

Hyperinflation in Argentina: which implications for your consolidated financial statements?

Argentina is now considered to be a hyperinflationary economy. IAS 29 – Financial Reporting in Hyperinflationary Economies is therefore applicable to entities whose functional currency is the Argentine peso.

This Technical Alert deals with the key issues surrounding the first-time application of IAS 29 in Argentina.

1- Why is Argentina now considered to be a hyperinflationary economy?

IAS 29 sets out a number of quantitative and qualitative characteristics for the purpose of assessing whether an economy is hyperinflationary (IAS 29.3), including:

- the general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency (e.g., the US dollar or the euro);
- transactions are conducted in terms of a relatively stable foreign currency;
- sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period;
- interest rates, wages and prices are linked to a price index; and
- the cumulative inflation rate over three years is approaching, or exceeds, 100%.

Inflation in Argentina has been very high for several years according to consensus observations, even though local inflation data has not been reported consistently by the public authorities. After declining for several months in 2017, inflation has increased significantly since early 2018 and the three-year cumulative inflation rate now exceeds 100%. Forecasts suggest that three-year cumulative retail price inflation at the end of 2018 will be around 120%, and 100% for the wholesale price index. In 2019, the inflation rate is not expected to fall significantly, especially in view of the devaluation of the Argentine peso.

In view of the three-year inflation rate exceeding 100% and several other qualitative indicators also pointing in the same direction, Argentina is now considered to be a hyperinflationary economy.

2- When does this apply?

Unlike other IFRSs, which allow entities to exercise judgement based on the facts and circumstances, IAS 29 recommends that all entities apply the standard from the same date (IAS 29.4).

Based on consensus opinion, Argentina is considered to be hyperinflationary from 1 July 2018.

However, IAS 29 states that the standard should apply from the beginning of the reporting period in which the country in question is considered to have become hyperinflationary (IAS 29.4). Therefore, IAS 29 should be applied by all entities with financial periods ending 31 December 2018 (i.e., with effect from 1 January 2018) as if the Argentine economy had always been hyperinflationary.

3- What are the main accounting impacts of applying IAS 29?

IAS 29 is applicable to entities whose functional currency is the Argentine peso. Accordingly, entities located in Argentina with a functional currency other than the Argentine peso (US dollar, Brazilian real, euro, etc.) are not required to apply IAS 29.

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Restatement to correct the loss of purchasing power of the Argentine peso

IAS 29 requires financial statements, whether based on a historical cost approach to be restated. This consists in applying a general price index such that the financial statements are presented in terms of the measuring unit current at the closing date. All non-monetary assets and liabilities must be restated for inflation to reflect their “real value” at the closing date. In addition, the statement of comprehensive income (income statement items together with other comprehensive income) are restated for inflation observed during the period. Monetary items do not require restatement, as they already reflect the purchasing power at the closing date.

An entity might prepare current cost financial statements. Items stated at current cost are not restated, because they are already stated in terms of the measuring unit current at the end of the reporting period. Other items in the balance sheet are restated in the same way as for historical financial statements. All items in the statement of comprehensive income also need to be restated by applying a general price index.

Adjustments to non-monetary assets and liabilities and income and expenses must be presented separately on a specific line of the statement of income in accordance with the requirement of IAS 29 that *“the gain or loss on the net monetary position shall be included in profit or loss and separately disclosed”* (IAS 29.9).

Examples of monetary assets and liabilities:

Monetary assets	Monetary liabilities
<ul style="list-style-type: none">• Cash and cash equivalents• Marketable debt instruments• Trade receivables and allowances for doubtful receivables• Other receivables• Contract assets (IFRS 15)	<ul style="list-style-type: none">• Trade payables• Other operating payables• Current tax payables• Borrowings and debt• Lease liabilities• Post-employment and other long-term benefit obligations• Liabilities recognised for puttable equity instruments• Refund liabilities (IFRS 15)

Examples of non-monetary assets and liabilities:

Non-monetary assets	Non-monetary liabilities
<ul style="list-style-type: none">• Prepayments• Inventories and allowances for inventories• Non-consolidated investments• Equity-accounted securities• Property, plant and equipment• Right-of-use assets (IFRS 16)• Intangible assets	<ul style="list-style-type: none">• Deferred income (e.g., state subsidies)• Equity• Contract liabilities (IFRS 15)

Example of restatements for an asset acquired in 2016 for the preparation of annual financial statements in accordance with IAS 29

- The asset was acquired on 1 January 2016 for 1 million pesos.
- The asset is depreciated on a straight-line basis over a period of 10 years.
- The rate of inflation observed between 1 January 2016 and 31 December 2018 is equal to 100%.

