In brief

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FX and inflation; Turkey expected to be highly inflationary

At a glance

Inflation is increasing across the globe, which can devalue currency. Cumulative inflation in Turkey is expected to exceed 100%, in which case it would be deemed to be highly inflationary under US GAAP.

What happened?

Continuing pressure on the global supply chain, increasing energy prices, the war in Ukraine, and the continuing economic impacts resulting from the COVID-19 pandemic are expected to continue to push inflation higher on a global basis. Under ASC 830, *Foreign Currency Matters*, a highly inflationary economy is one that has cumulative inflation of approximately 100% or more over a three-year period. As of the end of February 2022, the three-year cumulative inflation rate for the country of Turkey reached 100.6%.

Turkey's inflation rate

Turkey's inflation rate has exceeded forecasts for each of the past four months. The month of February saw Turkey's annualized inflation rate hit 54.44%, the highest level the country has seen in 20 years. As a result, Turkey saw its three-year cumulative inflation rate increase from 52.9% at the end of November 2021 to 100.6% at the end of February 2022. These figures are derived from source data published by the Turkish Statistical Institute and were included in the *Addendum to the November 6, 2021 International Practices Task Force Document for Discussion, Monitoring Inflation in Certain Countries*. The determination of a highly inflationary economy is performed by calculating the cumulative inflation rate for the three years that precede the beginning of the reporting period, including interim reporting periods. For example, for calendar year-end reporting entities that report on an interim basis, Turkey is expected to be considered a highly inflationary economy as of April 1, 2022, unless there is a significant reversal of current inflation trends.

Why is this important?

ASC 830-10-45-11 requires that the financial statements of a foreign entity in a highly inflationary economy be remeasured as if the functional currency were the reporting currency. Therefore, a reporting entity with a US dollar reporting currency would be required to change the functional currency of their Turkish operations to the US dollar.

A change in functional currency can have a meaningful impact on a reporting entity's financial statements. For example, monetary assets and liabilities denominated in the Turkish Lira will need to be remeasured into the new functional currency each reporting period, with changes in that value recorded through earnings. See Chapter 6 of PwC's *Foreign currency* guide for additional information on accounting for operations in highly inflationary economies.

Importance of monitoring other economies

Global inflationary pressures are not expected to ease in the near term. Reporting entities should ensure they have effective processes and controls to monitor inflation in all countries in which they operate.

What's next?

Reporting entities with material operations in Turkey should evaluate the reporting period in which they should start to consider Turkey as highly inflationary. Calendar year-end reporting entities (that report on an interim basis) with operations in Turkey should be prepared to account for Turkey as highly inflationary as of April 1, 2022.

To have a deeper discussion, contact:

Thomas Barbieri
Deputy Chief Accountant
Email: thomas.barbieri@pwc.com

Christopher Gerdau
Partner
Email: christopher.gerdau@pwc.com

John Horan
Managing Director
Email: john.f.horan.iii@pwc.com

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