyperinflationary functional currency—in this situation, the reporting entity translates the results and financial position of the foreign operation using the most recent closing rates (applying paragraph 42 of IAS 21) but applies the IAS 29 restatement methodology to its own results and financial position.

Consolidation challenges in the submitted fact pattern

25. Applying our possible solution, a non-hyperinflationary foreign operation's results, statement of financial position and comparative information would be translated using the most recent closing exchange rate but the hyperinflationary parent's results, statement of financial position and comparative information would be prepared applying the IAS 29 restatement methodology. Consequently, there could be application questions about the elimination of intragroup income and expenses and other balances (see paragraph A13 of Appendix A for an illustration).

26. However, as paragraph 18 of Agenda Paper 5B notes, this is not a new question—it is also applicable to other situations. Addressing this question would require a more fundamental review of the principles and requirements of IAS 21 that goes beyond the scope of this narrow-scope standard-setting project.

Disclosure of summarised financial information about the subsidiary

27. Paragraph 16 of Agenda paper 5A notes feedback from investors suggesting it would be useful to receive information about the summarised financial position and results of the non-hyperinflationary subsidiary in the non-hyperinflationary functional currency or the proportion of the group's assets, liabilities and results that the non-hyperinflationary subsidiary represents. In our view, our possible solution does not need to include specific additional disclosure requirements to meet this request. IFRS 12 *Disclosure of Interests in Other Entities* already includes disclosure requirements for an investor to evaluate the nature of, and risks associated with, its interests in other entities, and the effects of those interests on its financial position, financial performance and cash flows. Paragraph 21 of this paper notes that an additional benefit of our possible solution is that it would simplify a conversion back to the non-hyperinflationary functional currency of amounts disclosed in the consolidated financial statements applying IFRS 12.

Feedback on possible solution

28. As Agenda Paper 5A explains, during Phase II of our additional research, we met with three accounting firms and with one preparer operating in a hyperinflationary economy that has a non-hyperinflationary subsidiary. We asked them to comment on the costs and benefits of applying the possible solution. We considered this feedback to refine the possible solution.

Benefits of the possible solution

29. Most respondents say the possible solution is adequate for the submitted fact pattern. In particular, the preparer says the possible solution achieves the objective of expressing all amounts in terms of the current measuring unit.

30. All respondents agree with the possible solution for the related matter. They consider it to be a practical solution which will improve financial reporting. Respondents say an additional benefit to the possible solution for the related matter is that it does not generate new exchange gains and losses that indefinitely accumulate in other comprehensive income (see paragraph 26 of Agenda Paper 5A).

31. One of the respondents, while agreeing with the possible solution for the related matter, did not agree with the possible solution for the submitted fact pattern. The respondent says the submitted fact pattern and the related matter are not sufficiently similar—in their view, the IAS 29 restatement methodology (or some aspects of that methodology as described under View 2) should be applied to the submitted fact pattern. In addition, in their view, the possible solution should apply to *all* entities translating their own financial statements (as opposed to a foreign operation) into a different presentation currency (regardless of whether that presentation currency is hyperinflationary) because then no new exchange gains and losses (that accumulate in other comprehensive income) will be generated. In our view, this suggestion goes beyond the scope of a possible narrow-scope project—it is also something the IASB

considered but rejected when developing the requirements in IAS 21 (see paragraphs BC15–BC23 of IAS 21).

Costs of applying the possible solution

32. All respondents agree that the possible solution is easy to apply, particularly for reporting entities with a non-hyperinflationary functional currency that present their financial statements in a hyperinflationary presentation currency (the related matter).

33. Most respondents also preferred a translation method that does not require making use of different mechanisms to translate different items in a single set of financial statements. In their view, applying, for example, the recent closing exchange rate to the current financial statements but changes in the general price index to the comparative financial statements of the same entity adds unnecessary complexity.

34. One of the large accounting firms highlighted the challenge of applying the possible solution to the comparative information for the submitted fact pattern (see paragraph 24 of this paper). However, the preparer says it does not expect significant practical challenges—the preparer says information of each entity in the group (before consolidation) exists on a discrete basis and can be adjusted without significant cost and effort. The preparer is of the view that the practical and conceptual benefits of consistently applying the most recent closing rate to all amounts (including the comparative information) outweighs other possible practical challenges.

