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Patrina Buchanan
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: Draft Technical Correction 1: Proposed Amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates*—Net Investment in a Foreign Operation

On behalf of the Technical Expert Group of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on Draft Technical Correction 1: Proposed Amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates*—Net Investment in a Foreign Operation (DTC1).

This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of any final Technical Correction based on DTC1.

We would at the outset like to make clear that we are very pleased to see the IASB moving so swiftly to address what it perceives to be an error in an existing standard. We accept that in practice errors will occur from time-to-time, and when that happens the best thing for all concerned is to deal with the error as quickly as possible. That is what the IASB is seeking to do.

Our more detailed comments are as follows:

- 1 We agree with the amendment that is being proposed to paragraph 33 of IAS 21.
- 2 There is a second, completely separate, draft technical correction that is proposed in DTC1, involving the amendment of both IAS 21 (by amending paragraph 15 and adding paragraphs 15A and 15B) and IAS 28. It would appear that the objective of these amendments is to clarify which items comprise a net investment in a foreign operation. This draft technical correction appears to receive no mention in DTC1's background section or invitation to comment. Furthermore, the brief reference to it in DTC1's Basis for Conclusions seems incomplete (because it does not, for example, explain what the perceived problem is with the existing wording in IAS 28 that DTC1 is proposing to amend).
 - (a) We agree with the amendments that are being proposed to IAS 21, although we think it essential that any final Technical Correction more fully explain the reason for making the specific changes being made.
 - (b) Bearing in mind the absence of any explanation as to the precise weakness the IAS 28 amendment is seeking to address and our own uncertainty as to what is the perceived problem, we are not able to support this aspect of the draft technical correction.

- 3 As you will be aware, we have responded to the IASB's draft Technical Corrections policy and, in that response, we have raised some concerns about the proposed process. During our consideration of DTC1, some additional process issues arose. We also have some concerns about the IASB's decision to issue the first draft Technical Correction before finalising the Technical Corrections Policy. These issues and concerns are set out in the appendix to this letter.

Yours sincerely

Stig Enevoldsen
Chairman
EFRAG

Appendix: Further comments from EFRAG on the Technical Corrections process

- 1 We note that the IASB has chosen to issue DTC1 before it has finalised its Technical Corrections Policy. We hope that this is not precedential, because such an approach gives the impression—and creates the risk—that the IASB is not really interested in the views of commentators on its draft Policy. It also makes it more difficult to comment on DTC1—particularly if one has significant concerns about some or all of the draft Policy, as we do—which in turn increases the risk of the comments you receive being misunderstood.
- 2 One of the proposals in the draft Policy on Technical Corrections is that both the draft and final amendment will be published in only two forms—electronically and in *IASB Update*. We supported this proposal in our comment letter on the IASB's Technical Corrections process.

Similarly, we support the overall objective of the draft Policy on Technical Corrections, which is to enable certain types of amendments to IFRS to be made quickly. However, we understand that DTC1 would have been published earlier (perhaps several weeks earlier) had it not been necessary to publish it in *IASB Update* at the same time as it was published electronically. Thus, it would appear that the proposal in the draft Policy—that the draft and final Technical Corrections should be published electronically and in *IASB Update* paper—and the way that proposal is currently being interpreted—that publication electronically should take place on the same date as publication in *IASB Update*—will not always be consistent with the objective of making the amendments as soon as possible.

We suggest therefore that the IASB consider either:

- (a) publishing draft Technical Corrections in electronic form only; or
- (b) ceasing the practice of publishing draft Technical Corrections in electronic form and in *IASB Update* on the same day, and instead publish the drafts electronically first and in *IASB Update* as soon as possible thereafter. If the IASB adopts this approach it should also make it clear that the 30-day comment period runs from the earliest publication of the draft.

We think that the way in which the IASB dealt with the publication of the IFRSs 1 and 6 amendments back in April might be a good way to approach Technical Corrections. (The IASB agreed at its meeting on 19 April that it should propose making what was in effect a technical correction to IFRS 1 and IFRS 6. Ten days later it issued *IASB Update*, which explained the decision and the amendment being proposed and informed readers that there would be a 30-day comment period; the draft amendments themselves were published subsequently when as soon as they were ready.) We suggest that the Technical Correction policy should state that, if the Technical Correction is not ready to be published at the time the *IASB Update* issued shortly after the meeting is issued, a note should be included in the *IASB Update* issued shortly after the Board meeting announcing that a Technical Correction is to be proposed, explaining the actual correction being proposed in as much detail as is at that time available, and reminding readers that they will have only 30 days from the publication date in which to respond. The draft Technical Correction can then be published as soon as possible thereafter electronically.

