Documents published to accompany

IFRIC 7

Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies

The text of the unaccompanied Interpretation, IFRIC 7, is contained in Part A of this edition. Its effective date when issued was 1 March 2006. The text of the Accompanying Guidance on IFRIC 7 is contained in Part B of this edition. This part presents the following document:

BASIS FOR CONCLUSIONS

Basis for Conclusions on IFRIC Interpretation 7 *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies*

This Basis for Conclusions accompanies, but is not part of, IFRIC 7.

In this Basis for Conclusions the terminology has not been amended to reflect the changes made by IAS 1 Presentation of Financial Statements *(as revised in 2007).*

Introduction

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.

Background

BC2 The IFRIC was asked for guidance on how an entity should restate its financial statements when it starts to apply IAS 29 *Financial Reporting in Hyperinflationary Economies*. There was uncertainty whether the opening balance sheet at the beginning of the reporting period should be restated to reflect changes in prices before that date.

BC3 In addition, there was uncertainty about the measurement of comparative deferred tax items in the opening balance sheet. IAS 29 states that at the balance sheet date deferred tax items of the restated financial statements should be measured in accordance with IAS 12 *Income Taxes*. However, it was not clear how an entity should account for the corresponding deferred tax figures.

BC4 In response, the IFRIC developed and published Draft Interpretation D5 *Applying IAS 29* Financial Reporting in Hyperinflationary Economies *for the First Time* for public comment in March 2004. It received 30 letters in response to the proposals.

Basis for consensus

The restatement approach

BC5 In developing D5, the IFRIC observed that the purpose of restating financial statements in hyperinflationary economies in accordance with IAS 29 is to reflect the effect on an entity of changes in general purchasing power. Paragraph 2 of IAS 29 states:

> 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.

This purpose applies to the financial statements of the first reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency as well as to subsequent reporting periods (if the criteria for a hyperinflationary economy are still met).

BC6 The IFRIC considered the meaning of paragraph 4 of IAS 29, which states:

> … this Standard applies to the financial statements of any entity from the beginning of the reporting period in which it identifies the existence of hyperinflation in the country in whose currency it reports.

The IFRIC noted that some may interpret this provision as restricting the restatement of an entity's opening balance sheet in the reporting period in which it identifies the existence of hyperinflation. Consequently, the opening balance sheet should be restated to reflect the change in a general price index for the reporting period only and not for changes in a general price index before the beginning of the reporting period, even though some balance sheet items may have been acquired or assumed before that date. However, the IFRIC also noted that paragraph 34 of IAS 29 requires:

> *Corresponding figures for the previous reporting period*, whether they were based on a historical cost approach or a current cost approach, are restated by applying a general price index so that the comparative financial statements are *presented in terms of the measuring unit current at the end of the reporting period*. Information that is disclosed in respect of earlier periods is also expressed in terms of the measuring unit current at the end of the reporting period … [emphasis added]

BC7 The IFRIC considered a possible inconsistency between the restriction in paragraph 4 of IAS 29 and the requirement in paragraph 34. The IFRIC noted that paragraph 4 is a scope paragraph, which identifies when an entity has to comply with the Standard. The paragraph clarifies that an entity applies the requirements of the Standard to its financial statements from the beginning of the reporting period to the balance sheet date and not only from the date when it identifies the existence of hyperinflation. However, paragraph 4 does not deal with the restatement and presentation of the financial statements (either at the balance sheet date or in relation to the comparative figures). Hence, paragraph 4 of IAS 29 does not exclude from the restatement of an entity's opening balance sheet changes in the general price level before the beginning of the reporting period in which the entity identifies the existence of hyperinflation.

BC8 The IFRIC concluded that, in the context of the purpose of the Standard, the restatement of the financial statements for the reporting period in which an entity identifies the existence of hyperinflation should be consistent with the restatement approach applied in subsequent reporting periods.

BC9 Some respondents to D5 expressed concerns about whether the restatement approach in IAS 29 was always practicable for preparers and whether it provided decision-useful information to users. Though the IFRIC understood those concerns, the IFRIC observed that such concerns reflected broader aspects related to the accounting for hyperinflation in general, rather than how an entity has to apply the current Standard.

BC10 Nevertheless, the IFRIC considered how an entity should apply the Standard if, for example, detailed records of the acquisition dates of items of property, plant and equipment are not available. The IFRIC noted that, in those circumstances, paragraph 16 of IAS 29 states:

> … In these rare circumstances, it may be necessary, in the first period of application of this Standard, to use an independent professional assessment of the value of the items as the basis for their restatement.

The IFRIC also noted that a similar exemption exists when a general price index may not be available. Paragraph 17 of IAS 29 states:

> … In these circumstances, it may be necessary to use an estimate based, for example, on the movements in the exchange rate between the functional currency and a relatively stable foreign currency.