Staff preliminary view

35. Based on our analysis and research, our preliminary view is that the IASB should amend IAS 21 to require a reporting entity to translate all items (assets, liabilities, equity items, income and expenses, including comparatives) at the most recent closing rate when the entity:

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

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

Appendix—Examples illustrating the possible solution

A1. The objective of the examples is to illustrate the application of the possible solution for the submitted fact pattern and the related matter.

The related matter

Facts

A2. Entity A has a non-hyperinflationary functional currency (NHC) but presents its financial statements in a hyperinflationary currency (HC).

A3. Entity A:

(c) was established on 1 January 20X1 with a share capital of NHC1,000;

(d) used the proceeds to buy a non-depreciable non-monetary asset for NHC1,000 on 1 January 20X1;

(e) generated cash sales of NHC50 on 1 January 20X1 and 1 January 20X2; and

(f) has a current reporting date of 31 December 20X2.

A4. The exchange rates between the currencies are:

(a) 1 January 20X1: NHC1: HC1

(b) 31 December 20X0: NHC1: HC2

(c) 31 December 20X1: NHC1: HC3

A5. Applying the possible solution to its financial statements for the year ended 31 December 20X2, Entity A translates all amounts (including comparative information) in its financial statements at closing exchange rate of NHC1: HC3.

31 December	20X2		20X1	
DR / (CR)	**NHC**	**HC**	**NHC**	**HC**
Income and expenses				
Revenue	(50)	(150)	(50)	(150)
Assets				
Non-monetary asset	1,000	3,000	1,000	3,000
Cash	100	300	50	150
Equity				
Share Capital	(1,000)	(3,000)	(1,000)	(3,000)
Retained earnings	(100)	(300)	(50)	(150)

A6. Applying the possible solution does not result in any new exchange differences.

Submitted fact pattern[3]

Facts

A7. Entity P (a parent) has a hyperinflationary functional and presentation currency (HC). Entity P owns 100% of the equity of Entity S (a subsidiary).

A8. Entity S:

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

(e) was established on 1 January 20X1 through an investment of HC1,000 by Entity P. Entity S used the capital to acquire a non-depreciable non-monetary asset for NHC1,000.

A9. Entity S generates cash sales of NHC50 on 1 January 20X1 and 1 January 20X2.

A10. The exchange rates between the currencies are:

(f) 1 January 20X1: NHC1: HC1

(g) 31 December 20X1: NHC1: HC2

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

(h) 31 December 20X2: NHC1: HC3

A11. The Consumer Price Index of the hyperinflationary economy in which Entity P operates are[4]:

(a) 1 January 20X1: 100

(b) 31 December 20X1: 200

(c) 31 December 20X2: 300

Solution

A12. Applying the possible solution to its financial statements as at, and for the year ended, 31 December 20X2, Entity P translates all amounts (including comparative information) in the financial statements of Entity S at closing exchange rate of NHC1: HC3.

Excerpts of Entity S's financial statements				
31 December	**20X2**		**20X1**	
DR / (CR)	**NHC**	**HC**	**NHC**	**to HC**
Income and expenses				
Revenue	(50)	(150)	(50)	(150)
Assets				
Non-monetary asset	1,000	3,000	1,000	3,000
Cash	100	300	50	150
Equity				
Share Capital	(1,000)	(3,000)	(1,000)	(3,000)
Retained earnings	(100)	(300)	(50)	(150)

A13. After Entity P translates the financial statements of Entity S, it includes these financial statements in its consolidated financial statements by:

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

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

(b) eliminate the carrying amount of its investment in Entity S as at 31 December 20X2 (HC1,000 × (change in general price index of: 300 ÷ 100) = HC3,000) and the Entity P's 100% interest in the share capital of Entity S at that same reporting date (HC3,000).[5]

[5] If the exchange rates do not fully reflect differing price levels between the two economies to which they relate, the carrying amount of the investment reported in the statement of financial position of Entity P, restated applying IAS 29, will not equal the carrying amount of the parent's interest in the share capital of Entity S as reported, after applying the possible solution, in the subsidiary's statement of financial position. See paragraphs 25–26 of this paper for further discussion about this challenge.