
**INTERPRETATION OF
FINANCIAL
REPORTING STANDARD**

INT FRS 107

**Applying the Restatement Approach under
FRS 29 *Financial Reporting in Hyperinflationary
Economies***

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APPLYING THE RESTATEMENT APPROACH UNDER
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BASIS FOR CONCLUSIONS

Interpretation of FRS 107 *Applying the Restatement Approach* under FRS 29 *Financial Reporting in Hyperinflationary Economies* (INT FRS 107) is set out in paragraphs 1–6. INT FRS 107 is accompanied by Illustrative Examples and a Basis for Conclusions. The scope and authority of Interpretations are set out in the *Preface* to the Interpretations of Financial Reporting Standards.

INTERPRETATION OF FINANCIAL REPORTING STANDARD INT FRS 107

Applying the Restatement Approach under FRS 29 *Financial Reporting in Hyperinflationary Economies*

References

- FRS 12 *Income Taxes*
- FRS 29 *Financial Reporting in Hyperinflationary Economies*

Background

1. This Interpretation provides guidance on how to apply the requirements of FRS 29 in a reporting period in which an entity identifies* the existence of hyperinflation in the economy of its functional currency, when that economy was not hyperinflationary in the prior period, and the entity therefore restates its financial statements in accordance with FRS 29.

Issues

2. The questions addressed in this Interpretation are:
 - (a) how should the requirement '...stated in terms of the measuring unit current at the balance sheet date' in paragraph 8 of FRS 29 be interpreted when an entity applies the Standard?
 - (b) how should an entity account for opening deferred tax items in its restated financial statements?

Consensus

3. In the reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, not having been hyperinflationary in the prior period, the entity shall apply the requirements of FRS 29 as if the economy had always been hyperinflationary. Therefore, in relation to non-monetary items measured at historical cost, the entity's opening balance sheet at the beginning of the earliest period presented in the financial statements shall be restated to reflect the effect of inflation from the date the assets were acquired and the liabilities were incurred or assumed until the closing balance sheet date of the reporting period. For non-monetary items carried in the opening balance sheet at amounts current at dates other than those of acquisition or incurrence, that restatement shall reflect instead the effect of inflation from the dates those carrying amounts were determined until the closing balance sheet date of the reporting period.

* The identification of hyperinflation is based on the entity's judgement of the criteria in paragraph 3 of FRS 29.

4. At the closing balance sheet date, deferred tax items are recognised and measured in accordance with FRS 12. However, the deferred tax figures in the opening balance sheet for the reporting period shall be determined as follows:
 - (a) the entity remeasures the deferred tax items in accordance with FRS 12 after it has restated the nominal carrying amounts of its non-monetary items at the date of the opening balance sheet of the reporting period by applying the measuring unit at that date.
 - (b) the deferred tax items remeasured in accordance with (a) are restated for the change in the measuring unit from the date of the opening balance sheet of the reporting period to the closing balance sheet date of that period.

The entity applies the approach in (a) and (b) in restating the deferred tax items in the opening balance sheet of any comparative periods presented in the restated financial statements for the reporting period in which the entity applies FRS 29.

5. After an entity has restated its financial statements, all corresponding figures in the financial statements for a subsequent reporting period, including deferred tax items, are restated by applying the change in the measuring unit for that subsequent reporting period only to the restated financial statements for the previous reporting period.

Effective date

6. An entity shall apply this Interpretation for annual periods beginning on or after 1 March 2006. Earlier application is encouraged. If an entity applies this Interpretation to financial statements for a period beginning before 1 March 2006, it shall disclose that fact.

Illustrative Example

This example accompanies, but is not part of, INT FRS 107.

IE1 This example illustrates the restatement of deferred tax items when an entity restates for the effects of inflation under FRS 29 *Financial Reporting in Hyperinflationary Economies*. As the example is intended only to illustrate the mechanics of the restatement approach in FRS 29 for deferred tax items, it does not illustrate an entity's complete FRS financial statements.

