Financial Reporting in hyperinflationary Economies (IAS 29)

Financial Reporting in hyperinflationary Economies

- Introduction
- History
- Objective and scope
- Definitions
- Disclosures
- Economy recovering

Introduction

- First issued in 1989, and reformatted in 1994

When to apply IAS 29

Objective

- In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not relevant, as money loses its purchasing power at such a rate that comparison of amounts of events and transactions which have taken place at different times is misleading.

- This standard prescribes the guidelines which are used by the entity whose currency is the currency of the hyperinflationary economy, to restate its financial statements in the measuring unit current at the end of accounting period.

LEARNING OBJECTIVES

1. Understand the distinction between changes in the general level of prices in an economy, which affect the purchasing power of the measuring unit, and changes in the fair values of specific assets and liabilities.
2. Restate financial statements based on acquisition costs to a common measuring unit.
3. Remeasure financial statements based on acquisition costs to current fair values.
4. Prepare financial statements based on fair values and a common measuring unit.

Scope

- The requirements of this standard are applicable to the individual and consolidated financial statements of the entity whose currency is the currency of the hyperinflationary economy.

When to apply IAS 29

Scope cont…

- Standard does not establish an absolute rate at which hyperinflation is deemed to arise hence a matter of judgment.
- Economic indicators in a country include but not limited to:

(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;

(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%.

Objective and Scope

- Purpose
  - sets out how an entity whose functional currency is the currency of a hyperinflationary economy should restate its financial statements
- ***Functional currency***
  - the currency of the primary economic environment in which entity operates
- ***Hyperinflation***
  - the standard indicates this is a matter of judgment
  - IAS 29 does not pinpoint a specific rate
- Conditions that are characteristic of a hyperinflationary environment:
  - the country’s wealth is kept in non-monetary assets or in a stable currency
  - prices may be quoted in another more stable currency.
  - key economic variables are linked to a price index.
  - cumulative inflation over three years is high, at close to 100% or more

Definitions

- **Inflation** - the systematic decrease of purchasing power and destroyer of wealth, a fundamental fact of economic activity over time and creates serious financial reporting and financial management problems
- **Monetary items** - as assets, liabilities, or capital, the amounts of which were fixed by contract or statute in terms of numbers of shillings regardless of changes in the purchasing power of the shilling

Restatement of Financial Statements

- An entity whose functional currency is the currency of a hyperinflationary economy
  - must restate its current period financial statements in terms of the measuring unit at the end of the reporting period
  - restate the comparative figures for the previous periods reported in the same way

- The approaches identified to be used in restating the financial statements are:-

  i. Current purchase power(Historical cost) approach
  ii. Current cost approach

- This requirement applies whether the entity uses a historical cost approach or a current cost approach on its primary statements

1. Historical Cost Financial Statements

- Also called Current Purchasing Power Approach
- Include some recognition of changing prices
  - not the same thing as statements prepared on a current or replacement cost basis
- The emphasis in this approach is that general purchasing power restatements change the unit of account but do not change the underlying measurement bases.
- Specifics:
  - restated items cannot be reported at amounts greater than their recoverable amount
  - restated inventory is reduced to a lower net realizable value
  - gain or loss on the entity's net monetary position is included in profit or loss and is reported as a separate line item

Part 3: IAS 29 – Restatement

Illustration 36-1 Price Level Adjustments: Historic Cost-Based Statements

Financial Statement Item	Restatement
Monetary assets and monetary liabilities	No restatement. These are already in end-of-period currency units.
Non-monetary assets and liabilities carried at cost or amortized cost	Restate using the change in price level from the acquisition date to the end of the current period.
Non-monetary assets carried at net realizable value or fair value	No restatement. These are already at amounts current at the end of the period.
Assets and liabilities linked by agreement to changes in prices	Adjust to end-of-the-period amounts according to the agreement.
Non-monetary assets and liabilities carried at revaluation amounts	Adjust using the change in price level from the date of the revaluation of the element's carrying amount.
Statement of comprehensive income items	Restate all items to end-of-period measuring units using the change in price level from the date the items were first recorded in the financial statements.
Components of owners' equity	Restate by applying the general price level from the beginning of the period or date of contribution, if later.
An entity holding net monetary liabilities in a period of inflation gains purchasing power; an entity holding net monetary assets loses purchasing power. The net gain or loss can be independently derived or estimated by applying the change in the general price index to the weighted average difference between monetary assets and liabilities for the period.[8]	

IAS 29 – Restatement

Statement of Financial Position

- All the non-monetary assets and liabilities will be restated from the currency units at the date of purchase to the currency units current at the end of reporting period using general price index such as plant & machinery, intangible assets and investment property
- However, the non-monetary assets which are already stated at the amounts current at the end of reporting period, will not be restated such as inventory at net realizable value and investments at fair value on reporting date
- If some non-monetary assets are stated at the amounts other than the currency units current at the date of purchase (such as when a non-current asset has been revalued after the date of purchase), in this case such assets will be restated from the date of re-measurement to the to the currency units current at the end of reporting period

