Grupo Latinoamericano
de Emisores de Normas
de Información Financiera

Group of Latin American
Accounting Standard Setters

November 22, 2019

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

RE: Tentative Agenda Decision— Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary (IAS 21 and IAS 29)

Dear members of the IFRS Foundation:

The "Group of Latin American Accounting Standard Setters" – GLASS welcomes the opportunity to comment on the Tentative Agenda Decision Project — Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary (IAS 21 and IAS 29) - (the Project).

This response summarizes the views of the directors of the different country's members of the GLASS Board[1], in accordance with the following due process.

Our position arises from a **general conceptual analysis** of the interaction between IAS 21, IAS 19 and other standards serves as the basis for answering the three points presented as "Tentative Agenda Decisions":

- Tentative Agenda Decision—Cumulative Exchange Differences arising before a Foreign Operation becomes Hyperinflationary (IAS 21 and IAS 29) -
- Tentative Agenda Decision—Presenting Comparative Amounts when a Foreign Operation First becomes Hyperinflationary
- Tentative Agenda Decision—Translation of a Hyperinflationary Foreign Operation: Presenting Exchange Differences (IAS 21 and IAS 29)

The document presenting the aforementioned analysis is attached as part of this response.

Due process

Discussions regarding the modifications proposed in the project were held within a specific Technical Working Group (GTT) created in October 2019, basically formed by GLASS directors representing 9 countries, taking the experience produced in those countries that are experiencing hyperinflation processes.

[1] The overall objective of the Group of Latin American Accounting Standard Setters (GLASS) is to present technical contributions with respect to all Exposure Drafts issued by the IASB. Therefore, GLASS aims to have a single regional voice before the IASB. GLASS Board is constituted by: Argentina (Chairman), Mexico (Vice Chairman), Brazil, Chile, Colombia, Costa Rica, Peru, Uruguay and Venezuela.

The GTT discussed the different views included in the summary through teleconferences. In these calls, the GTT developed a final document based on the consensual responses and technical views of all its members. Finally, the GTT document was submitted to and approved by the GLASS Board.

General comment

We have read the Decision of the Tentative Agenda of the IFRS Interpretations Committee held on September 17, 2019, which deals with "the project".

We believe that we can provide useful information based on our experience with this matter, taking into account that many countries in the region had, and some have, high inflation for prolonged periods related to the presentation of financial information in hyperinflationary environments.

Our technical group has developed a study document (attached) related to the application of IFRS in the described context, identifying what we consider the appropriate application of IFRS in its entirety and the accounting treatment that will be applied in the circumstances.

The agenda decision explains that "*Before the foreign operation becomes hyperinflationary, IAS 21 requires an entity to: (a) present in other comprehensive income (OCI) any exchanges differences resulting from translating the results and financial position of that non-hyperinflationary foreign operation; and (b) present in a separate component of equity the cumulative amount of those exchange differences (cumulative pre-hyperinflation exchange differences)",* and continues: *"The request asked whether, at the beginning of the period during which the foreign operation becomes hyperinflationary, the entity reclassifies within equity the cumulative pre-hyperinflation exchange differences––that is, whether the entity transfers the cumulative pre-hyperinflation exchange differences to a component of equity that is not subsequently reclassified to profit or loss.*

The Committee observed that paragraph 41 of IAS 21 requires the entity to present the cumulative pre-hyperinflation exchange differences in a separate component of equity 'until disposal of the foreign operation'. Furthermore, paragraph 48 of IAS 21 requires the entity to reclassify the cumulative pre-hyperinflation exchange differences from equity to profit or loss (as a reclassification adjustment) on disposal of the foreign operation.

Accordingly, the Committee concluded that, in the fact pattern described in the request, the entity retains the cumulative pre-hyperinflation exchange differences as a separate component of equity (to which paragraph 48 of IAS 21 applies) until disposal of the foreign operation. The entity does not reclassify within equity the cumulative pre-hyperinflation exchange differences when the foreign operation becomes hyperinflationary.

The Committee concluded that the principles and requirements in IAS 21 provide an adequate basis for an entity to determine how to present the cumulative pre-hyperinflation exchange differences when a foreign operation becomes hyperinflationary. Consequently, the Committee [decided] not to add the matter to its standard-setting agenda".