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Cost (in pesos)	Restated value (in pesos)
<ul style="list-style-type: none"> Gross value = 1,000,000 Depreciation = 300,000 Net value = 700,000 	<ul style="list-style-type: none"> Gross value = $1,000,000 \times 2 = 2,000,000$ Depreciation = $2,000,000 \times 3/10 = 600,000$ Net value = 1,400,000

The entity discloses the following accounting entries:

Restatement of the asset acquired in 2016			
Dt	Gross value of asset	1,000,000	
Dt	Depreciation expenses	100,000	300,000
Ct	Accumulated depreciation		
Ct	Reserves or other comprehensive income ⁽¹⁾⁽²⁾		470,000
Ct	Profit on net monetary position ⁽¹⁾		330,000

(1) A constant rate of inflation was applied over three years

(2) See point 6 below.

Example of revenue restatements for January 2018 and February 2018 for the preparation of annual financial statements in accordance with IAS 29

- The Argentine subsidiary generated revenue of 20 million and 15 million pesos in January 2018 and February 2018, respectively.
- The rates of inflation observed between 1 January 2018 and 31 December 2018 and between 1 February 2018 and 31 December 2018 are equal to 25% and 20%, respectively.

Cost (in pesos)	Restated value (in pesos)
<ul style="list-style-type: none"> Revenue for January = 20,000,000 	<ul style="list-style-type: none"> Revenue for January = $20,000,000 \times 1.25 = 25,000,000$
<ul style="list-style-type: none"> Revenue for February = 15,000,000 	<ul style="list-style-type: none"> Revenue for February = $15,000,000 \times 1.20 = 18,000,000$

The entity discloses the following accounting entries:

Restatement of revenue for January 2018 and February 2018			
Dt	Loss on net monetary position	8,000,000	
Ct	Revenue for January 2018		5,000,000
Ct	Revenue for February 2018		3,000,000

Translation into the group presentation currency

Once the financial statements of subsidiaries whose functional currency is the Argentine peso have been restated for the effects of inflation, they must be translated into the group presentation currency in accordance with IAS 21. IAS 29 specifies that restated financial statements are translated at closing rates. Accordingly, assets, liabilities, equity, income and expenses are translated at the closing rate for the reporting period.

4- What are the other main impacts caused by the application of IAS 29?

The first application of IAS 29 may have other impacts, in particular:

- An update of inventory and non-current asset impairment tests (property, plant and equipment and intangible assets including goodwill) even if no impairment was recorded in the historical cost convention financial statements.
- A reassessment of deferred taxes assets and liabilities due to the increase in temporary differences.

The impacts will be accounted for in equity as of 1 January 2018, as long as they relate to prior years (see point 6).

5- Since IAS 29 is applied retroactively, should comparative periods be restated (2017, or even 2016)?

For groups presenting financial statements in a stable currency (e.g., in euros), paragraphs 42(b) and 43 of IAS 21 – The Effects of Changes in Foreign Exchange Rates apply, which state that comparative amounts presented in prior financial periods in a stable currency are not restated.

French groups with subsidiaries in Argentina that present financial statements in euros are not therefore required to restate comparative revenue data published for 2017 or 2016.

6- What restatements must be made to opening equity?

The provisions of IAS 29 are effective from the beginning of the reporting period in which the country in question is considered to have become hyperinflationary, which in the case of Argentina is 1 July 2018. For financial periods aligned with the calendar year, entities must therefore apply IAS 29 with effect from 1 January 2018. At that date, they must restate non-monetary assets and liabilities for the effects of inflation since the acquisition date for assets or the date of initial recognition for liabilities.

Comparative amounts for financial statements presented in a stable currency in 2017 are not restated for inflation (see point 5 above). This therefore generates a difference between equity at 31 December 2017 (not restated) and opening equity at 1 January 2018 (restated for IAS 29) because the rate at which the hyperinflationary currency depreciates against a stable currency is rarely equal to the rate of inflation.

