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IAS® Standard 29 Financial Reporting in Hyperinflationary Economies



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IAS® Standard 29 Financial Reporting in Hyperinflationary Economies

Scope and Key Definitions

In a global world, business development has no borders and entities are set up in different countries or make new business combinations and invest in different continents around the world. There are economic challenges, when inflation is high, and we are not sure whether the information in the financial statements is relevant today. On the entity level, it becomes unclear whether the assets and liabilities reflect the actual financial position or whether it has the influence of high inflation in the country. On the level of entity groups, there are doubts whether it is possible to consolidate such different types of information. Another issue when preparing comparative information includes the fact that we need to review whether the previously acquired assets or liabilities assumed at the high inflation rate are worth the same amount today.

The IAS Standard® 29 Financial Reporting in Hyperinflationary Economies defines the rules for preparing the financial statements of an entity or a group of entities, when the functional currency of the entity is the currency of a hyperinflationary economy. The recalculations of financial statements must be made, because, in a hyperinflationary economy, the results of operations and financial position data without the recalculations are misleading in decision making. If a business operates in a hyperinflationary economy, money loses its purchasing power at a high rate, and comparing amounts without recalculation becomes misleading.

Figure 1 presents the characteristics of a country's economic environment that may indicate that the country is operating in a hyperinflationary economy.

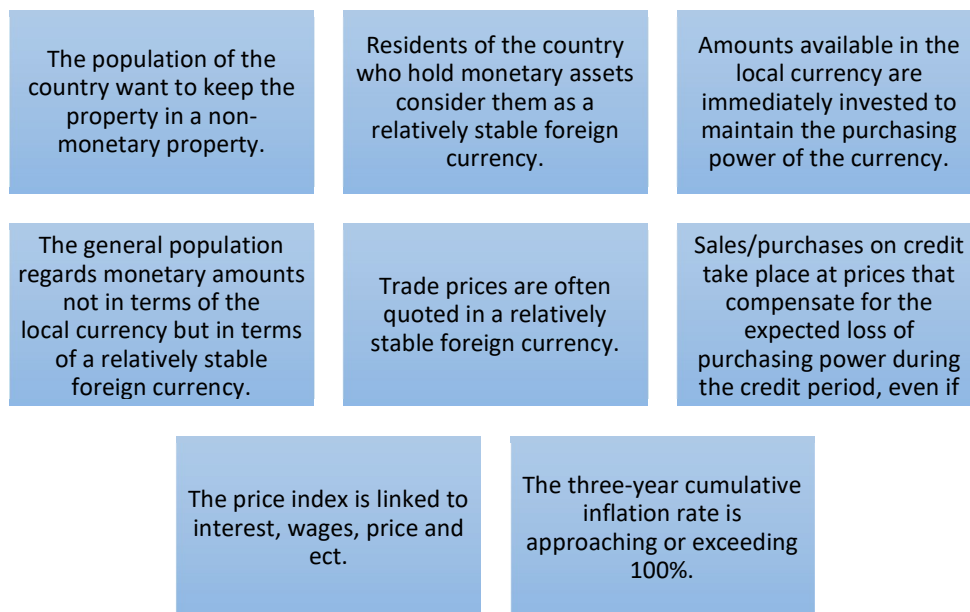


Figure 1. The characteristics of a hyperinflationary economy

Entities shall apply IAS 29 when preparing their financial statements from the reporting period, in which the hyperinflation starts in the country. Moreover, for groups of entities reporting in the same currency in a hyperinflationary economy, it is desirable that all entities apply the IFRS Standard from the same date.

Key definitions:

Hyperinflationary economy – any economy where inflation exceeds 100 per cent in the period of three years (IAS 29.3).

Functional currency – the currency is used in the economic environment in which the business operates and in which the entity generates and spends money (IAS 29.1).

Price index – a relative measure of price changes showing the average change in prices between periods (IAS 29.37).

Gain or loss on the net monetary position – the difference of recalculated non-monetary assets, equity and profit (loss) elements by price index (IAS 29.27).

Fundamental Issues: Recognition

Entities choose different accounting policies, and certain elements of accounting are presented in the financial statements at the historical cost or fair value. Financial statements prepared by the entities that are based on historical cost do not take into account changes in the general price level or increases in the prices of specific assets or liabilities. Otherwise, the entity presents those assets and liabilities at fair value, in which case the effect of changes in prices is apparent.

Entities may not always be able to measure value at the time of preparation of the financial statements using fair value methods. Therefore, in a hyperinflationary economy, it is immaterial whether the financial statements are prepared using the historical cost method or the current costs method. These values will be useful, if they are converted and expressed in terms of the measuring unit current at the end of the reporting period.