Grupo Latinoamericano de Emisores de Normas de Información Financiera

Group of Latin American Accounting Standard Setters

We agree with the analysis that paragraphs 41 and 48 of IAS 21 requires the entity to present the cumulative pre-hyperinflation exchange differences in a separate component of equity ‘until disposal of the foreign operation’ and to reclassify the cumulative pre-hyperinflation exchange differences from equity to profit or loss (as a reclassification adjustment) on disposal of the foreign operation, and therefore the application of IAS 29 by the controlled entity doesn’t require any reclassification but, as you can observe in the enclosed study paper, the requirement of IAS 29 to retrospective application implies, in our opinion, the re-measurement of the accumulated amounts previously recorded in the mentioned separate component of equity for the reasons expressed in the paper.

Accordingly, because of our conclusions on the matter we ask the IFRS IC to include the submission in its agenda because we consider it is a very relevant issue, with widespread effect and with severe difficulties of understanding in economic environments where hyperinflation never exists or at least doesn’t exist for the last 40 years.

We offer our collaboration with the staff or the committee in the development of the future interpretation in order to produce the input you consider necessary

Contact

If you need to ask some questions about our comments, please contact glenif@glenif.org

Kind regards

Jorge Gil
Chairman
Group of Latin American Accounting Standard Setters (GLASS)

Grupo Latinoamericano de Emisores de Normas de Información Financiera

Group of Latin American Accounting Standard Setters

ANEXX – STUDY PAPER

Measurement of the participation in a Subsidiary

The case raised has the following characteristics:

- The controlling entity has a presentation currency that is not the currency of a hyperinflationary economy as defined in IAS 29;
- The controlling entity has a foreign operation with a functional currency that is the currency of a hyperinflationary economy as defined in IAS 29 (hyperinflationary foreign operation); and
- The controlling entity translates the results and financial position of the hyperinflationary foreign operation into its presentation currency in preparing its consolidated financial statements.

Applicable standards:

- The wright application of IFRS requires that all the applicable standards to a particular event or situation have to be considered, and that they have to be applied in its entirety in order to meet the requirements for application of IFRS.
- Measurement of assets, liabilities, income and expense of the period and OCI of the period of the subsidiary for the purpose of consolidation - IFRS 10 *Consolidated Financial Statements*
- Restatement of the measurements of assets, liabilities, income and expense of the period, OCI of the period and Equity, in a hyperinflationary economic environment - IAS 29 *Financial Reporting in Hyperinflationary Economies*
- Translation of the functional currency of the subsidiary (hyperinflationary – i.e. Argentine Peso) to the presentation currency of the controlling entity (not hyperinflationary – i.e. US Dollar) - IAS 21 *The Effects of Changes in Foreign Exchange Rates*

Analysis:

- IFRS 10 doesn’t include in its text much detail on the consolidation mechanism, which is substantially consistent with the one used for the measurement of participations in other entities using the equity method, contemplated and developed by IAS 28.
- The consolidation mechanism consists basically in incorporating the assets and liabilities of a subsidiary into the consolidated statements, replacing the recognized amount of the participation in the said entity as investment in its separate statements. This also implies the recognition of the causes that generate variations in the investment in the subsidiary, that is to say the variations originated in results of the period, OCI of the period, contributions from and dividends to the stockholders.
- It is also sometimes necessary to modify the amount of participation on the subsidiary recognized, for reasons other than those mentioned, which is the case of changes in equity of the subsidiary due to the recognition of errors from previous periods or retrospective changes in equity because of changes in accounting policies.

- Paragraph 3 of IAS 28 describes the applicable method to the measurement of participation in other entities: *The* <u>*equity method*</u> *is a method of accounting whereby the investment is initially recognized at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.* This expression is complemented by the statements included in paragraph 26 of the same standard that are transcribed below: *26. Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.*
- The transcribed definitions do not contemplate all the causes of the variations, but they are complemented with paragraph 10 of that standard that states: *10. Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. The investor's share of the investee's profit or loss is recognised in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised in the investor's other comprehensive income (see IAS 1 Presentation of Financial Statements).*
- It can be concluded that IAS 28 requires that all variations that do not arise from reciprocal transactions between the subsidiary and other companies of the group (those that must be eliminated) must be recognized with counterpart in the same concept that gave rise to their recognition in the subsidiary. Thus, the participation in profit or loss for the period must be done under the same concept in the consolidated statements (or in the separate statements of the controlling entity) and the same occurs with all other causes of variations that are recognised, among which can be found retrospective modification of the subsidiary equity that must be recognized, by analogy, as retroactive changes in equity of the controlling entity.
- In that sense, it is clear that the treatment in profit or loss of the period, OCI of the period and other items of Equity must be similar whether it is a subsidiary that must be consolidated or an associate or joint venture that must be recognised using the equity method. Although it is not explicitly established in IAS 28, we can conclude by analogy with the underlying logic in its mechanics that, in case the investee retroactively corrects the magnitude of its assets, for example by the recognition of an error or a change In accounting policy, the controlling entity must make a retrospective correction in the measurement of the book value of the participation in the subsidiary in a similar manner, and its reflection in its equity in the same manner adopted by the investee.

