



IFRS Alert

Argentina confirmed as hyperinflationary Issue 2018 - 05

Executive summary

In July we alerted you to the likelihood that Argentina would be considered hyperinflationary in the second half of 2018. We now confirm that this is the case and that IAS 29 'Financial Reporting in Hyperinflationary Economies' will need to be applied from 1 July 2018. This Alert sets out some of the implications of applying IAS 29.

Introduction

IAS 29 '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. This threshold has been exceeded in Argentina from the middle of this year, and accordingly the country should be treated as hyperinflationary from no later than 1 July 2018.

IAS 29 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. This means, for example, that calendar year entities with operations in Argentina will apply IAS 29 for the first time for the year ending 31 December 2018. Those calendar-year entities that prepare quarterly interim financial statements will also need to apply IAS 29's guidance for the quarter ended 30 September 2018.

The mechanics of restatement

IAS 29 requires that 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
- 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

IAS 29 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 that it is preferable that all entities that report in the currency of the same hyperinflationary economy apply this Standard from the same date. Our view is that Argentina should be treated as hyperinflationary from 1 July 2018.

The Federación Argentina de Consejos Profesionales de Ciencias Económicas (the Argentine Federation of Professional Councils of Economic Sciences or FACPCE) has issued Resolution JG 539/18 (<https://www.facpce.org.ar/pdf/RESJG539-18.pdf>), which prescribes the index to be used by entities with a functional currency of the Argentine peso when applying IAS 29's restatement procedures. The guidance prescribes a synthetic inflation index, reflecting differences in the degree of reliability of different Argentinian inflation indices at various points in recent years.

Restatement of prior year comparatives

IAS 29 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.

IAS 21 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 in 2018

IAS 29 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.

As noted above, our view is that Argentina should be treated as hyperinflationary for IAS 29 purposes from 1 July 2018. Calendar year entities that prepare quarterly interim financial statements will therefore need to apply IAS 29's guidance for the quarter ended 30 September 2018.



It follows that the year to date figures for the nine months ended 30 September 2018 will be on an IAS 29 basis (ie with amounts being re-indexed for the effects of hyperinflation from 1 January 2018). 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 IAS 29 basis before determining the figures for the three months ended 30 September 2018.

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 IAS 29 basis then part of the catch-up effect produced by IAS 29 will be accounted for as a restatement of earlier quarters, adjusting the opening equity for the figures for the three months ended 30 September 2018.

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 2018.

Given the lack of clarity in the Standard and that this issue arises only on first time application of IAS 29, our view is that 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 2019 quarterly financial statements.

Impact on deferred taxation

In many situations, applying IAS 29 will result in the creation of additional temporary differences under IAS 12 'Income Taxes'. This is because the restatement of item under IAS 29 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 IAS 29 the tax base of an asset may be close to 100% of its book value but after IAS 29'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 IAS 12.

Impact on impairment testing

IAS 29 requires the restated amount of a non-monetary item to be reduced, in accordance with appropriate IFRSs, 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 IAS 29, 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 IAS 29 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.

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 IAS 21 '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 IAS 21, entities may, but are not required, to restate them in accordance with IAS 29 from the transaction date.

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

IAS 21 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 IAS 21 does not specifically address the initial period when IAS 29 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 IAS 21 are clear and accordingly restatement of the comparative prior year is not appropriate in the period that hyperinflationary accounting is first applied.

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