Comparative information for previous years must be recalculated and expressed in terms of the measuring unit current at the end of the reporting period. Differences, resulting from the recalculation by measuring unit current at the end of the reporting period, are recognized as a gain or loss on the net monetary position and are included in the statement of profit or loss and other comprehensive income and presented separately (see Fig. 2).

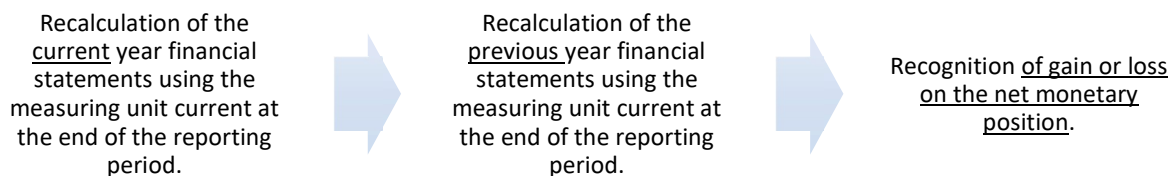


Figure 2. Elements of recalculation of financial statements in a hyperinflationary economy

It should be noted that the presentation of the information required by IAS 29 as a supplement to unrestated financial statements in a hyperinflationary economy context is not permitted and it is not recommended to submit financial statements before the recalculation.

Fundamental Issues: Measurement

This section discusses how to recalculate the financial statement data, if an entity uses the historical costs method and the current costs method.

Preparation of financial statements when using the historical cost method

Statements of the financial position amounts are recalculated using the general price level index (see, fig. 3).

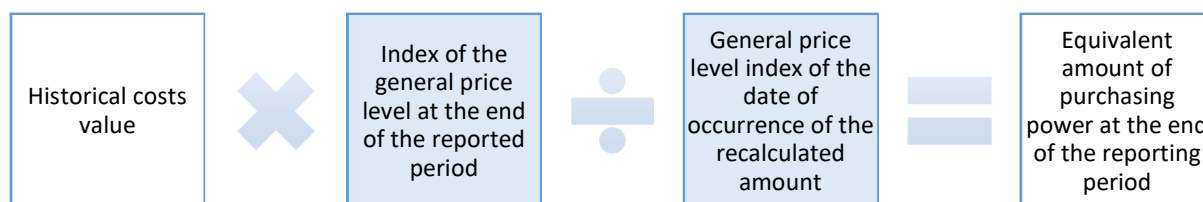


Figure 3. Recalculation of amounts using a general price level index

It should be noted that monetary items are not recalculated, because they are denominated in the monetary unit at the end of the reporting period. Certain exceptions apply, when assets or liabilities are connected to price changes (for example, loans are linked to the price index and are contractually adjusted). If other assets and liabilities are non-monetary and have been carried at net realisable value or fair value, they are not recalculated. All other non-monetary assets and liabilities are recalculated. If the owner contributions are restated from the date of the contribution, the retained earnings are restated from all other amounts presented in the restated statement of the financial position. Table 1 provides examples of such recalculations.

Table 1. Examples of items recalculation in hyperinflationary economies

Elements of the statements of the financial position	Examples in hyperinflationary economies
<p>Inventory The entity purchased inventory on July 5, 20x1 for CU5,000 and did not use it until the end of the year. The inventory balance on 31 December, 20x1 remained at CU5,000.</p>	<p><i>It is known that the price index on July 5, 20x1 was 150 and the price index on December 31, 20x1 was 185. Therefore, the value of inventories must be recalculated according to the level of the general price index: $CU5,000 \times 185/150 = \sim CU6,167$.</i> Inventories will be shown in the statements of the financial position (December 31, 20x1) for CU6,167.</p>

<p>Tangible non-current assets</p> <p>The entity acquired production equipment for CU10,000 on March 31, 20x1 and set a useful life of 6 years and a residual value of CU1,000. Under the accounting policy, the entity applies the straight-line depreciation method and has calculated depreciation of CU1,125 during the 20x1 year. The carrying amount of equipment on 31 December 20x1 is CU8,875.</p>	<p><i>It is known that the price index on March 31, 20x1 was 150 and the price index on December 31, 20x1 was 110. Therefore, the value of the tangible non-current assets has to be recalculated according to the level of the general price index: $\frac{CU8,875 \times 110}{150} = \sim CU6,508$.</i></p> <p>Assets will be shown in the statement of financial position (December 31, 20x1) for CU6,167.</p>
<p>Share capital</p> <p>The entity was established, and the share capital of CU50,000 formed on February 5, 20x1. The amount of the share capital did not change during the reporting period.</p>	<p><i>It is known that the price index on February 5, 20x1 was 220 and the price index on December 31, 20x1 was 180. Therefore, the value of share capital must be recalculated according to the level of the general price index: $CU50,000 \times \frac{180}{220} = \sim CU40,909$.</i></p> <p>Share capital will be shown in the statements of the financial position (December 31, 20x1) for CU40,909.</p>