- If the payment of a non-monetary asset is deferred in future without the interest charge, then such asset will be restated from the date of payment rather than from the date of purchase to the currency units current at the end of reporting period
- Monetary assets and liabilities such as receivables and payables are not restated as these are already stated at the currency units current at the end of reporting period
- The restated amount of the non-monetary assets should be not exceed its recoverable value, if this is the case then the asset will be written down to its recoverable value
- The financial statements of the associate or joint venture which reports in a hyperinflationary economy will be first restated to the currency units current at the end of reporting period before the application of equity method
- The components of equity are restated from the general price index at the start of the period or at the date when these components arose if it is later

- If general price index is not available at the end of reporting then the entity will use the estimated movement in exchange rate between the functional currency and the relatively stable foreign currency
- The general price index should reflect the change in general purchasing power.
- The retained earnings will be taken as a balancing figure
- The restatement of assets and liabilities to the currency units at the end of reporting period may result it carrying values of such assets and liabilities being different from their respective tax bases, however such differences will be accounted for as per IAS 12

Statement of Profit or Loss

- The entity is required to restate all the income and expenses from the date of relevant transaction to the currency units current at the end of reporting period.

Restatement of Financial Statements

2. *Current Cost Financial Statements*

- have been adjusted to reflect the effects of changes in the specific prices of assets held
- the adjustment process is different
  - an item's current cost or replacement cost at the balance sheet date is already expressed in a measuring unit that is current at the end of the period

Illustration 36-2 Price Level Adjustments: Current Cost-Based Statements

Financial Statement Item	Restatement
Current cost items on the statement of financial position	No restatement. They are already in period-end measuring units.
Other items on the statement of financial position	Use the same method to restate as for historic cost-based statement items.
Statement of comprehensive income items	All expenses on a current cost statement, including cost of goods sold and depreciation amounts, are reported at their current cost when consumed in the current period. Therefore they are already in current period currency units. Use a general price index to restate them to end-of-period units.
A gain or loss on the holding of net monetary balances is determined when current cost financial statements are restated as well.	

Worked Example

AB Ltd operates in a country whose economy is subject to hyperinflation. The financial statements of the entity for the year ended 31 December 2018 are as follows:

Assets:	Zlotys'000
Plant & Machinery	1,800
Inventory	5,400
Cash	700
Total Assets	**7,900**
Equity & Liabilities	
Share Capital (Issued at 31 December 2014)	800
Retained Earnings	4,700
Non Current Liabilities	1,000
Current Liabilities	1,400
Total Equity & Liabilities	**7,900**

- The plant and machinery was purchased on 31 December 2016.
- The inventory is stated at cost of 30 June 2018.
- The non-current liabilities entail a loan which was raised on 31 December 2018

The general price index is as follows:

Year	General Price Index
31 December 2014	100
31 December 2015	130
31 December 2016	150
31 December 2017	240
31 December 2018	300

Required:

Prepare the statement of financial position restated to the currency units at 31 December 2018

Solution:

Assets:	**Zlotys'000**
Plant & Machinery (1,800 × 300 / 150)	3,600
Inventory (5,400 × 300 / 270)	6,000
Cash	700
Total Assets	**10,300**
Equity & Liabilities	
Share Capital (800 × 300 / 100)	2,400
Retained Earnings (Balancing Figure)	**5,500**
Non Current Liabilities	1,000
Current Liabilities	14,00
Total Equity & Liabilities	**10,300**

Part 3: IAS 29 – Other Issues

- A variety of other items are addressed by this standard:
  - general price index reflects the changes in general purchasing power
  - differences between restated amounts and their carrying values in statement of financial position may give rise to deferred taxes
  - all items in statement of cash flows are expressed in terms of measuring unit current at the end of the reporting period
  - corresponding figures on comparative financial statements are restated in terms of the current period-end measuring unit
  - when an economy ceases to be hyperinflationary, entity uses amounts expressed in the measuring unit current at end of the last reporting period as beginning carrying amounts in its subsequent statements

IAS 29 – Disclosures

- Disclosures are needed in restated financial statements so that the basis for dealing with the effects of inflation is clear and the results are understandable

- What does the entity need to report?
  - that current and comparative financial statements have been restated for changes in the general purchasing power of the functional currency
  - that statements are restated into the measuring unit current at the balance sheet date

- What does the entity need to identify?
  - whether the statements restated were based on historic cost or current cost
  - information about the general price levels and changes in them during the current and previous periods

Economies ceasing to be hyperinflationary

When an economy ceases to be hyperinflationary and an entity discontinues the preparation and presentation of financial statements prepared in accordance with this Standard, it shall treat the amounts expressed in the measuring unit current at the end of the previous reporting period as the basis for the carrying amounts in its subsequent financial statements.

Questions?

Thank you!