Facts

IE2 An entity's FRS balance sheet at 31 December 20X4 (before restatement) is as follows:

Note	Balance sheet	20X4 ^(a)	20X3
		CU million	CU million
	ASSETS		
1	Property, plant and equipment	300	400
	Other assets	XXX	XXX
	Total assets	XXX	XXX
	EQUITY AND LIABILITIES		
	Total equity	XXX	XXX
	Liabilities		
2	Deferred tax liability	30	20
	Other liabilities	XXX	XXX
	Total liabilities	XXX	XXX
	Total equity and liabilities	XXX	XXX
	Notes		
1	<i>Property, plant and equipment</i>		
	All items of property, plant and equipment were acquired in December 20X2. Property, plant and equipment are depreciated over their useful life, which is five years.		
2	<i>Deferred tax liability</i>		
	The deferred tax liability at 31 December 20X4 of CU30 million is measured as the taxable temporary difference between the carrying amount of property, plant and equipment of 300 and their tax base of 200. The applicable tax rate is 30 per cent.		
	Similarly, the deferred tax liability at 31 December 20X3 of CU20 million is measured as the taxable temporary difference between the carrying amount of property, plant and equipment of CU400 and their tax base of CU333.		
	(a) In this example, monetary amounts are denominated in currency units (CU).		

IE3 Assume that the entity identifies the existence of hyperinflation in, for example, April 20X4 and therefore applies FRS 29 from the beginning of 20X4. The entity restates its financial statements on the basis of the following general price indices and conversion factors:

	General price indices	Conversion factors at 31 Dec 20X4
December 20X2 ^(a)	95	2.347
December 20X3	135	1.652
December 20X4	223	1.000

(a) For example, the conversion factor for December 20X2 is $2.347=223/95$.

Restatement

IE4 The restatement of the entity's 20X4 financial statements is based on the following requirements:

- Property, plant and equipment are restated by applying the change in a general price index from the date of acquisition to the balance sheet date to their historical cost and accumulated depreciation.
- Deferred taxes should be accounted for in accordance with FRS 12 *Income Taxes*.
- Comparative figures for property, plant and equipment for the previous reporting period are presented in terms of the measuring unit current at the end of the reporting period.
- Comparative deferred tax figures should be measured in accordance with paragraph 4 of the Interpretation.

IE5 Therefore the entity restates its balance sheet at 31 December 20X4 as follows:

Note	Balance sheet (restated)	20X4	20X3
		CU million	CU million
	ASSETS		
1	Property, plant and equipment	704	939
	Other assets	XXX	XXX
	Total assets	XXX	XXX
	EQUITY AND LIABILITIES		
	Total equity	XXX	XXX
	Liabilities		
2	Deferred tax liability	151	117
	Other liabilities	XXX	XXX
	Total liabilities	XXX	XXX
	Total equity and liabilities	XXX	XXX
	Note		
1	<i>Property, plant and equipment</i>		
	All items of property, plant and equipment were purchased in December 20X2 and depreciated over a five-year period. The cost of property, plant and equipment is restated to reflect the change in the general price level since acquisition, i.e. the conversion factor is 2.347 (223/95).		
		Historical CU million	Restated CU million
	Cost of property, plant and equipment	500	1,174
	Depreciation 20X3	(100)	(235)
	Carrying amount 31 December 20X3	400	939
	Depreciation 20X4	(100)	(235)
	Carrying amount 31 December 20X4	300	704
2	<i>Deferred tax liability</i>		
	The nominal deferred tax liability at 31 December 20X4 of CU30 million is measured as the taxable temporary difference between the carrying amount of property, plant and equipment of CU300 and their tax base of CU200. Similarly, the deferred tax liability at 31 December 20X3 of CU20 million is measured as the taxable temporary difference between the carrying amount of property, plant and equipment of CU400 and their tax base of CU333. The applicable tax rate is 30 per cent.		
	In its restated financial statements, at the balance sheet date the entity remeasures deferred tax items in accordance with the general provisions in FRS 12, i.e. on the basis of its restated financial statements. However, because deferred tax items are a function of carrying amounts of assets or		

liabilities and their tax bases, an entity cannot restate its comparative deferred tax items by applying a general price index. Instead, in the reporting period in which an entity applies the restatement approach under FRS 29, it (a) remeasures its comparative deferred tax items in accordance with FRS 12 after it has restated the nominal carrying amounts of its non-monetary items at the date of the opening balance sheet of the current reporting period by applying the measuring unit at that date, and (b) restates the remeasured deferred tax items for the change in the measuring unit from the date of the opening balance sheet of the current period up to the balance sheet date.

