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Ms Sue Lloyd
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Our ref CS/288

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Dear Ms Lloyd

**Tentative agenda decisions: Translating a Hyperinflationary Foreign Operation (IAS 21 and IAS 29)**

We appreciate the opportunity to comment on the following tentative agenda decisions (TADs) of the IFRS Interpretations Committee (the Committee):

- Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences
- Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary
- Presenting Comparative Amounts when a Foreign Operation First becomes Hyperinflationary

We have consulted with, and this letter represents the views of, the KPMG network.

We do not support finalising the TADs as currently drafted. Below, we first set out our comments on the technical analysis in relation to each of the three TADs and the current requirements of IFRS standards. We then set out our recommendation for a long-term solution to clarify the issues and to promote consistent application of IFRS standards.

**Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences**

With respect to the first tentative agenda decision, we support the Committee's tentative conclusion that, in the fact pattern described in the request, an entity could either present:

- the restatement and translation effects in other comprehensive income (OCI), or
- the translation effect in OCI and the restatement effect directly in equity.

However, we also believe that it would be permissible for an entity to present the combination of the restatement effect and the translation effect directly in consolidated equity and we disagree with the Committee's apparent tentative view that such an approach is not permitted. The arguments for allowing this alternative approach are as follows:

- The TAD makes reference to the requirements in IAS 21.41 and says that 'the Committee observed this explanation also applies if the functional currency is hyperinflationary.' However, IAS 21.41 does not apply when the functional currency of the foreign operation is hyperinflationary. IAS 21.41 is expanding on IAS 21.39 which states that it applies when the functional currency of the foreign operation is not hyperinflationary. Extending the mandatory applicability of IAS 21.41 to a hyperinflationary environment, when it clearly is focused solely on a non-hyperinflationary environment, seems to be an interpretation rather than a matter to be resolved through an agenda decision.
- Because of the economic interrelationship between the changes in exchange rate and inflation, the hyperinflation and translation effects are interlinked and generally presented together (i.e. as prices measured in the hyperinflationary currency increase, its value against other currencies tends to decrease at a rate that reflects the excess of price inflation in the hyperinflationary currency compared to price inflation in other currencies). Specifically, IAS 21.43 states: "When an entity's functional currency is the currency of a hyperinflationary economy, the entity shall restate its financial statements in accordance with IAS 29 before applying the translation method set out in paragraph 42 [i.e. all amounts translated at the closing rate at the end of the current period], except for comparative amounts that are translated into a currency of a non-hyperinflationary economy." The language and guidance does not contemplate computation of any exchange differences or their separate presentation as a gain or loss in comprehensive income. Proponents of this approach argue that it would not be economically meaningful to provide a split since the remeasurement process under IAS 29 will generally give rise to large increases in the local currency amount of net assets which usually are offset by devaluation in the exchange rate. Indeed, this is why IAS 21 requires all amounts to be translated at year-end exchange rates. Accordingly, proponents argue that IAS 21 does not permit computation of any exchange differences based on first retranslating the current year local-currency IAS 29 financial statements at last year's exchange rate. This approach is quite different from identifying exchange differences arising from remeasurement of foreign currency transactions (which IAS 21 explicitly requires to be included in profit or loss) and identifying those arising from retranslation of the financial statements of a non-hyperinflationary operation (which IAS 21 explicitly requires to be included in other comprehensive income).
- IAS 21 and IAS 29 require a comprehensive remeasurement of the financial statements of a hyperinflationary subsidiary and any adjustments to the

measurement of the assets and liabilities of the subsidiary arising from that process are matched by equal and opposite adjustments to the components of equity of the subsidiary. In effect, it may be argued that the changes in equity result from changes in the measuring unit applied to the net investment in the foreign operation. IAS 29 does not view these changes as giving rise to gains or losses, but instead treats them as adjustments to the corresponding equity balances (as per IAS 29.25).

— Also, as corroborated by the staff's research, it seems that there are a number of entities that present both the restatement effect and the translation effect directly in consolidated equity in practice.

**Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary**

With respect to the second tentative agenda decision, we would support the Committee's conclusion that in the fact pattern described in the request the entity could retain the pre-hyperinflation foreign currency translation reserve as a separate component of equity until disposal of the foreign operation. However, we believe that the so-called "reclassification" within equity of the pre-hyperinflation translation reserve could also be an acceptable approach and we disagree with the Committee's tentative view that it is not acceptable. We believe that "reclassification" would be an acceptable alternative approach if the entity has adopted a policy to present the restatement effect and the translation effect directly in consolidated equity, as discussed above. In this case, the foreign currency translation reserve is not simply reclassified but rather it is remeasured as nil as a result of retrospective application of the new policy. The arguments for allowing this alternative approach are as follows:

— IFRIC 7.3 and IFRIC 7.BC17 clearly state that the amounts presented at the date of initial application of IAS 29 are calculated as if the currency had always been hyperinflationary, similar to retrospective application of a change in accounting policy. Indeed, the "as if" terminology comes from IAS 8.22 which is the core statement in IFRS as to what retrospective application means. It seems entirely reasonable for an entity to conclude that this retrospective approach would apply also to recalculation of the previous foreign currency translation reserve, just as an entity would apply IAS 21 to changes to foreign currency balances arising on retrospective adoption of other requirements.

— The requirements in IAS 21.39(c) and 41 are not applicable to hyperinflationary economies. In addition, IAS 29.24 states that: "[…] at the beginning of the first period of application of the Standard, the components of owners' equity, except retained earnings and any revaluation surplus, are restated […] any revaluation surplus that arose in previous periods is eliminated. Restated retained earnings are derived from all other amounts in the restated statements of financial position." Consequently, the first application of IAS 29 generates an overall restatement of the opening equity components of the foreign operation whose functional currency

becomes hyperinflationary during the financial year. This restatement is relevant also in determining opening equity in the group financial statements, even if the comparatives presented for the prior period are not restated.

— Furthermore, as corroborated by the staff's research, it seems that there are a number of entities that have reclassified within equity the pre-hyperinflation translation reserve in practice.

**Presenting Comparative Amounts when a Foreign Operation First becomes Hyperinflationary**

With respect to the third agenda decision, we note that the TAD does not provide any technical analysis or insights. The mere fact that the Committee has not observed significant diversity with respect to presentation of comparatives on first application does not mean that the requirements of IFRS standards are clear.

We believe that it is unclear in the current IFRS standards whether on first application of hyperinflationary accounting an entity should restate its comparatives for price changes in prior periods if its presentation currency is not hyperinflationary. In our view, an entity should choose an accounting policy, to be applied consistently, on whether it restates its comparatives in these circumstances. If the entity chooses to restate its comparatives in these circumstances, then they are measured in purchasing power in the functional currency at the previous reporting date and translated into the presentation currency at the closing exchange rate at the previous reporting date.

Also, we believe that an entity would be required to restate comparative amounts in its interim financial statements in the year after the foreign operation becomes hyperinflationary, if the foreign operation was not hyperinflationary during the comparative interim period. This is because:

— IAS 29 is required to be applied from the start of the annual period in which hyperinflation is identified (see IAS 29.4).

— So, for example, if hyperinflation was identified in Q3 of the comparative year, then IAS 29 should have been applied from the start of Q1 of the comparative year. Indeed IAS 29 would have been applied on this basis in the annual financial statements for the comparative year.

— It is therefore reasonable in this example to expect that any re-presentation of information for Q1 or Q2 of the previous year would be prepared on a consistent basis using IAS 29. In any event, calculating IAS 29 amounts for Q1 and Q2 of the comparative year would have been necessary in order to prepare IAS 29 information for Q3 of the comparative year.

**Recommendation to the Committee**

Overall, it appears that the IFRS standards are not clear on the issues under discussion. Given that the issues are narrow in scope, we believe that they would be most efficiently resolved through an interpretation or amendment of IAS 21 and/or IAS 29.

If the Committee decides not to proceed with developing an interpretation or amendment of IAS 21/ IAS 29, then we recommend the Committee amends the TADs consistent with our substantive comments on the technical analysis set out above.

Please contact Chris Spall on +44 (0) 20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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cc: Brian O’Donovan, KPMG