EFRAG
European Financial Reporting Advisory Group

DRAFT COMMENT LETTER

Comments should be submitted by 22 November 2010 to Commentletters@efrag.org

XX Month 2010

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Dear Sir / Madam,

Re: Exposure Draft *Severe Hyperinflation – Proposed amendments to IFRS 1*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft *Severe Hyperinflation – Proposed amendments to IFRS 1* ('the ED'). This letter is submitted in EFRAG's capacity of contributing to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG, in its capacity as advisor to the European Commission, on endorsement of the definitive amendment in the European Union and European Economic Area.

EFRAG appreciates the IASB's responsiveness in addressing the accounting issues faced by entities emerging out of severe hyperinflation. However, we have various concerns regarding the scope and application of the proposals, as identified in the appendix. We recommend that the IASB clarify the drafting in these respects.

If you wish to discuss our comments further, please do not hesitate to contact Joaquín Sánchez-Horneros or me.

Yours sincerely,

Francoise Flores
EFRAG, Chairman

Appendix

Question 1

The Board proposes adding an exemption to IFRS 1 that an entity can apply at the date of transition to IFRSs after being subject to severe hyperinflation. This exemption would allow an entity to measure assets and liabilities at fair value and use that fair value as the deemed cost of those assets and liabilities in the opening IFRS statement of financial position.

Do you agree that this exemption should apply when an entity prepares and presents an opening IFRS statement of financial position after being subject to severe hyperinflation?

Why or why not?

Notes for EFRAG constituents

1 *When the functional currency of an entity is the currency of a hyperinflationary economy, there are certain circumstances ('severe hyperinflation') that may make it impossible for that entity to apply IAS 29 and to measure reliably its assets and liabilities in accordance with IFRSs. As a result, such an entity may be unable to prepare financial statements under IFRSs for a period of time.*

2 *Once an entity resumes reporting under IFRSs after a period of severe hyperinflation, it would be considered a first-time adopter of IFRSs. However, current IFRSs do not provide any specific guidance to help such an entity to prepare financial statements under IFRSs.*

3 *The IASB published the Exposure Draft, Severe Hyperinflation – Proposed amendment to IFRS 1 ('the ED'), on 30 September 2010. The ED proposes* to *add an exemption to IFRS 1 to allow an entity that has been subject to severe hyperinflation to measure assets and liabilities at fair value and use that fair value as the deemed cost of those assets and liabilities in the opening IFRS statement of financial position.*

4 *A currency is subject to severe hyperinflation when:*

(a) a reliable, general price index is not available to all entities with transactions and balances in the currency; and

(b) exchangeability between the currency and a relatively stable foreign currency does not exist.

5 *An entity that applies the exemption should disclose the facts and circumstances regarding their functional currency that lead the entity to apply the exemption.*

6 *The functional currency of an entity ceases to be subject to severe hyperinflation on the functional currency normalisation date, which is the date on which:*

(a) the functional currency no longer has either, or both, of the characteristics in paragraph 4 above; or

(b) there is a change in the entity's functional currency to a currency that is not subject to severe hyperinflation.

7 *The effective date will be determined after exposure and earlier application is permitted.*

EFRAG's response

Entities within the scope of the exemption

8 As EFRAG has previously stated in comment letters on other amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*, the objective of IFRS 1 is to ensure that an entity's first IFRS financial statements contain high quality information that:

(a) is transparent for users and comparable between the periods presented;

(b) provides a suitable starting point for accounting in accordance with IFRS; and

(c) can be generated at a cost that does not exceed the benefits.

For these same reasons, we would also be supportive of these proposals as they enable additional entities to report under IFRS.

9 As noted in a staff paper to the Board, the original request received by the IFRS Interpretations Committee ('Interpretations Committee') was 'to clarify how an entity should resume presenting financial statements in accordance with IFRSs after a period of severe hyperinflation, during which it had been unable to comply with IAS 29 *Financial Reporting in Hyperinflationary Economies*.' Our assumption had been that the proposed exemption would only be available to entities that resume reporting under IFRSs, after a relatively brief period in which they could not apply IFRSs because of severe hyperinflation (e.g. Zimbabwe). However, it appears that the proposed exemption would be available to *any* entity that operates in an economy that *used to be* subject to severe hyperinflation, even if:

(a) the severely hyperinflationary period was in the distant past; or

(b) most of the assets and liabilities of the entity were acquired after the period of severe hyperinflation.

10 In other words, the scope of the proposed exemption appears to be significantly broader than intended. We therefore recommend that the IASB should clarify which entities are within the scope of the exemption.

Question 2

Do you have any other comments on the proposals?

EFRAG's response

Application of the exemption

11 Paragraph D30 of the ED states that 'the entity may elect to measure assets and liabilities at fair value.' In addition, paragraph BC13 of the ED states that:

'The Board believes that an entity should not be required to apply the exemption, but instead may elect to apply it when measuring assets and liabilities in the opening IFRS statement of financial position. This is because, by applying other guidance in IFRS 1 to measure specific assets and liabilities, an entity may provide users with more useful information, for example when measuring assets and liabilities that were not affected by severe hyperinflation.'

12 However, it is not clear from the wording above whether the exemption:

(a) may be applied on an item-by-item basis (similar to paragraph D6 of IFRS 1):

(i) without any constraints;

(ii) only when the item in question was affected by severe hyperinflation; or

(iii) only when application of other guidance in IFRS 1 would not result in useful information; or

(b) should apply to all assets and liabilities collectively, although individual items may not have been affected by severe hyperinflation (e.g. items acquired after the severely hyperinflationary period or assets and liabilities of a subsidiary operating in a non-hyperinflationary economy).

13 We believe that the IASB should more clearly articulate (1) the rationale for providing the proposed exemption, (2) why the resulting information provides a suitable starting point for accounting under IFRSs and (3) when the exemption may be applied and to which items (i.e. assets and liabilities).

Disclosure requirements

14 We understand that the purpose of paragraph 31C of the ED is to require disclosure of the facts and circumstances that lead an entity to apply the proposed exemption. As the actual wording of that paragraph of the ED is unclear, we would recommend that the IASB clarify the drafting.

Review of IAS 29

15 We would like to draw your attention to the fact that IAS 29 is difficult to apply in practice because of the economic and political complexities associated with hyperinflation. It was, and also still is, held by many preparers to produce less decision-useful information on economic performance in such circumstances than 'hard-currency accounting,' which was widely used under IFRSs prior to SIC-19 *Reporting Currency – Measurement and Presentation of Financial Statements under IAS 21 and IAS 29*. For these reasons, we believe that the IASB should consider a more fundamental review of accounting in hyperinflationary economies.