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Exposure Draft ED/2010/12

Severe Hyperinflation

Proposed amendment to IFRS 1

Comments to be received by 30 November 2010

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(proposed amendment to IFRS 1)

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APPROVAL BY THE BOARD OF *SEVERE HYPERINFLATION*

BASIS FOR CONCLUSIONS

Introduction

This exposure draft contains a proposal by the International Accounting Standards Board to amend IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The purpose of the amendment is to provide guidance on how an entity should resume presenting financial statements in accordance with IFRSs after a period when the entity was unable to comply with IFRSs because it had a functional currency that was subject to severe hyperinflation.

The proposed amendment will add an exemption to IFRS 1. This exemption would allow an entity that has been subject to severe hyperinflation to measure assets and liabilities at fair value and use that fair value as the deemed cost of those assets and liabilities in the opening IFRS statement of financial position.

Invitation to comment

The Board invites comments on all aspects of this exposure draft and in particular on the questions set out below. Respondents need not comment on all of the questions. Comments are most helpful if they:

- (a) respond to the questions as stated;
- (b) indicate the specific paragraph or paragraphs to which the comments relate;
- (c) contain a clear rationale; and
- (d) describe, if applicable, any alternatives that the Board should consider.

The Board is not requesting comments on matters in IFRS 1 other than those set out in this exposure draft. Comments should be submitted in writing and must arrive no later than **30 November 2010**.

Question 1 – Severe hyperinflation exemption

The Board proposes adding an exemption to IFRS 1 that an entity can apply at the date of transition to IFRSs after being subject to severe hyperinflation. This exemption would allow an entity to measure assets and liabilities at fair value and use that fair value as the deemed cost of those assets and liabilities in the opening IFRS statement of financial position.

Do you agree that this exemption should apply when an entity prepares and presents an opening IFRS statement of financial position after being subject to severe hyperinflation?

Why or why not?

Question 2 – Other comments

Do you have any other comments on the proposals?

Proposed amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

After paragraph 31B a heading and paragraph 31C are added.

Presentation and disclosure

Use of deemed cost after severe hyperinflation

- 31C If an entity elects to measure assets and liabilities at fair value and to use that fair value as the deemed cost in its opening IFRS statement of financial position because of severe hyperinflation (see paragraphs D27–D30), the entity’s first IFRS financial statements shall disclose an explanation of how, and why, the entity had, and then ceased to have, a functional currency that has both of the following characteristics:
- (a) a reliable general price index is not available to all entities with transactions and balances in the currency.
 - (b) exchangeability between the currency and a relatively stable foreign currency does not exist.

Paragraph 39H is added.

Effective date

- 39H *Severe Hyperinflation* (Amendment to IFRS 1), issued in [date], amended paragraph D1 and added paragraphs 31C and D27–D30. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

Paragraph D1 is amended (new text is underlined and deleted text is struck through) and a heading and paragraphs D27–D30 are added.

Appendix D

Exemptions from other IFRSs

- D1 An entity may elect to use one or more of the following exemptions:
- (a) ...
 - (o) transfers of assets from customers (paragraph D24); ~~and~~
 - (p) extinguishing financial liabilities with equity instruments (paragraph D25); ~~and~~
 - (q) severe hyperinflation (paragraphs D27–D30).

An entity shall not apply these exemptions by analogy to other items.

Severe hyperinflation

- D27 If a first-time adopter has a functional currency that was, or is, the currency of a hyperinflationary economy, it shall determine whether it was subject to severe hyperinflation before the date of transition to IFRSs.
- D28 The currency of a hyperinflationary economy is subject to severe hyperinflation if it has both of the following characteristics:
- (a) a reliable general price index is not available to all entities with transactions and balances in the currency.
 - (b) exchangeability between the currency and a relatively stable foreign currency does not exist.
- D29 The functional currency of an entity ceases to be subject to severe hyperinflation on the functional currency normalisation date. That is the date when the functional currency no longer has either, or both, of the characteristics in paragraph D28, or when there is a change in the entity's functional currency to a currency that is not subject to severe hyperinflation.
- D30 When an entity's date of transition to IFRSs is on, or after, the functional currency normalisation date, the entity may elect to measure assets and liabilities at fair value on the date of transition to IFRSs and use that fair value as the deemed cost of those assets and liabilities in the opening IFRS statement of financial position.

