Hill House
1 Little New Street
London EC4A 3TR
United Kingdom

Tel: National +44 20 7438 3000
Direct Telephone: +44 20 7007 0907
Direct Fax: +44 20 7007 0158
www.deloitte.co.uk
www.iasplus.com

Deloitte Touche Tohmatsu

13 May 2004

Kevin Stevenson, Chairman
International Financial Reporting Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Kevin,

Applying IAS 29 *Financial Reporting in Hyperinflationary Economies* for the First Time

Deloitte Touche Tohmatsu is pleased to comment on the International Financial Reporting Interpretations Committee's (IFRIC) Draft Interpretation 5-*Applying IAS 29 Financial Reporting in Hyperinflationary Economies for the First Time* (draft interpretation or D5). We concur with the consensus reached on the three issues dealt with by the draft interpretation for the reasons set out in the Basis for Conclusions.

Regarding the issue of how an entity should account for opening deferred tax, we believe IFRIC should consider whether a portion of the restatement of a comparative period should be reflected as part of the net monetary adjustment as opposed to the tax line. This issue is expounded in Appendix A of this letter by reference to the illustrative example.

We concur with IFRIC on clarifying that paragraph 16 of IAS 29 refers to fair value when an independent professional assessment is used in the first period of application. The wording in this paragraph has, to date, led to various interpretations of 'value', some of which are not in line with fair value. In addition to the content of paragraph 6 of the draft interpretation, we believe there would be benefit in IFRIC acknowledging the practical approach taken by certain entities when applying IAS 29 for the first time where professional valuations are available as at a subsequent date. Preparers may apply indices to a valuation amount derived subsequent to the balance sheet date of a prior period and "work back" to determine the restated amount at that prior period balance sheet date using indices and information pertaining to other economic fundamentals. This is a practical application where information pertaining to asset acquisition dates is unavailable.

We are aware that the International Accounting Standards Board (IASB) has considered a comprehensive project of a long-term nature to address broader issues relating to IAS 29 and that the IFRIC was cognisant of this in drawing up the draft interpretation. We believe the guidance appended to the draft interpretation is useful in clarifying the application of IAS 29 in as far as the issues dealt with in D5 are concerned. However, we have reservations regarding the basic nature of the illustrative example as it does not deal with certain issues of a practical and more complex nature, that are currently faced by preparers. The following are some of the more significant issues that the illustrative example does not deal with:

- Determination of fair value in hyperinflationary economies, given the unique functionality of such economies. This includes the existence of price controls and fixed exchange rates. Related to this are the accounting disparities resulting from the significant mismatch of fluctuations in general price indices and foreign exchange rates that may arise in such economies.
- Guidance on the general restatement approach where general price indices and exchange rates are unavailable. Preparers apply pragmatic processes to counteract the lack of detailed information in this regard.
- Cash flow presentation issues including whether an analysis is required between the restatement effect of comparative balances and actual cash flows on monetary balances.
- Treatment of equity items related to cash flow hedges. It is unclear whether such equity items should be treated in a similar manner to revaluation surpluses on property, plant and equipment.
- The different classes of inventories described in paragraph 3 of IAS 2 would require separate consideration under paragraph 14 of IAS 29. This would best be illustrated by expanding the example to include such various sub-classes of inventory.
- Illustration of the identification of borrowing costs that compensate for inflation and those that do not, pursuant to paragraph 21 of IAS 29.
- Income received in advance and prepayments for goods and services, which are common in hyperinflationary economies.

As a result, we suggest that IFRIC consider withdrawing the example completely in light of the limited guidance that it provides, or limiting the example only to an illustration of the deferred taxation issue dealt with by the draft interpretation. If the illustrative example is retained, we believe a cash flow statement, statement of changes in equity and comparatives for each component of the financial statements should be provided in order to make the example complete.

Although addressed in paragraph 3 of the draft interpretation, we are concerned that the illustrative example has not adequately dealt with the restatement of the opening balance sheet at the beginning of the earliest comparative period presented. This process is vital in applying the requirements of IAS 29 correctly. The implicit assumption in the illustrative example, that the restated retained income balance of CU163 reflected on the 20X3 balance sheet is a balancing amount, is incorrect as this should be derived from the statement of changes in equity, had a complete set of financial statements been presented. In applying IAS 29 for the first time, the balancing number in the restatement process should be the retained earnings balance as at 31 December 20X2.

