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Straight away

IFRS bulletin from PricewaterhouseCoopers

Venezuela enters hyperinflation

What is the issue?

Inflation in Venezuela has been high for a number of years, and cumulative inflation for the three years ending 30 November now exceeds 100%. Venezuela should therefore be considered a hyper inflationary economy, and IAS 29, 'Reporting in hyperinflationary economies', should be applied by entities in Venezuela in financial statements for the year ending 31 December 2009. IAS 29 should also be applied to restate the financial statements of subsidiary entities based in Venezuela before they are included in the consolidation.

This 'Straight away' explains why Venezuela is now hyperinflationary and the consequences for financial reporting.

Why is Venezuela hyperinflationary?

Quantitative factors

IAS 29 states that a cumulative inflation rate over three years at or approaching 100% is an indicator that an economy is hyper inflationary. Entities in Venezuela have previously used the Consumer Price Index (CPI) to measure inflation, although the CPI covers only the cities of Caracas and Maracaibo. The cumulative three year inflation rate using this index exceeded 100% at the end of October 2009.

The National Consumer Price Index (NCPI) has been developed to cover the entire country but only has data since 1 January 2008. Some entities have used a blended NCPI and CPI to measure inflation; the cumulative three year inflation rate using this index is 101% at the end of November 2009.

Qualitative factors

IAS 29 also requires a number of qualitative factors to be considered to determine whether an economy is hyperinflationary. The qualitative characteristics in the case of Venezuela are as follows:

- The population in Venezuela prefers to keep its savings in US dollars or other hard currencies.
- The exchange rate to the US dollar is fixed by the government at Bs2.15/US$1 and has not increased since 2005. However, the access to US dollars at the official exchange rate is limited to a list of goods and services determined by the government.
- Delays in obtaining US dollars at the official exchange rate and the removal of some products from the official list of items that may be imported using US dollars have led to an increase in transactions using a parallel currency market – a legal mechanism to buy hard currency outside the official arrangements. The exchange rate in the parallel market is now approximately Bs6/US$1.
- Many prices and agreements in Venezuela are calculated in US dollars, using the parallel exchange rate.
- Sales and purchases are generally calculated using the parallel exchange rate, giving a margin for protection that is higher than the official rate of inflation.
- Many prices are linked to the inflation index, as price controls on some goods and services keep the inflation rate at a monitored level. Interest rates are set by the Government and are controlled at high levels but are not linked specifically to inflation. Wages are increased in many cases by inflation or a specific index.

The qualitative indicators also indicate the characteristics of a hyperinflationary economy.

Who is affected?

Entities with a Venezuela Bolivar functional currency – restatement is required

IAS 29 para 4 and IFRIC 7 para 3 require the financial statements to be restated in the reporting period in which an entity identifies the existence of a hyperinflationary economy. IAS 29 should be applied as if the economy had always been hyperinflationary. Transactions in 2009 and non-monetary balances at the end of the year should be restated to reflect a price index current at the balance sheet date. The comparatives and the opening statement of financial position at the beginning of the earliest period should also be restated to reflect a price index current at the balance sheet date.

A summary of the accounting required by IAS 29 and the restatement process is available for internal and external users on PwC inform (and internally on the IFRS NoE). A more detailed description of the restatement procedures and some illustrative examples are contained in Chapter 6 of the IFRS *Manual of Accounting 2010* and the publication of *Financial Reporting in Hyperinflationary Economies – Understanding IAS 29*. Venezuela will also become hyperinflationary under US GAAP. The US accounting model is different to IFRS and entities will transition to hyperinflation accounting and apply the principles required by US GAAP in 2010.

Entities with a subsidiary that has a Venezuela Bolivar functional currency

Group reporting – hyperinflation

A parent that reports its consolidated financial statements in a currency of a non-hyperinflationary economy (a 'stable currency') should restate the financial statements of a subsidiary with the Venezuelan bolívar as its functional currency in accordance with IAS 29 before inclusion in the consolidation. All amounts for the current period should then be translated into the stable currency at the closing rate for inclusion in the consolidation. The comparatives, which were presented as current year amounts in the prior-year financial statements in a stable currency, are not restated (that is, they are not adjusted for subsequent changes in the price level or subsequent changes in exchange rates) in accordance with IAS 21 para 43 and IAS 21 para 42(b). The resulting difference is recognised as a movement in the equity items to which it relates.

Group reporting – translation

The rate used to translate a net investment is often the dividend remittance rate, but another rate may be more appropriate if the proceeds would in practice be remitted in another way. Where a country has multiple exchange rates, judgment is often required to determine which exchange rate qualifies as a spot rate that can be used for translation under IAS 21. An entity should consider whether currency can be obtained at an official quoted rate and whether the official rate is available for immediate delivery and is therefore a spot rate. A normal administrative delay in obtaining funds would not mean that a rate is not a spot rate.

Management should consider the level of access to the official exchange market in Venezuela and whether the official rate is a spot rate. Where an entity is unable to access money on the official market on a timely basis, it might be appropriate to use the parallel exchange rate to translate the results and balance sheets of foreign operations that have the Venezuelan Bolivar as functional currency.

For more information, speak to your local PwC contact.

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