

Use of a hyperinflationary presentation currency by a non- hyperinflationary entity (IAS 21)

Issues Paper

Objective

- 1 The objectives of the session are:
 - (a) To provide EFRAG FR TEG members with an overview of hyperinflation and the use of hyperinflationary currencies and seek their views on the matter's prevalence; and
 - (b) To provide an overview of the IASB project and seek the views of EFRAG FR TEG members on the IASB's tentative decisions to date, the corresponding EFRAG Secretariat analysis and the feedback provided by EFRAG working groups on the issue.

What is hyperinflation?

Economic theory on hyperinflation

- 2 Hyperinflationary episodes have most commonly been defined as “beginning in the month in which monthly inflation exceeds 50% and that end in the month before the month in which monthly inflation is less than 50% for at least one year”¹. This definition appears to be used consistently across older² and more recent research literature.
- 3 A case in point is the [study by José Luis Saboin-García](#)³, covering the period between 1960 and 2013. In this study, hyperinflation was defined as an annual inflation rate of more than

¹ Philip Cagan, “The Monetary Dynamics of Hyperinflation”, 1956.

<https://people.bu.edu/rking/SZGcourse/Cagan.pdf>

² Andrés Solimano, “Inflation and the costs of stabilization: Historical and Recent Experiences and Policy Lessons”, The World Bank Research Observer, 1990.

<https://documents1.worldbank.org/curated/en/557541468327561601/pdf/770020JRN0WBRO0Box0377291B00PUBLIC0.pdf>

³ José Luis Saboin García, “The Modern Hyperinflation Cycle: Some New Empirical Regularities”, IMF Working Paper, 2018.

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500 percent. A hyperinflationary cycle was defined as a period starting when the annual average inflation rate was higher than 50 percent, including a period of hyperinflation and ending when there was a period of 5 years with an annual average inflation rate of less than 50 percent. Under the criterion used in his paper 19 hyperinflation cycles were found in 19 countries. "The duration of an average hyperinflation cycle is 16-17 years with an annual average inflation of 893 percent (a median duration of 14 years and a median annual inflation of 45 percent)."

- 4 It is thus demonstrated that in hyperinflationary episodes the local currency's value is rapidly eroded, with respect to both its domestic purchasing power and its exchange rate in comparison to foreign currencies.

Hyperinflation in IFRS Accounting Standards

- 5 According to paragraph 2 of IAS 29 *Financial Reporting in Hyperinflationary Economies*, "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." (our emphasis)

- 6 In addition, paragraph 3 of IAS 29 states, "This Standard does not establish an absolute rate at which hyperinflation is deemed to arise. It is a matter of judgement when restatement of financial statements in accordance with this Standard becomes necessary. Hyperinflation is indicated by characteristics of the economic environment of a country which include, but are not limited to, the following:

- (a) the general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power;
- (b) the general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency;
- (c) sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short;

<https://www.imf.org/en/Publications/WP/Issues/2018/12/07/The-Modern-Hyperinflation-Cycle-Some-New-Empirical-Regularities-46368>

- (d) *interest rates, wages and prices are linked to a price index; and*
- (e) *the cumulative inflation rate over three years is approaching, or exceeds, 100%.”*

7 As noted in paragraph 3 of IAS 29, assessing when hyperinflation arises, leading to the need for a restatement of financial statements, is a matter of judgement. In addition, relatively recent research⁴ distinguishes between hyperinflation and “very high inflation”, with the latter being ascribed a quantitative threshold of a 12-month cumulative inflation rate of 100%. It can be observed that the quantitative threshold set in paragraph 3(e) of IAS 29 is lower than those used for defining hyperinflation and “very high inflation”.

EFRAG Secretariat analysis

- 8 As noted in paragraph 2 of IAS 29, “*reporting of operating results and financial position in the local currency without restatement is not useful*” and “*comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.*” Moreover, it is noted that even if all amounts are translated using the closing rate, in a severely hyperinflationary environment, the value of the local currency may have changed drastically between the reporting date and the publication date of the financial statements, which hinders comparability.
- 9 Therefore, **using a currency of a hyperinflationary environment as a presentation currency may lead to information that is of limited usefulness to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.** Lastly, it is noted that some respondents to the IASB’s outreach ([AP5A](#) June 2023 IFRIC meeting) considered that financial statements prepared under IAS 29 are generally difficult to understand.
- 10 The EFRAG Secretariat acknowledges that a number of jurisdictions require local entities to present their financial statements in local currency, which is often done to protect the relevance of the local currency and for local tax purposes. However, taking into consideration the aforementioned matters related to the decision-usefulness of the information, **the EFRAG Secretariat considers that IAS 21 should permit the presentation currency of a reporting entity to be any currency except for a currency of a hyperinflationary economy.**

⁴ Fischer, Sahay and Végh, “Modern Hyper- and High Inflation”, IMF Working Paper, 2002.