BC11 The IFRIC observed that, in developing IFRS 1 *First-time Adoption of International Financial Reporting Standards*, the International Accounting Standards Board discussed whether IFRS 1 should exempt first-time adopters of IFRSs from the effects of restatement in their first IFRS financial statements. Paragraph BC67 of IFRS 1 states:

> Some argued that the cost of restating financial statements for the effects of hyperinflation in periods before the date of transition to IFRSs would exceed the benefits, particularly if the currency is no longer hyperinflationary. However, the Board concluded that such restatement should be required, because hyperinflation can make unadjusted financial statements meaningless or misleading.

BC12 However, the IFRIC also observed that first-time adopters of IFRSs could use, for example, the fair value at transition date as deemed cost for property, plant and equipment, and, in some instances, also for investment property and intangible assets. Hence, if a first-time adopter that would otherwise have to apply IAS 29 at its transition to IFRSs applies the fair value measurement exemption of IFRS 1, it would apply IAS 29 to periods only after the date for which the fair value was determined. Such remeasurements would therefore reduce the need for a first-time adopter to restate its financial statements.

BC13 The IFRIC noted that the exemptions from the general restatement approach for preparers that already apply IFRSs, as stated in paragraph BC10 above, apply only in specific circumstances, whereas a first-time adopter may always elect to use the fair value remeasurement exemption for property, plant and equipment in IFRS 1. Nevertheless, the IFRIC concluded that the application of the exemptions in the Standards is clear and, therefore, extending the exemptions in IAS 29 to permit preparers that already apply IFRSs to elect fair value remeasurement of property, plant and equipment when applying the restatement approach under IAS 29 would require amendments of the Standard itself, rather than an Interpretation.

BC14 Respondents to D5 also argued that the procedures, as proposed to be clarified, are inconsistent with the accounting for a change in functional currency under IAS 21 *The Effect of Changes in Foreign Exchange Rates*, which in their view is comparable to moving into a state of hyperinflation. Moreover, they noted that retrospective application is also inconsistent with the

US GAAP approach, which accounts for a change in hyperinflation status prospectively.

BC15 In relation to the reference to a change in functional currency, the IFRIC observed that the existence of hyperinflation may (but not necessarily should) initiate such a change. The IFRIC noted that a change in functional currency is a change in the currency that is normally used to determine the pricing of an entity's transactions. As clarified in paragraph BC5 above, the purpose of restatement for the effects of hyperinflation is to reflect the effect of changes in purchasing power in the economy of an entity's functional currency. Therefore, the IFRIC did not believe that the application of accounting for hyperinflation should be based on the accounting for the change in an entity's functional currency.

BC16 The IFRIC also observed that respondents' reference to prospective application under US GAAP reflects requirements only for investments in foreign entities in hyperinflationary economies. In this case, paragraph 11 of SFAS 52 *Foreign Currency Translation* states:

> The financial statements of a foreign entity in a highly inflationary economy shall *be remeasured as if the functional currency were the reporting currency*. Accordingly, the financial statements of those entities shall be remeasured into the reporting currency according to the requirements of paragraph 10 … [emphasis added]

Therefore, under US GAAP a foreign entity's financial statements are remeasured into its investor's functional currency. The IFRIC noted that this approach is different from the restate/translate approach under IFRSs. US GAAP provides different guidance for reporting entities operating with a hyperinflationary functional currency. APB Statement No. 3 *Financial Statements Restated for General Price-Level Changes* is also based on a restatement approach, and would require retrospective application, as under IAS 29. The IFRIC observed that for the purpose of presenting comparative amounts in a different presentation currency under IFRSs paragraphs 42(b) and 43 of IAS 21 apply. In such instances, an entity will have relief from the required restatement of comparatives under IAS 29. Paragraph BC22 of IAS 21 explains the reasoning for this specific exemption as follows:

> … If exchange rates fully reflect differing price levels between the two economies to which they relate, the SIC-30 approach will result in the same amounts for the comparatives as were reported as current year amounts in the prior year financial statements. Furthermore, the Board noted that in the prior year, the relevant amounts had been already expressed in the non-hyperinflationary presentation currency, and there was no reason to change them.

BC17 D5 proposed that applying the restatement approach under IAS 29 should be regarded as a change in circumstances, rather than a change in accounting policy. Some respondents to D5 believed this was inconsistent. This is because IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, paragraph 16, states that a change in circumstances is not a change in accounting policy and an entity would not apply IAS 29 retrospectively. However, the IFRIC observed that IAS 29 contains specific requirements on this point, as noted in paragraphs BC5–BC16 above. The IFRIC concluded that the opening balance sheet for the reporting period in which an entity identifies the existence of hyperinflation ought to be restated as if the entity had always applied the restatement approach under IAS 29. The IFRIC reconfirmed its view that this treatment is similar to the retrospective application of a change in accounting policy described in IAS 8.

Deferred tax items

BC18 The IFRIC was asked for guidance on the accounting for deferred tax items when an entity restates its financial statements according to IAS 29. In particular, the IFRIC was asked for guidance on measuring deferred tax items in the opening balance sheet for the reporting period in which an entity identifies the existence of hyperinflation.

