Rechnungslegungs Interpretations
Accounting Interpretations Committee e. V.

RIC • Charlottenstr. 59 • 10117 Berlin

Telefon +49 30 206412-12
Telefax +49 30 206412-15
E-Mail info@drsc.de

Berlin, 18. Mai 2004

Kevin Stevenson
Chairman of the
International Financial Reporting Interpretations Committee
30 Cannon Street

London EC4M 6XH
United Kingdom

Dear Kevin

Comment letter on IFRIC Interpretation D5 Applying IAS 29 Financial Reporting in Hyperinflationary Economies for the First Time

We appreciate the opportunity to comment on IFRIC D5. In general, we share IFRIC's view that IAS 29 needs more guidance. However, we are concerned whether the proposed interpretation meets the current needs of preparers. Following our specific comments on D5 we set out more general observations on accounting in hyperinflationary economies.

Deferred tax issues

We are concerned about IFRIC´s approach on accounting for deferred taxation under hyperinflation. We understand that the vital issue concerning this approach is the question whether deferred taxes are deemed to be monetary items or non monetary items. Given the definition in IAS 21.8 (revised 2003), deferred taxes are deemed to be monetary items. However, in example 5 page 19 the deferred tax is calculated as if it were a non-monetary item. This treatment is referred to in BC12. However, we do not find this persuasive. We recommend expanding the basis for conclusion by explaining this deviation from current literature.

We are of the opinion that the approach for recalculating deferred tax items is difficult to understand. We therefore recommend that in case the IFRIC retains the approach the example concerning deferred tax should be expanded.

D5 also lacks clarity concerning the accounting treatment for deferred taxes reflecting the change in the measuring unit from the date of the opening balance sheet of the current reporting period up to the balance sheet date (the same applies for the comparative period). Should that effect be recognised in the income statement or directly in equity? We recommend expanding the example by showing the effects explicitly.

We also emphasise that taxation in hyperinflationary economies tends to deviate considerably from taxation in non inflationary economies underlying the traditional deferred tax accounting model. Taxation in a hyperinflationary environment may vary from accelerated upfront lump sum payments, hard currency deposits replacing all or portions of income taxation to situations where taxes are calculated on a hard currency basis. Generally, there is a tendency to replace income tax by sales and trade taxes. The linkage between tax basis and carrying amount as assumed in deferred tax accounting may be weak and remote in a hyperinflationary economy and it can be difficult to decide whether a difference is temporary in nature. A field study on current practices seems appropriate before expanding the problematic index model to the field of deferred taxes.

Exemptions from the restatement approach

We disagree with paragraph 6 of the draft interpretation requiring that in rare circumstances entities use an independent professional assessment of the fair value of PP&E. There are no requirements of that nature in any other IFRS (neither IAS 19 nor IAS 40). Thus we recommend withdrawing this proposal. We rather recommend retaining the current wording of IAS 29.16 stating that in rare circumstances it may be necessary to use independent professional assessment.

Other

- On page 17 no.1 PP&E is calculated by using the index. For the avoidance of doubt it should be emphasised that in accordance with IAS 29.19 the amount recognised must not exceed the recoverable amount.
- The interpretation should encompass guidance on how IAS 29.24 has to be applied in cases where fair value adjustments of financial assets are recognised in equity.
- For the avoidance of doubt D5 should clearly state in paragraph 5 on page 19 that no deferred tax other than from PP&E exist even after restatement.

General concern

IAS 29 dates back to 1990 and thus does not reflect recent developments, e.g. fair value oriented accounting models or lessons learned in hyperinflationary economies throughout the nineties. The index-based restatement approach of IAS 29 may have been influenced by certain practices in Latin America. Some Latin American countries had a tradition of hyperinflation and had local accounting models in place that were index based. With hindsight, local index based hyperinflationary accounting was not a reliable approach to capture the loss of purchasing power suffered by hyperinflationary currencies. The indices employed were generated by local government agencies and had a tendency to understate the impact of hyperinflation. Using inflation indices from other sources (authorized or unauthorized) or deriving

indices on an individual basis is not practicable both from a cost benefit standpoint and with relation to the reliability of such information.
While some Latin American countries managed to terminate hyperinflation, new hyperinflationary countries appeared, especially some former Eastern and Central European countries. In many hyperinflationary countries local index based accounting models do not exist. There is a clear tendency to use parallel hard currency books in those countries. Especially subsidiaries of foreign hard currency parent entities quite frequently adopt USD or EURO as their quasi functional currencies and keep their accounting books and records in that currency. Typically major capital expenditure and financing transactions are executed in that currency; so there is little room for non-hard currency items.

However, IFRIC D5 does not address the above developments. It rather expands on the out dated and problematic index model. IAS 29 paragraph 3(b) correctly observes that in hyperinflationary countries "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;". The logical consequence would be to reflect this behaviour in accounting, i.e. requiring entities resident in hyperinflationary countries to prepare financial statements based on parallel hard currency accounts.
Given the current situation and the development in the past, reconsidering IAS 29 appears helpful. A field study on current practices in hyperinflationary countries should be staged giving due credit to the situation of consolidated subsidiaries of hard currency parent entities and addressing the issue of functional currency in hyperinflationary countries. In the meantime using parallel hard currency financial information should be permitted as an allowed alternative treatment, at least for consolidation purposes.

When a currency qualifies as hyperinflationary for the first time, items that historically originated in hard currency, e.g. purchases of PP&E made in USD, should be accounted for using the historical hard currency amounts retrospectively. All other items should be marked to fair value in hard currency at the date of transition to hyperinflation.

From a pragmatic perspective, hyperinflation accounting based on a hard currency approach should be implemented earlier than the traditional 100 % inflation in three consecutive years. Identifying hyperinflation at an early stage should ensure that sufficient hard currency information is available.

With best regards

Liesel Knorr
Chairman