In the example, the restated deferred tax liability is calculated as follows:

	CU million
At the balance sheet date:	
Restated carrying amount of property, plant and equipment (see note 1)	704
Tax base	(200)
Temporary difference	<u>504</u>
@ 30 per cent tax rate = Restated deferred tax liability 31 December 20X4	<u>151</u>
Comparative deferred tax figures:	
Restated carrying amount of property, plant and equipment [either 400×1.421 (conversion factor $1.421=135/95$), or $939/1.652$ (conversion factor $1.652=223/135$)]	568
Tax base	(333)
Temporary difference	<u>235</u>
@ 30 per cent tax rate = Restated deferred tax liability 31 December 20X3 at the general price level at the end of 20X3	71
Restated deferred tax liability 31 December 20X3 at the general price level at the end of 20X4 (conversion factor $1.652=223/135$)	<u>117</u>

IE6 In this example, the restated deferred tax liability is increased by CU34 to CU151 from 31 December 20X3 to 31 December 20X4. That increase, which is included in profit or loss in 20X4, reflects (a) the effect of a change in the taxable temporary difference of property, plant and equipment, and (b) a loss of purchasing power on the tax base of property, plant and equipment. The two components can be analysed as follows:

	CU million
Effect on deferred tax liability because of a decrease in the taxable temporary difference of property, plant and equipment (-CU235 + CU133) × 30%	31
Loss on tax base because of inflation in 20X4 (CU333 × 1.652 - CU333) × 30%	(65)
Net increase of deferred tax liability (debit to profit or loss in 20X4)	34

The loss on tax base is a monetary loss. Paragraph 28 of FRS 29 explains this as follows:

The gain or loss on the net monetary position is included in net income. The adjustment to those assets and liabilities linked by agreement to changes in prices made in accordance with paragraph 13 is offset against the gain or loss on net monetary position. Other income statement items, such as interest income and expense, and foreign exchange differences related to invested or borrowed funds, are also associated with the net monetary position. Although such items are separately disclosed, it may be helpful if they are presented together with the gain or loss on net monetary position in the income statement.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, INT FRS 107.

Introduction

- BC1 This Basis for Conclusions summarises the considerations in reaching the consensus. Greater weight was given to some factors than to others.

Background

- BC2 This Interpretation seeks to provide guidance on how an entity should restate its financial statements when it starts to apply FRS 29 *Financial Reporting in Hyperinflationary Economies*. There was uncertainty whether the opening balance sheet at the beginning of the reporting period should be restated to reflect changes in prices before that date.
- BC3 In addition, there was uncertainty about the measurement of comparative deferred tax items in the opening balance sheet. FRS 29 states that at the balance sheet date deferred tax items of the restated financial statements should be measured in accordance with FRS 12 *Income Taxes*. However, it was not clear how an entity should account for the corresponding deferred tax figures.
- BC4 In response, the Draft Interpretation ED INT FRS *Applying FRS 29 Financial Reporting in Hyperinflationary Economies for the First Time* was developed and published for public comment in March 2004.

Basis for consensus

The restatement approach

- BC5 In developing the ED INT FRS, it was observed that the purpose of restating financial statements in hyperinflationary economies in accordance with FRS 29 is to reflect the effect on an entity of changes in general purchasing power. Paragraph 2 of FRS 29 states:

In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.

This purpose applies to the financial statements of the first reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency as well as to subsequent reporting periods (if the criteria for a hyperinflationary economy are still met).

