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Dear Patrina

Draft Technical Corrections to IAS 21 *The Effects of Changes in Foreign Exchange Rates* - Net Investment in a Foreign Operation

We appreciate the opportunity to comment on Draft Technical Correction 1 ("DTC 1") Proposed amendments to IAS 21 *The Effects Of Changes In Foreign Exchange Rates* - Net Investment in a Foreign Operation. This letter expresses the views of the international network of KPMG member firms.

We support the changes proposed in DTC 1 to IAS 21. However, from a process standpoint we are concerned that the Board is using its *Proposed Policy on Technical Corrections* ("the proposed policy") to change a standard when the proposed policy is in 'draft' and has neither been reconsidered in light of the views provided by constituents nor ratified by the Board. We set out our views in more detail in the remainder of this letter.

Net investment in a foreign operation

We support the clarification in DTC 1 that a reporting entity or any of its subsidiaries which have a monetary item that is receivable or payable to a foreign operation, for which settlement is neither planned nor likely to occur in the foreseeable future, is in substance a part of the entity's net investment in that foreign operation. This clarification is consistent with our current interpretation of the standard. However, we are not convinced by the argument used in the Basis for Conclusions, paragraph 7, that control should be the deciding factor in concluding that an investment by an associate of the reporting entity in a foreign operation is not part of the reporting entity's net investment in that foreign operation.

Recognition of exchange differences

We support the amendment proposed in DTC 1 to require a monetary item that is denominated in the functional currency of the reporting entity or the foreign operation, or indeed any other currency, to be recognised in equity in the consolidated financial statements, assuming that the criteria in IAS 21.15 are met. We consider that it is appropriate for the impact on these monetary items from fluctuations in foreign exchange rates to be included in equity in the group's consolidated financial statements because the gains and losses will remain unrealised as long as there is no intention to require settlement in the foreseeable future. The foreign exchange component of the transaction does not impact the net cash flows of the group and therefore it is not meaningful for the fluctuations to be reflected at each remeasurement date in the income statement.

IAS 21 uses the term 'reporting entity' interchangeably to refer to either the parent entity or the consolidated group. The addition of the term reporting entity in paragraph 15 continues the confusion as to what is the intended meaning of this term. We suggest that paragraph 15 is amended as follows: "A parent ~~reporting~~ entity or any of its subsidiaries…".

The use of reporting entity in Paragraph 15A results in ambiguity as to whether the group entity – Subsidiary A – now has a net investment in Subsidiary B, or if it is the parent entity that has increased its net investment in Subsidiary B. Similarly, the first sentence of paragraph 33 is also unclear. We request that the intention of the Board be clarified by stating which entity has the investment in the subsidiary.

We believe that paragraph 33 is incomplete as it does not acknowledge that there may be exchange differences arising in the group entity advancing the loan to its sister entity and that these exchange differences must also be reclassified to equity in the group consolidated financial statements. We propose the following change to the sentence added in DTC 1 to paragraph 33:

> "If such an item is denominated in a currency other than the functional currency of either the lender or the borrower ~~reporting entity or the foreign operation~~, an exchange difference arises in both the lender and borrower's ~~reporting entity's~~ separate financial statements ~~and in the foreign operation's individual financial statements in accordance with paragraph 28~~."

Comparison of changes proposed with U.S GAAP

We note that the proposed changes to the standard would create a difference with U.S GAAP. We interpret SFAS 52 as requiring a sister entity that provides a loan to another sister entity: (a) to have the same functional currency as the reporting entity; and (b) for there to be no entities in between it and the reporting entity with different functional currencies, for exchange differences to be recorded as a translation adjustment (ie., in equity) in the group consolidated financial statements.

Applying this to paragraph 15B of DTC 1, Subsidiary A must have the same functional currency as the parent entity, and there must be no intervening entity between Subsidiary A and the parent entity, if the loan is to be recognised as part of the reporting entity's net investment in Subsidiary B. Therefore, any foreign exchange differences may only be recognised in equity in the group consolidated financial statements if these criteria are met.

The Board may wish to consider this in its deliberations if it anticipates a future project to converge IAS 21 with SFAS 52.

Process used to amend the standard

The proposed technical correction policy has been issued by the IASB in 'draft' and the Board has yet to consider constituents' views on the proposed policy. We consider it inappropriate that a DTC is being issued before such time when (and if) the proposed policy is formally ratified by the Board following full consideration of constituents' views.

The Board noted in its proposed policy that the policy is intended to apply to changes to standards that do not require due process because they are editorial corrections. We agree that the change proposed in relation to the net investment in a foreign operation is an editorial correction. However, we believe that the change proposed in relation to recognition of exchange differences is an amendment to the standard and not merely a clarification of the Board's intention. The amendment reverses a position that is set out clearly in the standard and so it is difficult to envisage how the existing position could not have been intended by the Board. Whilst we agree with the Board's answer in this particular case, we are concerned about the "short-cut" in due process.

Transitional provisions

In our view, an immediate effective date for technical corrections will make it impossible for convergence to be maintained by national standard setters and other bodies responsible for the application of IFRSs in individual jurisdictions (for example the adoption process in the European Union). As the primary method of implementation of IFRSs in major economies is indirect application either through converged national GAAP or an adoption mechanism, this will make convergence difficult in these jurisdictions.

We believe that these changes proposed to the standard, including the technical correction, should have an effective date that is delayed for an appropriate period. In any case, given that the change proposed in relation to exchange differences is an 'amendment' there should be specific transitional provisions included within the proposal. We believe that all changes proposed to IAS 21 should have the same deferred effective date with retrospective application.

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Please contact Mark Vaessen at 020 7694 8089 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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