BC19 The IFRIC observed that paragraph 32 of IAS 29 states:

> The restatement of financial statements in accordance with this Standard may give rise to differences between the carrying amount of individual assets and liabilities in the balance sheet and their tax bases. These differences are accounted for in accordance with IAS 12 *Income Taxes*.

Therefore, at the closing balance sheet date of the reporting period an entity remeasures its deferred tax items on the basis of the restated financial statements, rather than by applying the general restatement provisions for monetary items or non-monetary items. However, the IFRIC noted that it was not clear how an entity should account for its comparative deferred tax items.

BC20 In developing D5, the IFRIC considered the following options:

(a) restatement of deferred tax items as monetary items;

(b) restatement of deferred tax items as non-monetary items; or

(c) remeasurement of deferred tax items as if the economy of the entity's functional currency had always been hyperinflationary.

BC21 D5 proposed clarifying that deferred tax items are neither clearly monetary nor non-monetary in nature. This was because deferred tax items are determined by the assets' (and liabilities') relative carrying amounts and tax bases. However, some respondents to D5 objected to that view, for various reasons. Some argued that deferred tax items, by nature, are received or paid in a fixed or determinable number of units of currency, and so should be considered as monetary items in accordance with paragraph 8 of IAS 21. Others noted that general practice is to classify deferred taxes as non-monetary items.

BC22 When considering respondents' comments the IFRIC confirmed that its conclusion in paragraph BC17 above should also apply to deferred tax items. In other words, the deferred tax items in the opening balance sheet for the reporting period in which an entity identifies the existence of hyperinflation should be calculated as if the environment had always been hyperinflationary, ie option (c) in paragraph BC20. Although the IFRIC acknowledged that deferred tax items may meet the definition of monetary items it noted that the purposes of option (c) would not be achieved if opening deferred tax items were restated in the same manner as applied generally for monetary items.

BC23 The IFRIC observed that some respondents to D5 suggested that deferred tax items in the opening balance sheet should be remeasured after restating the opening balance sheet with the measurement unit current at the closing balance sheet date of the reporting period. In the IFRIC's view, that proposal would (in case of a deferred tax liability) overstate the deferred tax item recognised in the opening balance sheet and, accordingly, understate the costs recognised in the reporting period. This is because the loss on the tax base caused by the inflation in the reporting period would be recognised directly in opening equity. The IFRIC illustrated this by the following example:

> At the end of Year 1, a non-monetary asset is restated at the measurement unit current at that date. Its restated amount is CU1,000[1] and its tax base is CU500. If the tax rate is 30 per cent, the entity would remeasure a deferred tax liability of CU150. In Year 2 inflation is 100 per cent. Assuming that nothing has changed the entity would, in its restated financial statements, recognise an asset of CU2,000 (both at the closing balance sheet date of the reporting period and in the comparative figures). At the closing balance sheet date, the deferred tax liability is remeasured at CU450 ((CU2,000 – CU500) × 0.3). However, if the comparative deferred tax liability is remeasured after restating the asset by the measuring unit current at the closing balance sheet date of the reporting period, the entity should recognise an opening deferred tax liability of CU450, and there would be no impact on profit or loss (CU450 – CU450). On the other hand, if the comparatives are stated as proposed in D5, the restated opening deferred tax liability would be CU300 ((CU1,000 – CU500) × 0.3) × 100% + CU150). Accordingly, the entity should recognise a loss of CU150 (CU450 – CU300), which is the loss of purchasing power on the tax base in the reporting period.

BC24 The IFRIC observed that paragraph 18 of Appendix A to IAS 12 explains:[2]

> Non-monetary assets are restated in terms of the measuring unit current at the balance sheet date (see IAS 29 *Financial Reporting in Hyperinflationary Economies*) and no equivalent adjustment is made for tax purposes. *(notes: (1) the deferred tax is charged in the income statement;*[3] *and (2) if, in addition to the restatement, the non-monetary assets are also revalued, the deferred tax relating to the revaluation is charged to equity*[4] *and the deferred tax relating to the restatement is charged in the income statement.)*

1 In this example monetary amounts are denominated in 'currency units (CU)'.

2 Paragraph 18 has been amended as a consequence of the changes made by IAS 1 *Presentation of Financial Statements* (as revised in 2007).

3 IAS 1 (revised 2007) requires an entity to present all income and expense items in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income).

4 Under IAS 1 (revised 2007), such effect is recognised in other comprehensive income.

BC25 Consequently, the IFRIC confirmed its conclusion that restatement of comparative deferred tax items would require an entity, first, to remeasure its deferred tax items on the basis of the financial statements of the previous reporting period, which have been restated by applying a general price index reflecting the price level at the end of that period. Secondly, the entity should restate those calculated deferred tax items by the change in the general price level for the reporting period.