- BC6 This Interpretation considered the meaning of paragraph 4 of FRS 29, which states:

...this Standard applies to the financial statements of any entity from the beginning of the reporting period in which it identifies the existence of hyperinflation in the country in whose currency it reports.

It was noted that some may interpret this provision as restricting the restatement of an entity's opening balance sheet in the reporting period in which it identifies the existence of hyperinflation. Consequently, the opening balance sheet should be restated to reflect the change in a general price index for the reporting period only and not for changes in a general price index before the beginning of the reporting period, even though some balance sheet items may have been acquired or assumed before that date. However, it was also noted that paragraph 34 of FRS 29 requires:

Corresponding figures for the previous reporting period, whether they were based on a historical cost approach or a current cost approach, are restated by applying a general price index so that the comparative financial statements are *presented in terms of the measuring unit current at the end of the reporting period*. Information that is disclosed in respect of earlier periods is also expressed in terms of the measuring unit current at the end of the reporting period...[emphasis added]

- BC7 This Interpretation considered a possible inconsistency between the restriction in paragraph 4 of FRS 29 and the requirement in paragraph 34. It was noted that paragraph 4 is a scope paragraph, which identifies when an entity has to comply with the Standard. The paragraph clarifies that an entity applies the requirements of the Standard to its financial statements from the beginning of the reporting period to the balance sheet date and not only from the date when it identifies the existence of hyperinflation. However, paragraph 4 does not deal with the restatement and presentation of the financial statements (either at the balance sheet date or in relation to the comparative figures). Hence, paragraph 4 of FRS 29 does not exclude from the restatement of an entity's opening balance sheet changes in the general price level before the beginning of the reporting period in which the entity identifies the existence of hyperinflation.
- BC8 It was concluded that, in the context of the purpose of the Standard, the restatement of the financial statements for the reporting period in which an entity identifies the existence of hyperinflation should be consistent with the restatement approach applied in subsequent reporting periods.
- BC9 Concerns were expressed about whether the restatement approach in FRS 29 was always practicable for preparers and whether it provided decision-useful information to users. It was observed that such concerns reflected broader aspects related to the accounting for hyperinflation in general, rather than how an entity has to apply the current Standard.
- BC10 Nevertheless, this Interpretation considered how an entity should apply the Standard if, for example, detailed records of the acquisition dates of items of property, plant and equipment are not available. It was noted that, in those circumstances, paragraph 16 of FRS 29 states:

... In these rare circumstances, it may be necessary, in the first period of application of this Standard, to use an independent professional assessment of the value of the items as the basis for their restatement.

It was also noted that a similar exemption exists when a general price index may not be available. Paragraph 17 of FRS 29 states:

... In these circumstances, it may be necessary to use an estimate based, for example, on the movements in the exchange rate between the functional currency and a relatively stable foreign currency.

- BC11 In developing FRS 101 *First-time Adoption of Financial Reporting Standards*, there was discussion whether FRS 101 should exempt first-time adopters of FRSs from the effects of restatement in their first FRS financial statements. It was noted that:

Some argued that the cost of restating financial statements for the effects of hyperinflation in periods before the date of transition to FRSs would exceed the benefits, particularly if the currency is no longer hyperinflationary. However, it was concluded that such restatement should be required, because hyperinflation can make unadjusted financial statements meaningless or misleading.

- BC12 However, it was also observed that first-time adopters of FRSs could use, for example, the fair value at transition date as deemed cost for property, plant and equipment, and, in some instances, also for investment property and intangible assets. Hence, if a first-time adopter

that would otherwise have to apply FRS 29 at its transition to FRSs applies the fair value measurement exemption of FRS 101, it would apply FRS 29 to periods only after the date for which the fair value was determined. Such remeasurements would therefore reduce the need for a first-time adopter to restate its financial statements.

