Accounting Standards Board

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Ms Patrina Buchanan
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28 October 2005

Dear Ms Buchanan

Draft Technical Correction 1 – Proposed Amendments to IAS 21 *The Effect of Changes in Foreign Exchange Rates* – Net Investment in a Foreign Operation

The ASB's principal comments on Draft Technical Correction 1 are set out below. More detailed concerns are in the Appendix.

Amendment to IAS 21

1. We agree that there is no logical reason for restricting amounts that qualify for inclusion in the net investment in a foreign operation to exclude amounts in a currency other than a functional currency of either the lender or borrower. Nor is there any reason to exclude loans and other balances between a fellow subsidiary and the foreign operation. Accordingly we agree with the technical rationale for the proposed amendment.

2. In our response to the IASB's proposed policy on Technical Corrections, we questioned whether the abbreviated process was appropriate for changes that were likely to result in restatement of financial information that had already been published.

3. We are therefore concerned to note that if the proposed Technical Correction is made, the amended standard will with immediate effect *require*, and not merely *permit*, all such intra-group loans and other balances to be treated as part of the net investment with the corresponding treatment of the foreign exchange gains and losses taken direct to equity, and this new required treatment is clearly not currently permitted under the standard before amendment. Because the proposed Technical

Correction will come into effect immediately, many entities will need to change their accounting policy at a late stage of the current year.

4. The short consultation period for the amendment also means that preparers have little time to identify the full extent of the likely difficulties and to make representations to IASB – for example, whether there are practical difficulties in obtaining full historical data for determining the retrospective application of the amendment.

5. We therefore suggest that the IASB issues the correction, subject to our further comments set out in the Appendix to this letter, but defers the effective date from which entities are *required* to implement the change.

Please contact Simon Peerless on 020 7492 2424 (e-mail s.peerless@frc-asb.org.uk) if you would like to discuss these comments further.

Yours sincerely

Ian Mackintosh
Chairman

Appendix – detailed comments on Draft Technical Correction 1

We set out below more detailed concerns arising from the draft Technical Correction.

Amendment to IAS 28

1. We do not agree that the proposed amendment to IAS 28 should be made. Although there appears to be no explanation in the basis of conclusions as to why this amendment is proposed, the purpose is presumably to require that the net investment in an associate, as determined for the purpose of limiting recognition of losses made by the associate, is not reduced by amounts payable to the associate. The rationale for this is (we presume) to mirror the exclusion of amounts payable to a foreign operation that is an associate from the amount of the net investment in that foreign operation; however, in our view, this is a separate issue.

2. IAS 21 addresses 'net investment in a foreign operation' – where paragraph 29 of IAS 28 is applied to an associate that is not a foreign operation, IAS 21 cannot have any bearing on the definition of net investment in that associate. If it is intended to exclude all amounts due *to* such an associate from the definition of net investment in paragraph 29 of IAS 28, this should be drafted more explicitly and, in our view, should be a separate amendment rather than merely an appendix to a Technical Correction addressing net investment in a foreign operation. Nor is it clear that this falls within the scope of Technical Corrections as set out in the IASB's draft policy.

3. We also do not think that the proposed change results in a clearly drafted requirement. The deletion of 'trade payables' from the list of items that are not permitted to be included in the net investment could be read as changing the standard so as to permit the inclusion of such items in future (the wording remains unclear, however, as it does not specify whether the receivable and payables are those of the associate or the investing entity).

Drafting issues

4. Although we agree that the clarification in paragraph 15 of IAS 21 is necessary, we would prefer if it were redrafted as 'A parent or any of its subsidiaries…' rather than 'A reporting entity or any of its subsidiaries…'. We would prefer to reserve the term 'reporting entity' for the whole of the group rather then the parent alone, as this is the meaning in other IFRS.

5. We also find the drafting of paragraph 15B somewhat confusing. There are two situations to be considered: (a) where the associate is itself the foreign operation that is under consideration; and (b) where the associate has a monetary balance with different foreign operation of the group.

6. Paragraph 15B clearly addresses (a), as indicated in its first sentence, and the second sentence states that amounts receivable from an associate that is a foreign operation may meet the criteria for inclusion in the net investment in that foreign

operation. However, the last sentence of the paragraph, excluding amounts payable *to* the associate, must be read as applying to both situations (a) and (b) – since paragraph BC7 of the basis for conclusions states that amounts due to the associate from a foreign operation are not intended to form part of the net investment in that foreign operation. The standard would be clearer and easier to apply consistently if (a) and (b) were dealt with in separate paragraphs, and situation (a) referred to in the basis for conclusions.