Approval by the Board of *Severe Hyperinflation* (proposed amendment to IFRS 1) published in September 2010

The exposure draft *Severe Hyperinflation* (proposed amendment to IFRS 1) was approved for publication by the fourteen members of the International Accounting Standards Board.

Sir David Tweedie Chairman

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Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the proposed amendment to IFRS 1.

Introduction

- BC1 In 2010 the IFRS Interpretations Committee received a request to clarify how an entity should resume presenting financial statements in accordance with IFRSs after a period of severe hyperinflation, during which it had been unable to comply with IAS 29 *Financial Reporting in Hyperinflationary Economies*.
- BC2 The request identified an entity whose functional currency is the currency of a hyperinflationary economy and which has applied IAS 29. However, the entity is unable, for a period of time, to comply with IAS 29 and prepare financial statements in accordance with IFRSs because of severe hyperinflation. This is because a reliable general price index is not available to all entities with that same functional currency, and exchangeability between the currency and a relatively stable foreign currency does not exist. The functional currency of the entity then changes at a later date to another currency, which is not the currency of a hyperinflationary economy. The change of functional currency to a non-hyperinflationary currency enables the entity to start applying IFRSs to subsequent transactions.
- BC3 The request asked how such an entity should resume preparing financial statements under IFRSs when the entity's functional currency ceases to be the currency of a severely hyperinflationary economy.

Decision to amend IFRS 1 *First-time Adoption of International Financial Reporting Standards*

- BC4 The Committee observed that an entity with the functional currency of a hyperinflationary economy cannot comply with IFRSs if a reliable general price index is not available, because of the requirements in paragraph 37 of IAS 29 to restate financial statements using a general price index. Furthermore, the absence of exchangeability between an entity's functional currency and a relatively stable currency eliminates a potential alternative to using a general price index by calculating an

estimate based on the movements in exchange rates in accordance with paragraph 17 of IAS 29. The Committee described a functional currency in the absence of a reliable general price index and exchangeability with a relatively stable currency as being subject to severe hyperinflation.

BC5 In the request the entity stopped preparing financial statements in accordance with IFRSs because it could not comply with IAS 29 and could not present reliable financial information in its financial statements. The Committee concluded that when

- (a) the entity is again able to apply IAS 29 because the characteristics of severe hyperinflation (the lack of a reliable general price index and absence of exchangeability of the functional currency with a relatively stable currency) are no longer present, or
- (b) the entity's functional currency changes to one that is not hyperinflationary,

and the entity becomes able again to present reliable financial information in accordance with IFRSs, the entity meets the criteria to be a first-time adopter. However, the Committee noted that IFRSs do not provide guidance on how an entity should resume presenting financial statements in accordance with IFRSs when the functional currency of the entity ceases to be subject to severe hyperinflation. Specifically, the Committee noted that because of the effects of severe hyperinflation an entity cannot comply with all of the requirements in IFRS 1 to prepare and present an opening IFRS statement of financial position. Consequently, the Committee recommended that the Board should amend IFRSs to address this issue.

BC6 The Board agreed with the Committee that current IFRSs do not provide guidance on how an entity should resume presenting financial statements in accordance with IFRSs after a period when its functional currency was subject to severe hyperinflation. Consequently, the Board proposes to amend IFRSs to provide guidance. The Board decided to address only situations when reliable measurement in accordance with IFRSs is not possible as a result of severe hyperinflation, rather than consider other circumstances when reliable measurement might not be possible.

BC7 The Board considered whether it was appropriate to amend IFRS 1 or IAS 29 to address this issue. The Board noted that an amendment to IAS 29 would reinforce the intention that the amendment should be very narrow and be limited to the situation where an entity meets the scope of IAS 29, but cannot apply the measurement requirements of that Standard

because of severe hyperinflation. However, in considering the amendment, the Board was also conscious of other concerns that interested parties have with applying the current scope of IAS 29 and with proposals to change IAS 29 only to address this issue of severe hyperinflation.

