Notice No. PN2024-009

UPDATE ON THE APPLICATION OF IAS 29 *Financial Reporting in Hyperinflationary Economies* ("IAS 29")- IN MALAWI

INTRODUCTION

The Institute of Chartered Accountants in Malawi ("ICAM" or the "Institute") has sighted publications including the IMF World Economic Outlook reports and the International Practices Task Force (IPTF) reports which have considered Malawi to be potentially hyperinflationary by 31 December 2024. ICAM respects such views but points out that such publications are **neither determinative nor represent the official position of the Institute of Chartered Accountants in Malawi.** The Institute is a body mandated by the Public Accountants and Auditors Act of 2013, to approve, adopt and promote implementation of accounting standards in Malawi.

The argument that Malawi's economy will be potentially hyperinflationary for financial reporting purposes seems to be based on a quantitative factor that suggests that Malawi's 3-year cumulative inflation will be 100% or exceed 100% by the end of December 2024.The Institute has held a series of meetings with local firms, regulators and other stakeholders on the applicability of IAS 29 in Malawi. This paper is an update on the communication issued by the Institute in June 2024.

In 2001 Malawi adopted International Financial Reporting Standards (IFRSs) as the basis for financial reporting. The standards provide a guide on how entities should report under certain conditions. In the case of a hyperinflationary economy, the reporting standard that deals with reporting in such a condition is IAS 29 – *Financial Reporting in Hyperinflationary Economies*. This standard applies when an entity's functional currency is that of a hyperinflationary economy.

1. Determining Whether an Economy is Hyperinflationary

Establishment of when an economy becomes hyperinflationary and more importantly, when it ceases to be so requires careful consideration of the prevailing economic indicators. **The Standard does not place premium on quantitative factors over qualitative indicators or vice versa. In this context, determining** whether an economy is hyperinflationary, in accordance with IAS 29, requires **professional judgement**. The following characteristics of a country's economic environment are considered strong indicators of the existence of hyperinflation (IAS 29.3):

a) The general population prefers to keep its wealth in non-monetary assets or a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power;

b) The general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency;

c) Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short;

d) Interest rates, wages, and prices are linked to a Consumer Price Index (CPI): and

e) The cumulative inflation rate over three years' approaches, or exceeds, 100%

2. The Situation of the Malawi Economy

2.1 Cumulative Inflation

The computation of cumulative inflation is based on CPI statistics released by the National Statistical Office (NSO) every month, the latest as of the date of the assessment being June 2024 publication.

The three-year assessment points were from June 2021. The cumulative inflation as of June 2024 was **109.6%** (CPIs for the assessment points being: 88.5 for June 2021, 109.3 for June 2022, 139.1 for June 2023, and 185.5 for June 2024 [calculated as (185.5/88.5)-(1)]*(Source: National Statistical Office, June 2024).*

2.2 The Impact of a Once-off Alignment of the Malawi Kwacha in Relation to Other Foreign Currencies

The impact of the devaluation of the Malawi Kwacha against the United States Dollar from USD/MK1,180.29 to USD/MK1,700.00 in November 2023, and a further devaluation in March 2024 to USD/MK1,751.00 has significantly influenced the cost of goods and services. This is because Malawi is predominantly a net importer, such that adverse movements in foreign exchange rates influence upward adjustment of prices.

3. Observations

Applying due professional care and judgement, the Institute has observed as follows with regarding each of the determining factors of hyperinflation:

Indicator	Observation
a) The general population prefers to keep its wealth in non-monetary assets or a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power	(i) There is no evidence to suggest that the general population keeps wealth in monetary assets denominated in a foreign currency other than Malawi Kwacha. (ii) There is no evidence to confirm that amounts of local currency are immediately invested to maintain the purchasing power.
b) The general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency	(i) Prices are quoted in Malawi Kwacha, and the general population still regard monetary amounts in the local currency.

Indicator		Observation
c) Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short	(i)	There is no evidence to confirm that sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power even in the short term.
	(ii)	Sales and purchases are based on historical cost (landed cost or past production cost) and not linked to purchasing power.
d) Interest rates, wages, and prices are linked to a Consumer Price Index (CPI)	(i)	Wages are fixed and are not linked to the CPI
	(ii)	Several organizations made a once-off adjustment of salaries and wages to compensate for the loss in purchasing power due to the impact of the devaluation of the local currency.
	(iii)	There is no evidence to suggest that prices are linked to the CPI.
	(iv)	Interest rates for commercial banks appear to respond to changes in the CPI. However, micro-finance institutions currently do not link their lending rates to changes in the CPI.
e) The cumulative inflation rate over three years' approaches, or exceeds 100%	(i)	The cumulative inflation rate over a three-year period has exceeded 100 percent (**109.6 percent** as of 30th June 2024), based on statistics released by the NSO. The year-on-year inflation as of June 2024 was 33.3% pushed mainly by food inflation which was around 41%. Non-food inflation has remained relatively stable at 22%. However, food inflation should ease, as it was temporarily affected by supply side effects occasioned by significant weather shocks.
	(ii)	A large contribution to the elevated cumulative Inflation comes from the once-off exchange rate adjustments undertaken in May 2022 and November 2023. Minus these shocks, inflation has not risen abnormally in the country.
	(iii)	Since weather shocks have affected food production thereby pushing up food inflation, there are significant efforts to sustain food supply and production which will help to stabilise and bring down food inflation in the short to medium term.

Indicator	Observation
	(iv) The country is currently implementing an IMF supported Extended Credit Facility program. The macroeconomic adjustments under the program are aimed at improving the country's external sector resilience and reducing inflation. This too has potential to reduce inflation and stabilise the economy. (v) The Government, through RBM, is taking measures aimed at improving its foreign currency reserves, which is one of the key factors that influences inflation. The Government has already taken steps to reduce the food deficit, which also influences inflation in Malawi. It is expected that these initiatives will push inflation downwards *(source: https://times.mw/reserve-bank-of-malawi-dismisses-devaluation-talk/.)*

4. Conclusion

Considering that the objective of IAS 29 is to provide reporting guidance for entities operating in a hyperinflationary economy, in order to provide meaningful financial information, the Institute would like to guide that, **all factors considered**, Malawi's economic environment is **not "hyperinflationary"** in terms of IAS 29, and that **"hyperinflationary reporting"** prescribed by the standard is therefore "**not applicable**".

The Institute will continue to monitor the economic environment in the country and advise stakeholders accordingly.

Moffat Ngalande.

CA. Moffat Ngalande
ICAM President
6th August 2024