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IAS® Standard 29 Financial Reporting in Hyperinflationary Economies



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CASE STUDY – IAS 29 FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES

Introduction

One of most important indicators in a market economy is inflation. Prices for goods and services always change, the total price level increases, and you can buy less for the same amount of currency than before. In some countries, these changes are significant and indicate hyperinflation.

The aim of this case study is to encourage students to think about the issues of preparation of the financial statements, if entity operates in a country with the hyperinflation economy. The case study addresses the following issues:

- First, it seeks to provide the ability to understand that financial statements without adjustment do not disclose the purchasing power of money, and financial data cannot be used to make financial decisions in hyperinflation economy countries.
- Second, its aim is to provide the ability to identify the methods used in different elements of accounting and make decisions about the elements of accounting adjustment, if it is needed in hyperinflation economy countries.

The Case Information

Global Consultation (GC) operates in a hyperinflationary economy country. The main activity of the company is the provision of services; the cost of services consists of the services of subcontractors. Revenue and expenses have incurred evenly during the current year. Company “GC applies the historical cost method. The financial statements below of the company GC are presented in the functional currency.

Statement of Financial Position		
Item	Current year, CU	Previous year, CU
Receivables amount	20,000	15,000
Cash	30,000	40,000
Total:	50,000	55,000
Share capital	10,000	10,000
Profit (loss)	40,000	45,000
Total:	50,000	55,000

Statement of Profit or Loss and Other Comprehensive Income		
Item	Current year, CU	Previous year, CU
Sales revenue	100,000	120,000
Costs of sales	(65,000)	(78,000)
Gross profit	35,000	42,000
Administrative expenses	(40,000)	(38,000)
Net profit	(5,000)	4,000

The price indexes were:

Current year		Previous year	
January 1 – 220	December 31 – 180	January 1 – 200	December 31 – 220

Discussion Questions

1. Can these financial statements of GC be presented to users of the financial statements? Explain.
2. What changes should be introduced in the financial statements of GC so they can be presented to the user and reveal the true and fair financial face of GC? Explain.
3. Prepare GC financial statements, provide calculations.

SOLUTION OF CASE STUDY – IAS 29 FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES

If GC is operating in a country with a hyperinflationary economy, unspecified financial statements cannot be presented to users, since without the recalculation by price index level, the financial statements do not reveal GC's true financial situation. In this case, the data in the financial statements must be adjusted to reflect the change in the level of the price index.

The amounts in the Statement of Financial Position should be recalculated as follows:

Statement of Financial Position						
Item	Current year			Previous year		
	CU	Index level	CCU*	CU	Index level	CCU*
Receivables amount	20,000	-	20,000	15,000	180/220	12,273
Cash	30,000	-	30,000	40,000	180/220	32,727
Total:	50,000		50,000	55,000		45,000
Share capital	10,000	180/220	8,182	10,000	180/220	8,182
Profit (loss)	40,000	50,000-8,182	41,818	45,000	45,000-8,182	36,818
Total:	50,000		50,000	55,000		45,000
<i>Gain (loss) on the net monetary position</i>	<i>Formed as a result of the following recalculation:</i> <i>Share capital 8,182 – 10,000 = -CU1,818 (expenses)</i> <i>Profit (loss) 40,000x180/220 – 40,000 = -CU7,273 (expenses)</i> <i>Total: -CU9,091 (loss)</i>			<i>Formed as a result of the following recalculation:</i> <i>Receivables amount 12,273 – 15,000 = -CU2,727 (expenses)</i> <i>Cash 32,727 – 40,000 = -CU7,273 (expenses)</i> <i>Share capital 8,182 – 10,000 = -CU1,818 (expenses)</i> <i>Profit (loss) 45,000x180/220 – 45,000 = -CU8,182 (expenses)</i> <i>Total: -CU20,000 (loss)</i>		

*Converted currency unit

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. Receivables amount and cash are not recalculated for the current year, because they are 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.

If income and expenses have incurred evenly over the year, the average change in the price index can be applied in recalculating the statement of profit or loss and other comprehensive income:

Current year		Previous year	
Average price index	January 1 – 220 December 31 – 180 (220+180)/2=200	Average price index	January 1– 200 December 31– 220 (200+220)/2=210

Recalculation of the income statement amounts:

Statement of Profit or Loss and Other Comprehensive Income						
Item	Current year			Previous year		
	CU	Index level	CCU*	CU	Index level	CCU*
Sales revenue	100,000	180/200	90,000	120,000	180/210	102,587
Costs of sales	(65,000)	180/200	(58,500)	(78,000)	180/210	(66,857)
Gross profit	35,000		31,500	42,000		35,730
Administrative expenses	(40,000)	180/200	(36,000)	(38,000)	180/210	(32,571)
Gain (loss) on the net monetary position			8,590			11,071
Net profit	(5,000)		4,090	4,000		14,230
<i>Gain (loss) on the net monetary position</i>	<i>Formed as a result of the following recalculation:</i> <i>Sales revenue 90,000 – 100,000 = - CU10,000 (loss)</i> <i>Costs of sales -58,500 – (-65,000) = CU6,500 (Gain)</i> <i>Administrative expenses -36,000 – (-40,000) = CU4,000 (Gain)</i> <i>Total: CU500 (gain from profit (loss) statement) – CU9,091 (loss from financial positions statement) = - CU8,591 (loss)</i>			<i>Formed as a result of the following recalculation:</i> <i>Sales revenue 102,857 – 120,000 = - CU17,143 (loss)</i> <i>Costs of sales -66,857 – (-78,000) = CU11,143 (gain)</i> <i>Administrative expenses -32,571 – (-38,000) = CU5,429 (gain)</i> <i>Total: 571 CU (gain from profit (loss) statement) – CU20,000 (loss from financial positions statement) = - CU19,429(loss)</i>		

*Converted currency unit

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

Statement of Financial Position		
Item	Current year, CU	Previous year, CU
Receivables amount	20,000	12,273
Cash	30,000	32,727
Total:	50,000	45,000
Share capital	8,182	8,182
Profit (loss)	41,818	36,818
Total:	50,000	45,000

Statement of Profit or Loss and Other Comprehensive Income		
Item	Current year, CCU	Previous year, CCU
Sales revenue	90,000	102,587
Costs of sales	(58,500)	(66,857)
Gross profit	31,500	35,730
Administrative expenses	(36,000)	(32,571)
Gain (loss) on the net monetary position	(8,591)	(19,429)
Net profit	(13,091)	(16,270)