- BC8 The Board also noted that an amendment to IAS 29 could be applied by an entity that is able to prepare and present financial statements in accordance with IFRSs, despite being affected by severe hyperinflation. Specifically, this would include entities with an interest in an entity that emerges from a severely hyperinflationary economy, for example a parent entity with a subsidiary that was affected by severe hyperinflation, and not just entities that directly suffered from severe hyperinflation. The Board identified that these entities would be unable to apply guidance in IFRS 1 if they had continued to prepare and present financial statements in accordance with IFRSs during the period that the entity in which they held an interest was subject to severe hyperinflation. However, the Board understood from interested parties that this is unlikely to be a significant or widespread issue for entities with such interests because they have generally been able to find appropriate existing guidance in IFRSs.
- BC9 Consequently, the Board proposes to amend IFRS 1. The Board observed that this would enable it to provide timely guidance to those entities that were unable, for a period of time, to prepare financial statements in accordance with IFRSs because of severe hyperinflation.
- BC10 The proposed amendment does not provide guidance for entities affected by severe hyperinflation that are not within the scope of IFRS 1. The Board did not make any decisions on how an entity should account for an interest in an entity that was subject to severe hyperinflation in the consolidated financial statements of parents, venturers and investors. This is because entities have generally been able to find sufficient guidance in IFRSs.
- BC11 The Board proposes to amend IFRS 1 to provide guidance on how an entity can resume preparing IFRS financial statements by presenting an opening IFRS statement of financial position on, or after, the functional currency normalisation date. The Board defined the functional currency normalisation date as the date when the entity's functional currency ceases to suffer from severe hyperinflation. This is the event that created the need for additional guidance. The Board identified that the characteristics of severe hyperinflation make it challenging to provide guidance that would result in the presentation of reliable financial

information that could be considered IFRS-compliant during the period of severe hyperinflation. However, the Board believes that allowing an entity to apply the exemption when presenting an opening IFRS statement of financial position after, and not just on, the functional currency normalisation date, addresses practical concerns that may arise if the functional currency normalisation date and an entity's date of transition to IFRSs are different.

Accounting at the functional currency normalisation date

- BC12 The Board proposes that an entity that has been subject to severe hyperinflation may elect to measure assets and liabilities at fair value and use that fair value as the deemed cost in its opening IFRS statement of financial position. The Board believes that this approach expands the scope of the deemed cost exemptions that currently exist in IFRS 1 to enable them to be applied in these specific circumstances (severe hyperinflation). The Board thinks that this provides a practical solution to providing guidance on how an entity can resume presenting financial statements in accordance with IFRSs, and consequently apply IFRS 1, after being subject to severe hyperinflation.
- BC13 The Board believes that an entity should not be required to apply the exemption, but instead may elect to apply it when measuring assets and liabilities in the opening IFRS statement of financial position. This is because, by applying other guidance in IFRS 1 to measure specific assets and liabilities, an entity may provide users with more useful information, for example when measuring assets and liabilities that were not affected by severe hyperinflation.
- BC14 The Board considers that any adjustments arising on electing to measure assets and liabilities at fair value in the opening IFRS statement of financial position arise from events and transactions before the date of transition to IFRSs. Consequently, they should be accounted for in accordance with paragraph 11 of IFRS 1, and an entity should recognise those adjustments directly in retained earnings (or, if appropriate, in another category of equity) at the date of transition to IFRSs. Hence, the Board does not propose further guidance on the accounting for those adjustments.
- BC15 The Board observed that entities are required to apply paragraph 21 of IFRS 1 and prepare and present comparative information in accordance with IFRSs for periods before the functional currency normalisation date. However, because of the effects of severe hyperinflation in periods before

the date of transition to IFRSs, the Board identified that entities should consider whether disclosure of non-IFRS comparative information and historical summaries, in accordance with paragraph 22 of IFRS 1, would provide useful information to users of the financial statements. The Board also noted that an entity should clearly explain the transition to IFRSs in accordance with paragraphs 23–28.