- In the case under analysis, we observe that although the application of IAS 29 for the first time is considered a "change in circumstances", the mechanics described by said standard require that the restatement of the values of assets, liabilities and equity of the entity must be carried out retroactively at the beginning of the oldest period presented, which indicates that the way of recognition have to be identical to that required for cases of errors and changes in accounting policies described in IAS 8.
- Continuing with the previous reasoning, an investor must reflect the change in the magnitude of the equity of the investee at the beginning of the comparative period that is presented, in the same way as the investee, that is to say, modifying the value of the participation in the subsidiary proportionally at the same date, in order to coincide with its equivalent participation in the equity of the investee.
- In the subsidiary, the change in equity results from changes in:

  a) the measurement of the contributions by the stockholders,

  b) the measurement of the items that reflect the accumulated OCI, and

  c) the measurement of the accumulated income.

  Therefore, the controlling entity should reflect the change in the measurement of its participation in the investee with counterpart in the equivalent concepts.

- An additional complexity arises when the controlling entity, as is the case, has a functional or presentation currency that is different, and it is not hyperinflationary (for example, US Dollar). In that case, the net effect arising from the impact of inflation on the economic environment of the investee and the change between the exchange rates of the hyperinflationary currency of the investee and that of the non-hyperinflationary currency of the controlling entity
- This situation generates an exception to the described treatment, which occurs as a result of having to recognize changes in the participation on the subsidiary that have no effect on the investee's equity, which is the one that arises from the need to convert to the presentation currency of the controlling entity (or the functional currency of the entity that has joint control or significant influence), which does not match the functional currency of the investee. This is because at the level of the investee, said situation does not generate any effect on the measurement of its equity, but it does affect the measurement of the investment of the parent in the investee, made in the presentation currency of the group or in the functional currency of the controlling entity in its separate financial statements

Conclusion:

- In the case presented, the wright and comprehensive application of IFRS requires that it proceed as follows:

  a) The investee must correct its financial statements retrospectively at the beginning of the comparative period of the year in which the existence of hyperinflation was identified. Said restatement will result in changes in the measurement of its assets, in the measurements of contributions of owners, in the accumulated OCI and in Accumulated Income by application of the procedures provided in IAS 29.

b) The new measurements of the equity components at that date must be translated at the historical exchange rate with the presentation currency of the controlling entity or the functional currency of the investment entity. The exchange rate is the same as the one used for the measurement of these concepts at the time of recognition, prior to the identification of the existence of hyperinflation in the functional currency of the subsidiary or investee.

a) The differences that arise in the accumulated OCI and in Accumulated Income of the investee at said date, measured in the presentation currency of the controlling entity or the functional currency of the investing entity, will be recognized in the controlling or investing entity respectively in the participation on the OCI of subsidiaries or associates accumulated and in accumulated income and those corresponding to the contributions of owners in accumulated translation differences.

b) The investee must correct its financial statements retrospectively at the closing date of the comparative period of the year in which the existence of hyperinflation was identified. Said restatement will result in changes in the measurement of its assets, in the measurements of contributions of owners, in the accumulated OCI and in Accumulated Income by application of the procedures provided in IAS 29.

c) The measurements of the items must be translated using the closing exchange rate of the period between the investee's hyperinflationary functional currency and the presentation currency of the controlling entity or the functional currency of the investment entity.

d) The difference in the equity measurement at the closing date determined in d) and the equivalent measurement of the initial equity determined in b) corrected by the changes measured in d) must be recognized in the OCI of the period in the item that reflects the difference in translation between currencies..

e) The same procedure has to be applied for the period in which the existence of hyperinflation is identified.