- BC13 This Interpretation noted that the exemptions from the general restatement approach for preparers that already apply FRSs, as stated in paragraph BC10 above, apply only in specific circumstances, whereas a first-time adopter may always elect to use the fair value remeasurement exemption for property, plant and equipment in FRS 101. Nevertheless, it was concluded that the application of the exemptions in the Standards is clear and, therefore, extending the exemptions in FRS 29 to permit preparers that already apply FRSs to elect fair value remeasurement of property, plant and equipment when applying the restatement approach under FRS 29 would require amendments of the Standard itself, rather than an Interpretation.
- BC14 There were arguments that the procedures, as proposed to be clarified, are inconsistent with the accounting for a change in functional currency under FRS 21 *The Effect of Changes in Foreign Exchange Rates*, which in their view is comparable to moving into a state of hyperinflation. Moreover, they noted that retrospective application is also inconsistent with the US GAAP approach, which accounts for a change in hyperinflation status prospectively.
- BC15 In relation to the reference to a change in functional currency, it was observed that the existence of hyperinflation may (but not necessarily should) initiate such a change. It was noted that a change in functional currency is a change in the currency that is normally used to determine the pricing of an entity's transactions. As clarified in paragraph BC5 above, the purpose of restatement for the effects of hyperinflation is to reflect the effect of changes in purchasing power in the economy of an entity's functional currency. Therefore, it was believed that the application of accounting for hyperinflation should not be based on the accounting for the change in an entity's functional currency.
- BC16 It was also observed that reference to prospective application under US GAAP reflects requirements only for investments in foreign entities in hyperinflationary economies. In this case, paragraph 11 of SFAS 52 *Foreign Currency Translation* states:

The financial statements of a foreign entity in a highly inflationary economy shall be remeasured as if the functional currency were the reporting currency. Accordingly, the financial statements of those entities shall be remeasured into the reporting currency according to the requirements of paragraph 10... [emphasis added]

Therefore, under US GAAP a foreign entity's financial statements are remeasured into its investor's functional currency. It was noted that this approach is different from the restate/translate approach under FRSs. US GAAP provides different guidance for reporting entities operating with a hyperinflationary functional currency. APB Statement No. 3 *Financial Statements Restated for General Price-Level Changes* is also based on a restatement approach, and would require retrospective application, as under FRS 29. It was observed that for the purpose of presenting comparative amounts in a different presentation currency under FRSs paragraphs 42(b) and 43 of FRS 21 apply. In such instances, an entity will have relief from the required restatement of comparatives under FRS 29. The reasoning for this specific exemption is explained as follows:

...If exchange rates fully reflect differing price levels between the two economies to which they relate, the INT FRS 30 approach will result in the same amounts for the comparatives as were reported as current year amounts in the prior year financial statements. Furthermore, it was noted that in the prior year, the relevant amounts had been already expressed in the non-hyperinflationary presentation currency, and there was no reason to change them.

BC17 The ED INT FRS proposed that applying the restatement approach under FRS 29 should be regarded as a change in circumstances, rather than a change in accounting policy. There were views that this was inconsistent. This is because FRS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, paragraph 16, states that a change in circumstances is not a change in accounting policy and an entity would not apply FRS 29 retrospectively. However, it was observed that FRS 29 contains specific requirements on this point, as noted in paragraphs BC5–BC16 above. It was concluded that the opening balance sheet for the reporting period in which an entity identifies the existence of hyperinflation ought to be restated as if the entity had always applied the restatement approach under FRS 29. It was reconfirmed that this treatment is similar to the retrospective application of a change in accounting policy described in FRS 8.

Deferred tax items

BC18 This Interpretation seeks to provide guidance on the accounting for deferred tax items when an entity restates its financial statements according to FRS 29. In particular, guidance on measuring deferred tax items in the opening balance sheet for the reporting period in which an entity identifies the existence of hyperinflation was requested.

BC19 Paragraph 32 of FRS 29 states:

The restatement of financial statements in accordance with this Standard may give rise to differences between the carrying amount of individual assets and liabilities in the balance sheet and their tax bases. These differences are accounted for in accordance with FRS 12 *Income Taxes*.