Following the recalculation using a general price level index, all elements of accounting are recognized in the financial statements at the adjusted amount. As shown in the example (see Table 1), in the case of non-current assets (such as property, production facilities and equipment) the value assets are historical costs minus depreciation. Therefore, recalculation of assets value is made relative to the general price index level at the date of acquisition. Exceptions may apply in atypical cases. If an asset has been acquired for a very long time and the acquisition date cannot be determined, in rare cases, it may be based on an appraisal by independent appraisers and this appraisal may be used as the basis for recalculations. If a general price index for the old period is not available, an estimate based on changes in the functional currency and a relatively stable foreign exchange rate may be used. If the revaluation method is used for tangible assets, then the recalculation is made based on the date of the last revaluation.

After the adjusted amount, the applicable accounting methods must also be taken into consideration. For example, inventories acquired are stated at the lower of cost and net realisable value. Therefore, if the value of the inventories is higher than the realisable value after the recalculation of inventories, the amount must be reduced (see Fig. 4). An appropriate example may be used in the case of non-current assets, goodwill or patents where the recoverable amount is less than the adjusted amount in the general price index.

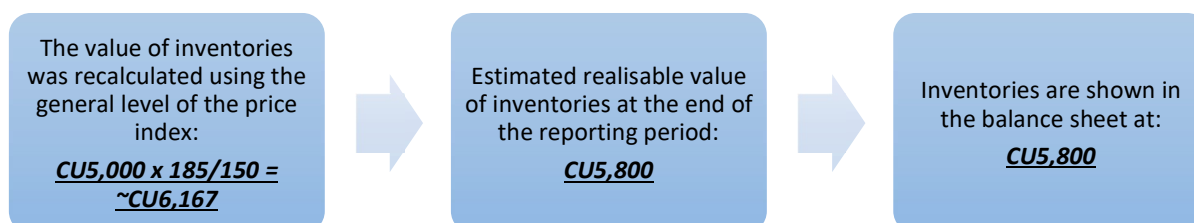


Figure 4. Estimation of realisable value

If an entity uses the equity method of investing and has invested in another entity the financial statements of which have been prepared in a hyperinflationary economy, the financial statements shall be recalculated by IAS 29 requirements in order to calculate the investor's share of its net assets and profit or loss. The identified effects of inflation are generally recognized as borrowing costs. Borrowing costs is recognised as an expense in the period in which the costs are incurred.

In order to prepare a statement of profit or loss and other comprehensive income in a hyperinflationary economy, all amounts of revenue and expenses must be recalculated from the date on which they are recognized in the accounts (see Table 2). The gain or loss on the net monetary position can be derived as the difference. This difference is deducted from the recalculated non-monetary assets, equity and adjustments to the elements in the statement of comprehensive income. Profit (loss) can be calculated by applying the change in a general price index to the weighted average.

Table 2. Examples of revenue and expense recalculation in hyperinflation economies