- A simple example of application of the concepts described here is attached, where they are identified at the beginning of the period of application of IAS 29 in Argentina (01/01/2017) and their subsequent recognition both in profit and loss and in OCI.

Grupo Latinoamericano de Emisores de Normas de Información Financiera

Group of Latin American Accounting Standard Setters

APPLICATION EXAMPLE OF THE PREVIOUS CONCEPTS

Argentine Subsidiary (Amounts in nominal AR$)				
	01/01/17	31/12/17	31/12/18	31/12/19
Items	AR$	AR$	AR$	AR$
Monetary Assets	100,00	349,00	674,00	1.051,00
Non Monetary Assets	900,00	855,00	810,00	765,00
Liabilities	0,00	-120,00	-260,00	-410,00
Contributed Capital	-1.000,00	-1.000,00	-1.000,00	-1.000,00
Retained earnings	0,00	0,00	-84,00	-224,00
Profit & Loss of the period	0,00	-84,00	-140,00	-182,00
Control	0,00	0,00	0,00	0,00
Revenue		-600,00	-1.000,00	-1.600,00
Cost of sales (Except depreciation)		375,00	665,00	1.155,00
Depretiation of NM Assets		45,00	45,00	45,00
Other expenses		60,00	90,00	140,00
Income Tax		36,00	60,00	78,00
P&L of the period	0,00	-84,00	-140,00	-182,00

CPI Index Closing date	100,00	130,00	210,00	300,00
CPI Index Period average		115,00	170,00	255,00
US$ Exchange rate Closing date	10,00	11,00	17,00	25,00
US$ Exchange rate Period average		10,50	14,00	21,00
Net investment in Arg Subs	100,00	98,55	72,00	56,24
Net income (expense) from Arg Subs	0,00	7,64	8,24	7,28
Accumulated income (expense) for inv foreign operation	0,00	7,64	15,87	23,15
OCI for inv in foreign operation - income (expense)	0,00	-9,09	-34,78	-23,04
Accumulated OCI for inv foreign operation - income (expense)	0,00	-9,09	-43,87	-66,91

Grupo Latinoamericano de Emisores de Normas de Información Financiera

Group of Latin American Accounting Standard Setters

Argentine Subsidiary (Amounts in restated AR$)				
Items	01/01/17	31/12/17	31/12/18	31/12/19
	AR$	AR$	AR$	AR$
Monetary Assets	100,00	349,00	674,00	1.051,00
Non Monetary Assets	900,00	1.111,50	1.701,00	2.295,00
Liabilities	0,00	-120,00	-260,00	-410,00
Contributed Capital	-1.000,00	-1.300,00	-2.100,00	-3.000,00
Retained earnings	0,00	0,00	-65,42	-21,43
Profit & Loss of the period	0,00	-40,50	50,42	85,43
Control	0,00	0,00	0,00	0,00
Revenue		-678,26	-1.235,29	-1.882,35
Cost of sales (Except depreciation)		423,91	821,47	1.358,82
Depretiation of NM Assets		58,50	94,50	135,00
Other expenses		67,83	111,18	164,71
Inflation effect (Gain) Loss		46,83	184,45	217,49
Income Tax		40,70	74,12	91,76
P&L of the period	0,00	-40,50	50,42	85,43

Net investment in Arg Subs	100,00	121,86	124,41	117,44
Net income (expense) from Arg Subs	0,00	3,86	-3,60	-4,07
Accumulated income (expense) for inv foreign operation	0,00	3,86	0,26	-3,81
OCI for inv in foreign operation - income (expense)	0,00	18,01	6,15	-2,90
Accumulated OCI for inv foreign operation - income (expense)	0,00	18,01	24,16	21,25
Previously reported Investment (Nominal amounts)	100,00	98,55	72,00	56,24
Previously reported Accumulated OCI (Nominal amounts)	0,00	-9,09	-43,87	-66,91
Previously reported Accumulated Income (Nominal amounts)	0,00	7,64	15,87	23,15

Accumulated difference in Investment measurement	0,00	23,32	52,41	61,20
Accumulated difference in OCI	0,00	27,10	68,03	88,16
Accumulated difference in Profit or loss of the period	0,00	-3,78	-15,62	-26,96