- 3 The draft Policy on Technical Corrections proposed that the only issues that should be addressed through the new procedure are:
 - (a) issues for which it is clear that the words in a standard do not properly convey the Board's intention, even when considered with the basis for conclusions and any related guidance; or

- (b) unexpected consequences of a standard that the Board would have corrected, had it been aware of them when the standard was issued.

Unfortunately the Basis for Conclusions does not explain which of these types of issues the IASB believes it is dealing with in DTC1, nor why the IASB believes the issue in DTC1 falls within that category. We think such explanations should always be included in the Basis for Conclusions of future draft Technical Corrections.

- 4 Our understanding is that the Board believes the issue addressed in DTC1 is an example of an unexpected consequence of a standard that the Board would have corrected, had it been aware of them when the standard was issued (in other words, an issue falling within (b) of the paragraph above). We do not believe that is correct.

It appears that the error the Board believes has occurred is that it included in the IFRS words that restricted the monetary items included as part of the reporting entity's net investment in a foreign operation to those monetary items that are denominated in the functional currency of either the reporting entity or the foreign operation. However, the words included could have had no other consequence than to impose that restriction. Therefore, the effect of including the words could have been unintended only if the IASB expected the words to have no effect in practice, and we doubt that the IASB would include words in a standard that were expected to have no practical effect.

It seems to us that the actual position is that, due to an oversight (on the part both of the IASB and of those that responded in the exposure draft, including EFRAG), words were included in the standard that should not have been included in the standard because the IASB did not want to achieve the effect that the words would have. Although that is, in our view, a very good reason for changing the standard, it does not mean that the draft Policy's definition of a Technical Policy has been met.

- 5 When we commented on the draft Policy on Technical Corrections, we expressed some concern about the policy's description of the issues that would be addressed through Technical Corrections. In particular, we did not believe that (a) and (b) in the paragraph 3 of this appendix describe the sort of issues that should be addressed through a fast-track mechanism of the type described in the draft policy. For that reason our response to the point made in paragraph 4—that the amendment proposed in DTC1 is not a technical correction as currently defined—would be to change the definition in the draft Policy, rather than to abandon the attempt to deal with this issue through a Technical Correction.

In our response to the draft Policy we suggested that the definition should be amended so that the new procedure applies only to where the fact that there is an error, and the way in which the error should be corrected, is obvious to everyone. We are not sure whether it is obvious to everyone that the issue being addressed in DTC1 is an error—IAS 21's Basis for Conclusions does not discuss the paragraphs being amended so it is difficult to be sure what the expected consequences of the paragraphs were. However, we agree that, having concluded that there is an error and what its nature is, the way in which it should be corrected is obvious.

We proposed our 'obvious to all' test because we believe that a fast-track process should be used only when there is no realistic possibility of the proposed amendment being controversial. We believe that is so in the case of DTC1.

- 6 As mentioned earlier, the underlying objective of the Technical Corrections policy is to make it possible to make certain changes to IFRS more quickly than at present. We support this basic objective. However, the endorsement process that all standards, IFRIC interpretations and (presumably) Technical Corrections have to go through in Europe makes it difficult for any change to endorsed IFRS to be made

quickly in Europe. The draft Policy states that, generally speaking, Technical Corrections will come into effect immediately on issue. Thus, when the IASB issues a Technical Correction that amends an IFRS that has already come into effect, IFRS as issued by the IASB (IASB IFRS) will differ from EU-adopted IFRS until Europe has been able to endorse the Technical Correction. Furthermore, until Europe has been able to endorse the Technical Correction, it will be the EU-adopted version of IFRS that European companies will be required to comply with. If it is not possible to comply with both EU-adopted IFRS and IASB IFRS, entities will have to depart from IASB IFRS. It would be very unfortunate if an entity that has adopted IASB IFRS and wishes to continue to adopt IASB IFRS is forced to stop adopting it because of a Technical Correction that it cannot apply because it has not been endorsed and is inconsistent with EU-adopted IFRS. Clearly this is an issue that Europe needs to think about further to see what can be done to address the problem; we think it is also an issue that the IASB could usefully give further thought to, particularly in view of the statement in the draft Memorandum of Understanding on the role of Accounting Standard-Setters and their relationship with the IASB that the IASB “should provide a reasonable lead time to allow other standard-setters to process the IFRSs for application in their local regulatory framework so that they have every opportunity to establish and maintain a set of standards that enable their constituents to continue to make an unreserved statement of compliance with IFRSs.”

- 7 We also note that the draft Policy states that, generally speaking, Technical Corrections will apply retrospectively. This may be a problem in jurisdictions where IFRS are part of law because there is, in such circumstances, a limit to the extent to which the law permits rules ~~can~~ to be applied retrospectively. We intend to discuss this matter further with the European Commission to try to ensure that it does not become a problem in practice in Europe. It may also be a practical problem if the Technical Correction is issued quite late in the reporting period when the entity has insufficient time to make the necessary calculations and adjustments.