MFRS Alert

Hyperinflationary countries

Executive summary

Below is a reminder of the accounting implications of applying MFRS 129 'Financial Reporting in Hyperinflationary Economies'. Our view is that until further notice, MFRS 129 should be applied by entities whose functional currency is the currency of the following countries:

- Argentina
- Sudan (and South Sudan)
- Zimbabwe
- Venezuela
- Iran
- Lebanon

Iran and Lebanon should be applying MFRS 129 for the first time in 2020.

Introduction

MFRS 129 'Financial Reporting in Hyperinflationary Economies' requires the financial statements of any entity whose functional currency is the currency of a hyperinflationary economy to be restated for changes in the general purchasing power of that currency so that the financial information provided is more meaningful.

The Standard lists factors that indicate an economy is hyperinflationary. One of the indicators of hyperinflation is if cumulative inflation over a three year period approaches, or is in excess of, 100 per cent.

MFRS 129 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 mechanics of restatement

MFRS 129 requires amounts in the Statement of Financial Position, that are not already expressed in terms of the measuring unit current at the end of the reporting period, are restated by applying a general price index. In summary:

- assets and liabilities linked by agreement to changes in prices, such as index linked bonds and loans, are adjusted in accordance with the agreement
- non-monetary items carried at amounts current at the end of the reporting period, such as net realisable value and fair value, are not restated
- all other non-monetary assets and liabilities are restated
- monetary items are not restated because they are already expressed in terms of the monetary unit current at the end of the reporting period. Monetary items are money held and items to be received or paid in money
- all items in the statement of comprehensive income are expressed in terms of the measuring unit current at the end of the reporting period. Therefore, all amounts need to be restated from the dates when the items of income and expenses were initially recorded in the financial statements, and
- a gain or loss on the net monetary position is included in profit or loss. The gain or loss on the net monetary position may be derived as the difference resulting from the restatement of non-monetary assets, owners' equity and items in the statement of comprehensive income and the adjustment of index linked assets and liabilities.

Indexation

MFRS 129 requires amounts in the statement of financial position that are not already expressed in terms of the measuring unit current at the end of the reporting period to be restated by applying a general price index. It further notes it is preferable that all entities report in the currency of the same hyperinflationary economy apply this Standard from the same date.

Restatement of prior year comparatives

When a country becomes hyperinflationary, MFRS 129 requires corresponding figures for the previous reporting period to be 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.

MFRS 121 however sets out specific requirements for the purpose of presenting comparative amounts in a different presentation currency (see later section).

Restatement of prior quarterly information

MFRS 129 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.

For example, if a country became hyperinflationary from 1 July 2020, calendar year entities that prepare quarterly interim financial statements will therefore need to apply MFRS 129's guidance for the quarter ended 30 September 2020.

It follows that the year to date figures for the nine months ended 30 September 2020 will be on an MFRS 129 basis (ie with amounts being re-indexed for the effects of hyperinflation from 1 January 2020). The Standard is less clear however on whether the figures for the first and second quarters of the year (which a quarterly filer will already have reported) need to be restated to an MFRS 129 basis before determining the figures for the three months ended 30 September 2020.

Depending on which approach is taken, the effect on profit or loss will vary.

- If the figures for the first and second quarters of the year are restated to an MFRS 129 basis then part of the catch-up effect produced by MFRS 129 will be accounted for as a restatement of earlier quarters, adjusting the opening equity for the figures for the three months ended 30 September 2020.
- Alternatively, if the first and second quarters are not restated then the entire catch up effect for the nine months year to date figures would be reported in the figures for the three months ended 30 September 2020.

Given the lack of clarity in the Standard and this issue arises only on first time application of MFRS 129, our view is either approach is acceptable. Entities should be aware though that the approach taken will also have an impact in terms of the comparatives that will be presented in the 2021 quarterly financial statements.

Impact on deferred taxation

In many situations, applying MFRS 129 will result in the creation of additional temporary differences under MFRS 121 'Income Taxes'. This is because the restatement of item under MFRS 129 will often lead to adjustments to the carrying amounts of items without corresponding changes to their tax bases. For example, prior to the application of MFRS 129 the tax base of an asset may be close to 100% of its book value but after MFRS 129's application the tax base may be a much smaller percentage. The effect of such temporary differences will need to be recognised in profit or loss under MFRS 121.