<https://www.imf.org/external/pubs/ft/wp/2002/wp02197.pdf>

Feedback from EFRAG working group discussions

- 11 The above depiction of hyperinflation, the overview of the IASB's project, and the EFRAG Secretariat analysis were discussed with the EFRAG FIWG (27 March), EFRAG User Panel (28 March) and EFRAG Academic Panel (8 May). Working group members provided the below feedback.
- 12 Members, especially users, concurred with the Secretariat view that figures reported in a hyperinflationary presentation currency provide limited usefulness. Overall, drawing from their experience, they considered that these figures are difficult to interpret, and the entity values are distorted. Moreover, they added two additional factors that create difficulties in such a context:
 - (a) in most cases the hyperinflationary currency is not even used in the real economy, an argument further bolstering the Secretariat view; and
 - (b) usually capital controls and lack of exchangeability are imposed in a hyperinflationary regime, which makes the reported figures even less relevant.
- 13 At the same time, members recognised challenges pertinent to the Secretariat proposal that a hyperinflationary presentation currency should be prohibited. They considered that the question of which currencies should be permitted under IFRS was a political one rather than a technical one. In light of this, some members expressed the view that accounting standards should not impose such requirements on jurisdictions, particularly if the recommendation came from EFRAG, a European stakeholder organisation, as Europe has currently limited interaction with hyperinflation. In addition, they acknowledged that local legislation (e.g. taxation) may be the reason entities are forced to report their figures in the local currency.
- 14 Moreover, members noted that there are economies which, while the exchange rate of the local currency is rapidly deteriorating in comparison to a stable currency, are still functional when expressed in terms of the local currency. Under these circumstances, this prohibition would force the local stock exchange to denominate securities in a different currency than the one used as a presentation currency in entities' financial statements. This would in turn reduce the usefulness of the information provided.
- 15 Taking into account the above, members agreed that reporting in a hyperinflationary regime is a recurring problem that calls for a principles-based accounting solution. Members considered that the EFRAG Secretariat proposals would call for a comprehensive overhaul of IAS 21, IAS 29 and a conceptualisation of reporting currencies. Acknowledging

the potential merit of such a discussion, they nevertheless commented that this was beyond the scope of the current IASB narrow-scope proposals.

Questions for EFRAG FR TEG

- 16 Do you have any experience with hyperinflation?
- 17 Do you consider that the use of a hyperinflationary presentation currency should be permitted in IFRS reporting?
- 18 If so, should all hyperinflationary currencies be allowed as presentation currencies?

Background of the project

- 19 The IFRS Interpretations Committee (IFRIC) received a submission ([AP2](#) June 2022 IFRIC meeting) about the accounting applied by a parent, whose functional currency is the currency of a hyperinflationary economy, when it consolidates a subsidiary whose functional currency is the currency of a non-hyperinflationary economy. In the fact pattern described in the submission, the parent entity applies paragraphs 39–41 of IAS 21 to translate the results and financial position of the non-hyperinflationary subsidiary into its presentation currency.
- 20 The submission asks whether, in preparing its consolidated financial statements, the parent applies IAS 29 to restate the current year and comparative amounts presented for its non-hyperinflationary subsidiary. If the parent were to restate the current year and comparative amounts, it would express those amounts in terms of the measuring unit current at the end of the reporting period (the reporting date).
- 21 IFRIC concluded that, applying the requirements in IAS 21 and IAS 29 to the submitted fact pattern, the parent could restate or not restate the subsidiary’s results and financial position in terms of the measuring unit current at the end of the reporting period.
- 22 Additional outreach was then carried out ([AP5A](#) June 2023 IFRIC meeting), through which the issue was identified as prevalent, and diversity in the accounting treatment was observed. IFRIC decided to then refer the matter to the IASB by recommending the IASB develop a narrow-scope amendment that addresses the fact pattern described in the request and a related matter of an entity whose functional currency is the currency of a non-hyperinflationary economy but presents its financial statements in the currency of a hyperinflationary economy.

