30 November 2010

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

Email: CommentLetters@ifrs.org

Dear Sir/Madam

SAICA SUBMISSION ON EXPOSURE DRAFT ON *SEVERE HYPERINFLATION* – PROPOSED AMENDMENT TO IFRS 1

In response to your request for comments on the IASB's exposure draft on *Severe Hyperinflation* – Proposed amendment to IFRS 1, attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

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SAICA SUBMISSION ON EXPOSURE DRAFT ON *SEVERE HYPERINFLATION* (PROPOSED AMENDMENT TO IFRS 1)

GENERAL COMMENTS

We are supportive of the Board's proposal to assist entities resuming presenting financial statements in accordance with IFRSs after a period of severe hyperinflation. In addition, we agree with the Board's assertion that its proposal to amend IFRS 1 – *First-time Adoption of International Financial Reporting Standards,* would provide timely guidance to those entities that were unable, for a period of time, to prepare financial statements in accordance with IFRSs because of severe hyperinflation. However, we have some concerns regarding the scope of the proposals and the application of the entity's date of transition to IFRSs.

Question 1 – Severe hyperinflation exemption

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?

Yes, we agree that an entity that was previously unable to present financial statements in accordance with IFRSs as a result of severe hyperinflation should be allowed to apply the proposed exemption. However, we have certain comments we would request the IASB to consider during the final drafting of the proposed amendment.

<u>Scope</u>

It would appear to be the Board's intention, as articulated in BC7 of the exposure draft, that the proposed amendment's scope should be limited. While we acknowledge the Board's practical concerns that resulted in entities been allowed to apply the exemption on or after the functional currency normalisation date, it is our view that the severe hyperinflation exemption as currently drafted would be available to any entity transitioning to IFRS who operates/operated in an economy that was subject to severe hyperinflation at any time prior to the entity's transition to IFRS. For example, an entity's functional currency that was subject to severe hyperinflation 10 years prior to its transition to IFRSs could be considered to be within the scope of the proposed exemption.

Currencies subject to hyperinflation do lack both reliable price indices and exchangeability from time to time. As a consequence, these currencies might be considered to have been subject to severe hyperinflation. Our concerns could be addressed by limiting the proposed exemption in D27-D30 to assets and liabilities required to be indexed in accordance with IAS 29 – *Financial Reporting in Hyperinflationary Economies*. We believe that such a requirement would not be unduly onerous for first-time adopters, because the requirement to apply IAS 29 for periods before the date of transition to IFRSs is already required as explained in IFRS 1 paragraph BC67.

For example, a company that was subject to severe hyperinflation 10 years prior to its date of transition to IFRSs may, for example, on transition hold monetary assets, liabilities and non-monetary assets acquired both before and after its functional currency normalisation date. As currently drafted, the entity may apply the exemption to all of its assets and liabilities. It would need to be clarified if this was the Board's intention in this regard. It may be argued that entities subject to severe hyperinflation many years ago may be able to apply the exemption.

<u>Date of transition to IFRSs</u>
The Board currently proposes that when an entity's date of transition to IFRSs is on, or after, the functional currency normalisation date, the entity may, in its opening IFRS statement of financial position, apply the severe hyperinflation deemed cost exemption. We believe the requirement for the date of transition to IFRSs to be on, or after, the functional currency normalisation date when read in conjunction with IFRS 1 paragraph 21 will create practical application difficulties. The severe hyperinflation exemption may be available to entities with the same year-end for different financial reporting periods because of when their functional currency changed. This can best be illustrated by the following example:

Company A and B both have a December year-end and prior to September 2008; both consider the Zimbabwean Dollar (ZWD) to be their functional currency. During October 2008 Company A changed its functional currency to the US Dollar (USD) because it was able to trade in foreign currency. Company B only changed its functional currency at the beginning of February 2009 because it was unable to trade in foreign currency before this date.

On transition to IFRS, Company A and B shall consider whether their functional currency normalisation date (date of change of functional currency) is on or after their date of transition to IFRSs. Company A may elect the severe hyperinflation exemption in its December 2010 financial statements because its date of transition to IFRSs (1 January 2009) is after the date the entity changed its functional currency (October 2008). In contrast, our constituents expressed different views around the first year-end Company B could present its IFRS financial statements utilising the proposed exemption as currently drafted:

a) 31 December 2011. The entity requires a full calendar year for comparative financial information, therefore its date of transition is 1 January 2010.
(b) 31 December 2010. The entity's date of transition to IFRSs could be viewed as 1 February 2009. As a consequence of the 11 month comparative period, the entity would disclose that its financial statements are not entirely comparable.

We propose that the exemption should clearly state whether entities previously subject to severe hyperinflation should be allowed to prepare their opening IFRS statement of financial position on the functional currency normalisation date, i.e. the functional currency normalisation date would be the entity's date of transition to IFRSs. The exemption should also clarify whether the comparative financial period presented may be less than a full calendar year as IAS 1 – *Presentation of Financial Statements,* provides guidance in paragraph 36 that would require the entity to provide the reason for using a shorter period and the fact that amounts presented in the financial statements may not be entirely comparable. Some of our constituents are of the view that the above would only apply if an entity changes its reporting period. As the year end has remained as December, some constituents are of the view that this paragraph cannot be used to justify a comparative financial period that is less than a financial year.

In addition, both approaches above assume comparative information being provided. This raises a question as to whether the amendments should not have made provision for an entity with a functional currency normalisation date and date of transition to IFRSs as 1 February 2009 to be able to prepare IFRS compliant financial statements at 31 December 2009 without the need to provide comparative information. We believe the Board should consider this when finalising the amendments.

Application of the exemption

The application of the severe hyperinflation exemption in the context of an entity adopting IFRSs, as it is currently drafted, is unclear. While we understand that the severe hyperinflation exemption is optional, it has been questioned whether an entity that elects the severe hyperinflation exemption shall apply it to all its assets and liabilities, even those not subject to severe hyperinflation, and whether the other exemptions contained in IFRS 1 are available to the entity.

Entities may not want to apply the severe hyperinflation exemption to all their assets and liabilities, especially those not subject to severe hyperinflation. For example, an entity has receivables and payables denominated in a currency other than the currency subject to severe hyperinflation that it would not want to fair value. The entity may know the amortised cost carrying value of the instrument in its host currency, and might elect to translate the amortised cost at the prevailing spot rate on the date of transition to IFRSs. Another example where an entity may prefer to use its previous carrying instead of fair value as deemed cost would be for the assets and liabilities of a subsidiary operating in an economy not subject to severe hyperinflation that prepares IFRS financial information.

The Board could clarify the application of the severe hyperinflation exemption by including the exemption alongside the other guidance in IFRS 1 dealing with fair value or revaluation as deemed cost, i.e. paragraphs D5 to D8. This would clarify that the exemption may be applied on an item-by-item basis.

Question 2 – Other comments

Do you have any other comments on the proposals?

We request the Board to consider for its future agenda the replacement/revision of IAS 29 – *Financial Reporting in Hyperinflationary Economies*, because the practical application of the current standard is complex. Many of our constituents with investments in Zimbabwe have indicated that, in their experience, current cost financial statements start to lose their reliability once inflation levels start to reach approximately 50% per month. We would urge the Board to draw on the experience of the Zimbabwean accounting profession should it take the replacement/revision of IAS 29 onto its agenda.

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