Elements of statement of profit or loss and other comprehensive income	Examples in hyperinflation economies																								
<p>Revenue of sales In 20x1, a entity sold services and recognized revenue: January 5 for CU20,000; April 10 for CU10,000; July 20 for CU20,000; October 30 for CU30,000. Total 20x1 revenue: CU80,000.</p>	<p><i>The general price index for 20x1 was:</i></p> <table border="1"> <thead> <tr> <th><u>Month</u></th> <th><u>Price index</u></th> </tr> </thead> <tbody> <tr> <td>January</td> <td>110</td> </tr> <tr> <td>April</td> <td>80</td> </tr> <tr> <td>July</td> <td>100</td> </tr> <tr> <td>October</td> <td>130</td> </tr> <tr> <td>December</td> <td>150</td> </tr> </tbody> </table>	<u>Month</u>	<u>Price index</u>	January	110	April	80	July	100	October	130	December	150												
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	<p><u>Alternative I: Recalculation of each period revenue</u></p> <table border="1"> <thead> <tr> <th><u>Month</u></th> <th><u>Revenue, CU</u></th> <th><u>Price index level</u></th> <th><u>Recalculated revenue, CU</u></th> </tr> </thead> <tbody> <tr> <td>January</td> <td>20,000</td> <td>150/110</td> <td>27,272.73</td> </tr> <tr> <td>April</td> <td>10,000</td> <td>150/80</td> <td>18,750.00</td> </tr> <tr> <td>July</td> <td>20,000</td> <td>150/100</td> <td>30,000.00</td> </tr> <tr> <td>October</td> <td>30,000</td> <td>150/130</td> <td>34,615.38</td> </tr> <tr> <td colspan="3" style="text-align: right;"><i>Total revenue:</i></td> <td>110,638.11</td> </tr> </tbody> </table>	<u>Month</u>	<u>Revenue, CU</u>	<u>Price index level</u>	<u>Recalculated revenue, CU</u>	January	20,000	150/110	27,272.73	April	10,000	150/80	18,750.00	July	20,000	150/100	30,000.00	October	30,000	150/130	34,615.38	<i>Total revenue:</i>			110,638.11
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October	30,000	150/130	34,615.38																						
<i>Total revenue:</i>			110,638.11																						
	<p><u>Alternative II: Recalculation of revenue using the weighted average</u> <i>The average price index is calculated: (110+150)/2=130</i> <i>Revenue is recalculated: CU80,000 x 150/130 = CU92,307.69</i></p>																								
<p>Sales expenses In April 20x1, a entity purchased advertising services for CU20,000.</p>	<p><i>The general price index for 20x1 was:</i></p> <table border="1"> <thead> <tr> <th><u>Month</u></th> <th><u>Price index</u></th> </tr> </thead> <tbody> <tr> <td>April</td> <td>80</td> </tr> <tr> <td>December</td> <td>150</td> </tr> </tbody> </table>	<u>Month</u>	<u>Price index</u>	April	80	December	150																		
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	<i>Expenses is recalculated: CU20,000 x 150/80 = CU37,500</i>
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Preparation of financial statements when the current cost method is used

If an entity uses the current cost method, depending on the financial statements, elements of financial statements are not recalculated. However, in some cases, they must be recalculated using the same methodology as presented in the historical cost way (see Table 3).

Table 3. Examples of financial statement in case of current cost method

Financial statement	Explanation	Examples
Statement of financial position	If elements of accounting are presented at current value, they are not recalculated.	The entity measures inventories at fair value, with the fair value of the inventories determined at the end of reporting period at CU10,000. <i>The value of these inventories at CU10,000 will be presented in the statements of the financial position.</i>
Statement of profit or loss and other comprehensive income	Given that the cost of sales and depreciation will be recognized at the time the acquisition of the asset has been recognized at its current value and the other expenses (sales and administrative) are recognized when incurred, recalculation of all the amounts will be needed using a general price index.	The entity purchased the building in June 20x1 for CU200,000, which will be used for 10 years. Throughout 20x1, the depreciation expenses are estimated at CU10,000. Depreciation is recalculated from the recalculated value of the building at the level of the general price index. The general price index was 110 in June and 150 in December. Depreciation is then calculated on the indexed value of the building $CU200,000 \times 150/110 = CU272,727.27$. Then depreciation for 20x1 is $CU272,727.27 / 10 \text{ years} / 12 \text{ months} \times 6 \text{ months} = CU13,636.36$. <i>The depreciation value CU13,636 will be presented in the statement of profit or loss and other comprehensive income.</i>
Statement of cash flows	Elements of the cash flow statement shall be presented in terms of the measuring unit current at the end of the period.	The cash flow statement shows that the entity had a loan of CU200,000 in April. The general price index was 120 in April and 150 in December. The value of

		the loan received will be recalculated $CU200,000 \times 150/120 = CU250,000$. <i>The loan value CU250,000 will be presented in the cash flows statement.</i>
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Fundamental Issues: Derecognition and /or Procedures

Whether the IAS 29 must be applied to an individual entity case depends on whether the entity operates in a hyperinflationary economy. This can be checked as publicly available data. For example, [The International Practices Task Force \(IPTF\) of the Center for Audit Quality \(CAQ\)](#) conducts assessments of high-inflation countries and periodically reports which countries are operating in a hyperinflationary economy. Here, countries are presented according to different groups, depending on whether the inflation has exceeded 100 per cent or not in three years, as well as other thresholds.

When an economy ceases to be hyperinflationary and an entity discontinues the preparation and presentation of financial statements prepared based on changes of general price index, 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.

Disclosures

The information for users of financial statements must disclose the elements of the financial statements that have been recalculated due to the hyperinflationary economy. Moreover, such disclosure must contain information about the method used (the historical cost or the current cost), as well as the information about the determination of the price index and its changes (see Fig. 5).