IASB tentative decisions

December 2023 meeting – Proposed amendments

- 23 In its December 2023 meeting, the IASB decided to add a maintenance project for developing narrow-scope amendments to IAS 21 to its work plan. The amendments would specify how to translate the results and financial position of an entity whose functional currency is non-hyperinflationary into a hyperinflationary presentation currency.
- 24 The IASB also tentatively decided to propose amending IAS 21 to require an entity to translate all amounts (assets, liabilities, equity items, income and expenses, including comparative amounts) at the closing rate at the date of the most recent statement of financial position if that entity:
- (a) Has a non-hyperinflationary functional currency and presents financial statements in a hyperinflationary presentation currency; or
 - (b) Translates the results and financial position of a foreign operation that has a non-hyperinflationary functional currency into a hyperinflationary presentation currency.

February 2024 meeting – Disclosure requirements, transition and early application, when the presentation currency becomes or ceases being hyperinflationary

- 25 *On disclosure requirements*, the IASB tentatively decided to propose that:
- (a) An entity that translates the results and financial position of a foreign operation with a non-hyperinflationary functional currency into a hyperinflationary presentation currency be required to disclose summarised financial information about that foreign operation;
 - (b) An entity within the scope of the proposed amendments be required to disclose that its financial statements (or the results and financial position of its foreign operation) and corresponding figures for previous periods have been translated at the closing rate at the date of the most recent statement of financial position; and
 - (c) An entity whose presentation currency ceases being hyperinflationary be required to disclose that fact.
- 26 *On transition and early application*, the IASB tentatively decided to propose that:
- (a) An entity that already applies IFRS Accounting Standards be required to apply the amendments retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when that entity first applies the proposed amendments;

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- (b) An entity that already applies IFRS Accounting Standards be exempt from disclosing the information required by paragraph 28(f) of IAS 8 when that entity first applies the proposed amendments;
- (c) No transition relief be provided for first-time adopters; and
- (d) An entity that already applies IFRS Accounting Standards be permitted to apply the proposed amendments earlier than the effective date and be required to disclose that it has done so.

27 *For a presentation currency that becomes or ceases being hyperinflationary, the IASB tentatively decided to propose that:*

- (a) No specific requirements be included to address situations in which an entity's presentation currency becomes hyperinflationary.
- (b) An entity be required to apply paragraph 39(b) of IAS 21 prospectively to income and expenses arising after the end of the previous reporting period if the entity's presentation currency ceases being hyperinflationary. The IASB tentatively decided an entity would not be required to retranslate income and expenses arising before the end of the previous reporting period.

[March 2024](#) - *Disclosure requirements for subsidiaries without public accountability and due process requirements*

28 *On disclosure requirements for subsidiaries without public accountability, the IASB tentatively decided that:*

- (a) An eligible subsidiary within the scope of the proposed amendments be required to disclose the fact that the entity's financial statements (or results and financial position of the eligible subsidiary's foreign operation) and corresponding figures for previous periods have been translated at the closing rate at the date of the most recent statement of financial position;
- (b) An eligible subsidiary whose presentation currency ceases to be hyperinflationary be required to disclose that fact; and
- (c) An eligible subsidiary that translates the results and financial position of a foreign operation applying the proposed amendments to IAS 21 be required to disclose summarised financial information about the results and financial position of that foreign operation.

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- 29 *On due process*, the IASB gave permission to begin the process for balloting the Exposure Draft, which is expected to be published in Q3 2024. The comment period will be set at 120 days.

EFRAG Secretariat analysis

- 30 As noted in paragraph 9 the principal position of the EFRAG Secretariat is that the currency of a hyperinflationary economy should not be used as a presentation currency in IFRS.
- 31 To the extent the IASB is determined to proceed with this project EFRAG Secretariat holds no objections to the tentative decisions of the IASB.

Feedback from EFRAG working group discussions

- 32 With regard to these proposals, members agreed with the tentative decisions taken, noting that they represent an improvement. However, they highlighted that the amendments would not address the broader issues arising from the use of a hyperinflationary presentation currency.
- 33 Finally, members made some additional recommendations:
- (a) An entity should be required to disclose why it has chosen a particular presentation currency.
 - (b) The parts of an entity's profit & loss affected by hyperinflation should be further delineated.
 - (c) With respect to entities with subsidiaries operating in a hyperinflationary environment, one possible solution could be equity accounting. In this case, the impact of hyperinflation would at least be isolated in a single balance sheet line item of the non-hyperinflationary parent entity.

Questions for EFRAG FR TEG

- 34 What is your view on the IASB proposals and the EFRAG Secretariat analysis?

Next steps

- 35 An ED is expected in July 2024 with a 120-day comment period.
- 36 EFRAG Secretariat to work on DCL for presentation to EFRAG FR TEG.