UNICE
THE VOICE OF BUSINESS IN EUROPE

22.7/8/1 27 April 2004

Mr Patrick Mommens
Project Manager
EFRAG
41 Avenue des Arts
1040 Brussels

Dear Mr Mommens,

RE: DRAFT EFRAG LETTER ON IFRIC D5 APPLYING IAS 29 FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES FOR THE FIRST TIME.

In response to your consultation on the EFRAG preliminary views on IFRIC draft interpretation *Applying IAS 29 Financial Reporting in Hyperinflationary Economies for the First Time* published on 11 March 2004, UNICE would like to offer the following remarks.

UNICE agrees with the general acceptance of the approach on deferred taxes but very much disagrees with other major conclusions. We focus on the issue of application for the first time in an existing IFRS environment. The relationship with IFRS 1 for first-time application of IFRS should be distinguished from, but derive from conclusions on, this primary issue. Unfortunately there appears to be some confusion of these two separate matters in D5.

As a starting point, UNICE is of the opinion that IAS 29 itself is a poor, low-quality standard in direct need of replacement with a more practical and meaningful approach - at least as an alternative for the purpose of multinationals' consolidation of financial statements of subsidiaries in hyperinflationary economies. This point has been repeatedly made to the IASB, to no avail (UNICE letters to IASB of 11 September and 16 October 2003 available on request) . The unfortunate result is that D5 is "putting a patch on a patch", as one commentator phrased it.

D5 concludes that, when an entity first identifies the existence of hyperinflation, its opening balance sheet "shall be restated to reflect the effect of inflation from the date when the assets were acquired..." For UNICE, this conclusion is not only wrong based on the relevant standards themselves but, it is also wrong from a practical viewpoint and - last but not least - conflicts with pragmatic common sense by requiring the application of hyperinflation procedures to data covering periods without hyperinflation.

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From the viewpoint of existing standards:

The purpose of IAS 29 is to generate useable financial information in circumstances when hyperinflation renders the monetary unit of measurement unacceptably unreliable as a basis. When those circumstances do not exist, no special adjustment is required to the financial information generated by other IFRS. To require the retrospective adjustment for periods when hyperinflation did not exist would produce quite inconsistent results.

In an entity operating in an economy which has enjoyed a low rate of inflation over many years but which suddenly experiences hyperinflation, the financial data relating to those earlier years would effectively be restated according to D5. On the other hand, those relating to the same years in an entity operating in an economy which does not experience such a change would not be restated. It is illogical to require application of rules designed for hyperinflationary situations to circumstances when there was no hyperinflation. Common sense dictates that restatement should be required only for hyperinflationary situations, which is also the implication of IAS 29, para. 4 saying that it applies "... **from the beginning of the reporting period in which [the entity] identifies the existence of hyperinflation**..."

This would also be consistent with the thrust of IAS 8: para. 16 in the revised version regards "the application of a new accounting policy for transactions, other events or conditions that did not occur previously ..." [e.g. hyperinflation] as **not** requiring retrospective adjustment. In short, it is in periods of hyperinflation that we need to make adjustment, not for periods when inflation is low.

The proposed D5 approach to data covering previous periods (i.e. retrospective adjustment) would be totally at variance with IAS 29's approach when an economy ceases to be hyperinflationary. Here, the entity discontinues use of IAS 29 prospectively (cf. para. 38).

The inconsistency between IAS 29, para. 34 (requiring restatement of comparatives for the changed conditions), and IAS 8 (revised), para. 16 (no retrospective adjustment for changed conditions) is a problem of existing standards, which is beyond the remit of IFRIC other than to point it out to the Board.

For the reasons given above, IAS 8 and IAS 29, para. 4, are in our view reasonable, justifiable and conceptually correct: the Board therefore needs to take steps to rectify IAS 29, para. 34. A practical, pragmatic approach to this could be to say that the financial data should be restated for the two years prior to that in which hyperinflation is identified if, and only if, the cumulative inflation rate for those two years exceeded 50%, but such restatements would be restricted to the inflation during those two years (i.e. not back to asset acquisition date).

From the practical viewpoint:

The D5 proposal is also unacceptable because restatements through adjustment back to asset acquisition date would be much more difficult and burdensome than the simple illustration given suggests and, since by definition they cover non-hyperinflation periods, such restatements would not generate more useful information for users. The system costs alone would generally be appreciable, and the on-going costs involved for entities as economies swing into and out of hyperinflation would be unlikely to be recouped in benefits of more useful information.

It is improbable that such restatements would be of use to local management in running the business: the IAS 29 approach is in any case often regarded as risible by many with local experience of such environments. (Often bizarre results currently emerging in Turkey from application of its Capital Markets Board's new inflation accounting rules well illustrate its weaknesses). Hence, a further wedge would be driven between management information and external financial reporting.

The alternative of having an appraisal exercise carried out, involving real cash costs to shareholders and/or customers without any significant benefit to the users of financial statements, is unjustifiable - especially as subsequent restatements would be purely arithmetic on the basis of indices of often dubious reliability and accuracy.

Alternative

The IASB has repeatedly been asked to consider permitting, for use in the consolidated financial statements of multinationals with non-hyperinflationary presentation currencies, the alternative hard-currency accounting approach for subsidiaries in hyperinflationary economies where it is deemed more appropriate in the particular circumstances. The IASB's unwillingness to give this serious consideration not only leaves an often significant divergence from US GAAP but also eliminates the possibility of giving the users of those consolidated financial statements financial information which is in many instances more meaningful and reliable than IAS 29 and leaves IFRIC with the unenviable task of having to provide impractical solutions to avoidable problems.

UNICE hopes that the above-mentioned concerns are taken into account in the EFRAG response to this matter and remains at your disposal should you need further clarification.

Yours sincerely,

(original signed by)
Jérôme P. Chauvin
Director, Company Affairs Department