Impact on impairment testing

MFRS 129 requires the restated amount of a non-monetary item to be reduced, in accordance with appropriate MFRS, when it exceeds its recoverable amount. It is possible then that assets may need to be written down following the restatement of amounts in the statement of financial position in accordance with MFRS 129, even if those assets were not previously considered impaired under historical cost accounting.

Entities should also consider whether the restatement of asset carrying values affects the results of impairment tests that have been conducted in previous reporting periods. Similarly, entities should consider whether there are any indicators of impairment for assets that were not tested for impairment in previous periods.

Group reporting

Hyperinflationary parent with subsidiaries that report in a hyperinflationary currency

A parent entity that reports in a hyperinflationary currency which has subsidiaries that also report in the same currency should restate the financial statements of those subsidiaries in accordance with MFRS 129 as part of the consolidation process.

Where a subsidiary reports in the currency of a different hyperinflationary currency, then its financial statements should first be restated by applying a general price index of the country in which it reports. The restated financial statements should then be translated at closing rates.

Refer below for two issues discussed by the IFRIC on this topic, where agenda decisions were made in March 2020, regarding:

- translating a hyperinflationary foreign operation and presenting exchange differences
- accounting for cumulative exchange differences before a foreign operation becomes hyperinflationary.

Hyperinflationary parent with subsidiaries that do not report in a hyperinflationary currency

The financial statements of subsidiaries that do not report in a hyperinflationary currency are translated initially in accordance with the requirements of MFRS 121 'The Effects of Changes in Foreign Exchange Rates'. Applying those requirements results in:

- items included in comprehensive income being translated at the rates on the dates of transactions (or an average rate)
- balance sheet items being translated at the closing rates.

Our view is that for items included in comprehensive income that are first translated in accordance with MFRS 121, entities may, but are not required, to restate them in accordance with MFRS 129 from the transaction date.

Non-hyperinflationary parent with subsidiaries that report in a hyperinflationary currency

MFRS 121 states that when the results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy are translated into the currency of a non-hyperinflationary economy, comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial statements (ie not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).

Some people have nevertheless taken the view that MFRS 121 does not specifically address the initial period when MFRS 129 is applied and that it is therefore possible to restate the comparative prior year in that initial period when hyperinflationary accounting is first applied.

Our view however is that the requirements of MFRS 121 are clear and accordingly restatement of the comparative prior year is not appropriate in the period that hyperinflationary accounting is first applied. This will be the case for Iran and Lebanon, who in 2020 are being deemed hyperinflationary economies for the first time. As noted below in the third matter on accounting for hyperinflation considered by IFRIC in March 2020, where IFRIC has now signalled it supports our view.

IFRIC decisions relating to hyperinflationary

The IFRS Interpretations Committee (IFRIC) considered three issues at the beginning of 2020, with agenda decisions being made at the March 2020 meeting. These matters are very relevant given Iran and Lebanon are considered hyperinflationary for the first time.

Translating a hyperinflationary foreign operation and presenting exchange differences

This request surrounded the application of MFRS 121 and MFRS 129, and where a foreign operation (whose currency is hyperinflationary) is restated and translated in the group financial statements. The committee concluded the entity does not recognise any exchange differences in equity, rather the entity presents in OCI any exchange difference resulting from the translation of a hyperinflationary foreign operation. The restatement effect resulting from restating the entity's interest in the equity of the hyperinflationary foreign operation is shown in OCI if the combination of the restatements and translation meets the definition of an exchange difference in MFRS 121, if it does not, the restatement is recognised in equity.

Accounting for cumulative exchange differences before a foreign operation becomes hyperinflationary

This issue questioned whether the entity reclassifies within equity the cumulative exchange differences (pre-hyperinflation) when the foreign operation becomes hyperinflationary, effectively transferring the cumulative pre-hyperinflation exchange differences to a component of equity that is not subsequently reclassified to profit or loss. The committee concluded that entity does not reclassify within equity the cumulative pre-hyperinflation exchange differences once the foreign operation becomes hyperinflationary.

Presenting comparative amounts when a foreign operation first becomes hyperinflationary

This matter questioned whether an entity should restate comparative amounts presented in a foreign operation in the annual financial statements for the period that the foreign operation becomes hyperinflationary and the first interim set of financial statements reported under MFRS 129 The committee concluded entities should not restate comparatives in their interim or annual financial statements for the first periods reporting under MFRS 129.