In our view, groups must choose between presenting the impact of IAS 29 on opening equity at 1 January 2018 either directly in equity (reserves) or in other comprehensive income (OCI) as a translation adjustment.

Recognition directly in equity (reserves) is consistent with a change in accounting policy in accordance with IAS 8. Recognition in other comprehensive income is consistent with IAS 1.109, which states that changes recognised directly in equity comprise only transactions with owners in their capacity as such.

7- What are the accounting impacts for interim financial information published in 2018?

Many groups publish interim financial information or communicate quarterly revenue data under IFRS.

As regards quarterly revenue for the period ended 30 September 2018, should published data for the first and second quarters of the year be restated, or should third-quarter 2018 data include the prior-period restatement?

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Given the absence of specific provisions, we have considered the following two options:

- The first consists in not restating data published for the first and second quarters, and in recognising the restatement for those two quarters in full in the third quarter. Revenue presented for the third quarter would therefore include the restatement for inflation corresponding to the third quarter together with the previous two quarters.
- The second option would be to restate each individual quarter for the impact of inflation observed for the corresponding period. In this scenario, first-quarter 2018 revenue would be restated for inflation observed between 1 January 2018 and 31 March 2018, and revenue for the second quarter would be adjusted for inflation observed between 1 January 2018 and 30 June 2018. Revenue presented for the second quarter would also include the impact of the increase in inflation between 31 March 2018 and 30 June 2018 relative to revenue for the first quarter of 2018.

We consider that the second option is preferable given that IAS 29 is applicable from the beginning of the year as if Argentina had always been a hyperinflationary economy. Under the second option, hyperinflation adjustments for periods prior to 1 July 2018 are accounted for in the corresponding period, ensuring better comparability between each quarter. In addition, under the second option, entities could present in 2019 comparative periods for the first two quarters of 2018 restated for hyperinflation.

8- Which general price index should be used?

IAS 29 states that all entities that report in the currency of the same economy should use the same general price index to measure the change in inflation. However, given the lack of reliable locally-published data for certain periods, determining the general price index is a sensitive matter.

The local accounting standard setter in Argentina should provide the table of indices to be used by entities with the functional currency of the Argentine pesos for the application of IAS 29. These indices would be largely based on the Wholesale Price Index for periods up to 31 December 2016 and the Retail Price Index thereafter. The table should be available at www.facpce.org.ar.

9- Which requirements for consolidated financial statements prepared under French GAAP in accordance with the provisions of Regulation CRC 99-02?

The Regulation CRC 99-02 (§ 3210) provides a non-restrictive list of criteria in order to assess whether an economy is hyperinflationary, including whether the cumulative inflation rate over three years is approaching, or exceeds, 100 %. Therefore, groups that issue consolidated financial statements prepared under French GAAP and that have in their scope of consolidation entities whose functional currency is Argentine peso shall restate their primary financial statements based on a historical cost approach.

Paragraph 3211 of the Regulation CRC 99-02 states that the currency of a hyperinflationary economy shall not be used as a functional currency. Entities that are not autonomous shall apply the general rule to convert their financial statements (see § 3200).

For autonomous entities, restatement of primary financial statements of subsidiaries whose functional currency is the one of a hyperinflationary economy must be performed using one of the following two methods (CRC 99-02, § 3211):

- Translating the primary financial statements based on a historical cost approach into another functional currency. The alternative functional currency should be either a stable currency used locally or, by default, the group presentation currency ;
- Translating the primary financial statements using the closing rate but primary financial statements shall previously be restated for inflation. In practice, financial statements are presented in terms of measuring unit current at the closing date by applying a general price index.

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When groups choose to restate the financial statement using a general price index, given the lack of guidance under Regulation CRC 99-02, we consider that the guidance under IAS 29 (as described above) can be applied except for the following two elements:

- CRC 99-02 (§ 313) states that deferred tax liabilities must not be accounted for in respect of temporary differences arising from the increase in value of the non-monetary assets ;
- The impact of restatement on opening equity shall be accounted for in equity (there is no OCI under French GAAP).

Regarding the selection of the general index price, CRC 99-02 does not provide any specific guidance. Therefore, determining the appropriate index may be difficult and requires some judgement. We consider that under French GAAP companies should use the same index as under IFRS (index to be published).

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