Therefore, at the closing balance sheet date of the reporting period an entity remeasures its deferred tax items on the basis of the restated financial statements, rather than by applying the general restatement provisions for monetary items or non-monetary items. However, it was noted that it was not clear how an entity should account for its comparative deferred tax items.

BC20 In developing the ED INT FRS, the following options were considered:

- (a) restatement of deferred tax items as monetary items;
- (b) restatement of deferred tax items as non-monetary items; or
- (c) remeasurement of deferred tax items as if the economy of the entity's functional currency had always been hyperinflationary.

BC21 The ED INT FRS proposed clarifying that deferred tax items are neither clearly monetary nor non-monetary in nature. This was because deferred tax items are determined by the assets' (and liabilities') relative carrying amounts and tax bases. However, there were objections to that view, for various reasons. Some argued that deferred tax items, by nature, are received or paid in a fixed or determinable number of units of currency, and so should be considered as monetary items in accordance with paragraph 8 of FRS 21. Others noted that general practice is to classify deferred taxes as non-monetary items.

BC22 When considering comments on the ED INT FRS, it was confirmed that the conclusion in paragraph BC17 above should also apply to deferred tax items. In other words, the deferred tax items in the opening balance sheet for the reporting period in which an entity identifies the existence of hyperinflation should be calculated as if the environment had always been hyperinflationary, i.e. option (c) in paragraph BC20. Although it was acknowledged that the deferred tax items may meet the definition of monetary items, it was noted that the purposes

of option (c) would not be achieved if opening deferred tax items were restated in the same manner as applied generally for monetary items.

- BC23 There were suggestions that deferred tax items in the opening balance sheet should be remeasured after restating the opening balance sheet with the measurement unit current at the closing balance sheet date of the reporting period. It was viewed that the above proposal would (in case of a deferred tax liability) overstate the deferred tax item recognised in the opening balance sheet and, accordingly, understate the costs recognised in the reporting period. This is because the loss on the tax base caused by the inflation in the reporting period would be recognised directly in opening equity. This was illustrated by the following example:

At the end of Year 1, a non-monetary asset is restated at the measurement unit current at that date. Its restated amount is CU1,000 and its tax base is CU500. If the tax rate is 30 per cent, the entity would remeasure a deferred tax liability of CU150. In Year 2 inflation is 100 per cent. Assuming that nothing has changed the entity would, in its restated financial statements, recognise an asset of CU2,000 (both at the closing balance sheet date of the reporting period and in the comparative figures). At the closing balance sheet date, the deferred tax liability is remeasured at CU450 $((\text{CU}2,000 - \text{CU}500) \times 0.3)$. However, if the comparative deferred tax liability is remeasured after restating the asset by the measuring unit current at the closing balance sheet date of the reporting period, the entity should recognise an opening deferred tax liability of CU450, and there would be no impact on profit or loss $(\text{CU}450 - \text{CU}450)$. On the other hand, if the comparatives are stated as proposed in D5, the restated opening deferred tax liability would be CU300 $((1,000 - \text{CU}500) \times 0.3) \times 100\% + \text{CU}150$. Accordingly, the entity should recognise a loss of CU150 $(\text{CU}450 - \text{CU}300)$, which is the loss of purchasing power on the tax base in the reporting period.

- BC24 Paragraph 18 of Appendix A to FRS 12 explains:

Non-monetary assets are restated in terms of the measuring unit current at the balance sheet date (see FRS 29 *Financial Reporting in Hyperinflationary Economies*) and no equivalent adjustment is made for tax purposes. *(notes: (1) the deferred tax is charged in the income statement; and (2) if, in addition to the restatement, the non-monetary assets are also revalued, the deferred tax relating to the revaluation is charged to equity and the deferred tax relating to the restatement is charged in the income statement.)*

- BC25 Consequently, it was confirmed that restatement of comparative deferred tax items would require an entity, first, to remeasure its deferred tax items on the basis of the financial statements of the previous reporting period, which have been restated by applying a general price index reflecting the price level at the end of that period. Secondly, the entity should restate those calculated deferred tax items by the change in the general price level for the reporting period.