Paragraph 3 of the draft interpretation refers to the restatement of assets and liabilities, but does not include equity. As equity represents a residual interest, it is generally not restated under the historical cost model or the hybrid model currently making up the IFRS suite of Standards for reasons given in paragraph BC 98 of IFRS 2 where the IASB considered exercise date measurement for share options. However, for restatement purposes in line with IAS 29, there is an exception, as issued shares are restated from date of issue together with items such as share premium. As this is a major shift from the norm, we believe reference to equity should be added into paragraph 3 as a potential item requiring restatement. We acknowledge that equity is correctly dealt with in the illustrative example. Similar wording as contained in paragraph 24 of IAS 29 may be used to make this clarification. In addition, we note that certain entities prefer to show equity items such as share capital and share premium at the historical amounts as these are items governed by legislation. In such instances, the effect of restatement is either presented as a separate item of equity or set off against other equity items such as retained earnings. It would be useful if IFRIC clarified in the basis for conclusions whether this application of IAS 29 is appropriate.

The financial assets referred to in the illustrative example are described in the notes as having been classified as available-for-sale. For consistency with the illustrative financial statement structure provided as Guidance on Implementing IAS 1, we suggest that the wording in IAS 1 be used in this example; “Available-for-sale investments”. In addition, we suggest IFRIC specify the exact nature of these investments in the notes to the example (e.g. investment in shares) in order to differentiate them from say, receivables purchased through a securitisation. Although both types of investments would be accounted for as financial assets in terms of IAS 39, receivables are a monetary item and the investment in shares is not. The ramifications in terms of IAS 29 would therefore not be the same for both types of financial assets.

We appreciate the opportunity to provide our comments. If you have any questions concerning our comments, please contact Ken Wild in London at (0207) 007 0907.

Sincerely,

Deloitte Touche Tohmatsu

Appendix A
Income statement classification issue arising on opening deferred taxation restatement

The income statement classification issue arises on the basis that the tax base of an item such as property, plant and equipment is not restated and is therefore akin to a monetary item. We acknowledge IFRIC's observation in BC12 that *"deferred tax items are neither clearly monetary nor non-monetary in nature"* and believe this to be consistent with the manner in which this classification issue arises.

A debit charge for deferred taxation of 34 (151-117) is determined in the illustrative example. This arises after determining the deferred taxation amount of 71 (235 X 30%) at 20X3 measuring units which is then restated to 20X4 units in determining the 117 (71 X 1.652). In determining the 71 (at 20X3) units, the tax base was not restated. However, in restating the 71 to 117 for the effects of hyperinflation in 20X4, the tax base has in effect been restated in a manner similar to any comparative monetary balance. In applying IAS 12, the temporary differences that arise, result in a different amount to be taken to the income statement as the deferred taxation charge or credit for the year. This suggests that a classification issue exists between the tax expense and monetary adjustment items in the income statement.

Deferred taxation computation - restated to 20X4 measuring units

	Carrying amount	**Tax base**	**Temporary difference**	**@30%**
31/12/X3	939	333	606	182
Difference arising on restatement				(65)
Restated deferred taxation balance per illustrative example				117
Depreciation	(235)			
Tax allowances		(133)		
31/12/X4	704	200	504	151
Income statement *charge*				34

By applying the income statement check, the following is determined as the deferred taxation movement for 20X4:

Current temporary differences (235-133)	102
Income statement *credit* (102 X 30%) or (182-151)	31

The charge per the illustrative example is thus made up of:

"Shortfall" on restatement of 20X3 deferred taxation	65
Current temporary differences	(31)
Income statement *charge*	34

Appendix A
Income statement classification issue arising on opening deferred taxation restatement (continued)

The following computation confirms that the CU65 is related to the tax base which has in effect been treated as a monetary item:

Tax base (restated to 20X4 measuring units) (333 X 1.652)	550
Tax base (not restated)	(333)
Difference	217
Tax rate	30%
Effect of restating tax base	65

The above illustrates that the effect of 20X4 temporary differences should result in a deferred taxation credit to the income statement compared to the debit of 34, a difference of 65.

As a result of the above, the following correcting journal entry would be required:

Debit: Monetary adjustment	65	
Credit: Deferred taxation – income statement		65

Although our illustration above is limited to the effect of property, plant and equipment, we draw your attention to the fact that the same issue applies to other balances, in particular inventory which generally has a material impact. We note that paragraph 18 of Appendix A to IAS 12, does not specify in "note 1" which line item in the income statement should contain the effect of such restatement. As a result, we believe IFRIC guidance would be appropriate.