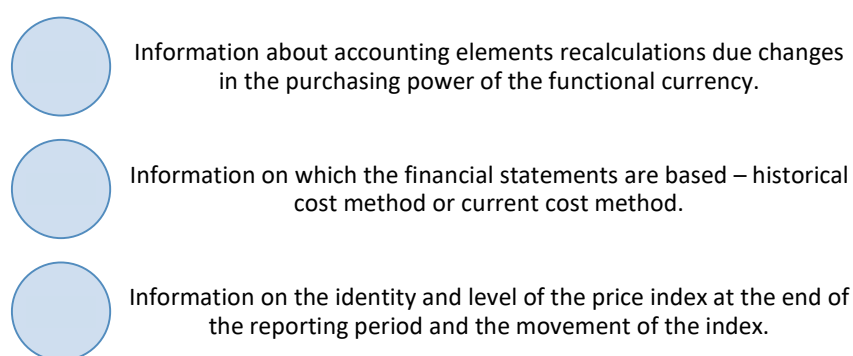


Figure 5. Disclosure of information for financial statements in a hyperinflationary economy

According to the data presented in Fig. 5, disclosure of information is necessary for users of financial statements to see the clear effects of inflation on the financial statements. This provides an understanding of how the amounts have been calculated and obtained in the financial statements.

Examples

Example No. 1

An entity was set up in December 20x1. It kept the money and did not make any transactions from 20x1 to 20x2. This entity operates in a country with a hyperinflationary economy. The financial statements below of the entity are presented in the functional currency.

Statements of the financial position		
Item	Current year, CU	Previous year, CU
Cash	30,000	30,000
Total:	30,000	30,000
Share capital	30,000	30,000
Total:	30,000	30,000

It is needed to prepare a restated statement of the financial position and a profit and loss account after estimating the impact of inflation on the general price level index. The general price level estimated in 20x2 increased by 60% (the general index increased from 100 to 160).

The amounts in the statements of the financial position are recalculated as follows:

Statements of the financial position						
Item	Current year			Previous year		
	CU	Index level	CCU*	CU	Index level	CCU
Cash	30,000	-	30,000	30,000	160/100	48,000
Total:	30,000		30,000	30,000		48,000
Share capital	30,000	160/100	48,000	30,000	160/100	48,000
Profit	-	30,000- 48,000	(18,000)			
Total:	30,000		30,000	30,000		48,000
Gain (loss) on the net monetary position	<i>Formed as a result of the following recalculation: Share capital 30,000 – 48,000 = - CU18,000 Total: -CU18,000</i>			<i>Formed as a result of the following recalculation: Cash 48,000-30,000 = CU18,000 Share capital 30,000 – 48,000 = - CU18,000 Total: CU0.00</i>		

*converted currency units

Data about the previous period (regardless of the historical cost method or the current cost method used) is recalculated using the current price index for the current reporting period. Cash is not recalculated for the current year, because it is already presented in the measuring unit current at the end of the period. The earnings retained (profit/loss) are calculated as the difference between the value of the assets and the value of the shares. The resulting gain (loss) on the net monetary position will be presented in the statement of profit or loss and other comprehensive income.

The following financial statements will be available to users of financial statements:

Statements of the financial position			Statement of profit or loss and other comprehensive income		
Item	Current year, CCU	Previous year, CCU	Article	Current year, CCU	Previous year, CCU
Cash	30,000	48,000	Gain (loss)	(18,000)	-
Total:	30,000	48,000			
Share capital	48,000	48,000			
Profit (loss)	(18,000)				
Total:	30,000	48,000	Total:	(18,000)	-

Example No. 2

An entity applies the historical cost method. It is known that the entity provides various services, while the revenue earned during the financial year is presented below.

Month	Current year, CU
January	20,000
March	40,000
April	60,000
July	80,000
September	20,000
December	30,000
Total:	250,000

Revenue in the statement of profit or loss and other comprehensive income must be recalculated, if the entity operates in a hyperinflationary economy. If income has not incurred evenly over a year, the revenue of each month needs to be recalculated individually by applying the price index of each month.

The price index:

Month	Price index
January	220
March	170
April	180
July	230
September	250
December	210

Recalculation of the revenue amounts:

Month	CU	Index level	CCU
January	20,000	210/220	19,091
March	40,000	210/170	49,412
April	60,000	210/180	70,000
July	80,000	210/230	73,043
September	20,000	210/250	16,800

December	30,000	210/210	30,000
Total:	250,000		258,346

In the statement of profit or loss and other comprehensive income, sales revenue will be reported as CU258,346, and loss on the net monetary position as CU8,346.