Project **IAS 21 *The Effects of Changes in Foreign Exchange Rates***

Topic **Repayment of investment / CTA**

Introduction

1. In July 2010, the Committee published a tentative agenda decision not to add to its agenda a request for guidance on an issue in IAS 21 *The Effects of Changes in Foreign Exchange Rates*. The issue relates to determining when the separate equity reserve related to the retranslation of the net assets of an investor's net investment in a subsidiary (often referred to as foreign currency translation reserve or 'FCTR') should be recycled.

2. The request specifically sought guidance on whether FCTR should be recycled when there is a reduction in:

   (a) **View 1 –** the **proportionate** (relative) equity ownership interest in a foreign operation; or

   (b) **View 2 –** the **absolute** amount of an entity's ownership interest in a foreign operation, even if there is no reduction in the proportionate equity ownership interest in the foreign operation.

3. The request was to address the issue as part of the Board's *Annual Improvements* project (AIP). However, given the recent changes to AIP and the Committee's involvement, this issue is being presented first for deliberation by the Committee.

4. The Committee tentatively decided that different interpretations could lead to diversity in practice in the application of IAS 21 on the reclassification of the

FCTR when repayment of investment in a foreign operation occurs. However, the Committee tentatively decided neither to add this issue to its agenda nor to recommend the Board to address this issue through AIP because it did not think it would be able to reach a consensus on the issue on a timely basis.

Staff analysis of comment letters

5. Three comment letters[1] were received. One comment letter agrees with the Committee's tentative decision not to add the issue to its agenda and two comment letters 'acknowledge' the reasons for the Committee's decision not to take this item onto its agenda.

6. However, all three comment letters recommend additional/ future action be taken to address this issue. One comment letter recommends that the Board should include this issue in any review of IAS 21 which may be undertaken as a part of the Board's post-2011 agenda.

7. The other two comment letters disagree with the Committee's decision not to recommend the Board add this issue to AIP. These comment letters state that paragraphs 48 and 49 of IAS 21 are partly unclear and ambiguous as evidenced by the Committee's lengthy discussions on this issue and believe that further clarification through AIP is needed. Paragraphs 8 to 10 summarise other points made in those two comment letters.

8. One of those comment letters requests that the Committee should at least add some more elaboration to the wording of the final agenda decision on issues (ie specific fact patterns) which appear to be rather straight forward in the given context. This respondent specifically recommends making a reference to the first sentence of paragraph 49 of IAS 21 and adding to the decision examples of when recycling of FCTR should occur in order to try to avoid different interpretations of the requirements of IAS 21.

[1] Deloitte Touche Tohmatsu, Accounting Interpretations Committee (AIC) of Germany and the Canadian Accounting Standards Board.

9. The second letter of disagreement notes that the Committee did not come to an agreement at its July meeting, and argues that those discussions provide evidence that an AIP to clarify paragraphs 48 and 49 of IAS 21 is needed. It also says that by discussing the two views on when to recycle FCTR in public, the Committee has to some extent endorsed both views:

> Further, by discussing the two views in a public forum and deciding not to recommend an Annual Improvement, the Committee has, de facto, endorsed both views. Although this endorsement does not create authoritative guidance, stakeholders can use the Committee's discussions and staff papers on this issue to support either view. As a result, divergent interpretations are more likely.

10. That comment letter also says that the Committee did not sufficiently assess whether an amendment through AIP is needed, as the discussions in July 2010 were too focused on the staff proposal, and whether that proposal could be amended in such a way that the Committee could reach an agreement on it. As a consequence the discussions were moved more to the underlying principles of IAS 21, rather than discussing whether the Committee could reach an agreement on clarifying the standard. [Emphasis included in original comment letter.]

> The staff paper focussed on interpreting the specific words in paragraph 48D that "A partial disposal of an entity's interest in a foreign operation <u>is any reduction in an entity's ownership interest in a foreign operation</u>...." If paragraphs 48-49 are considered as a whole instead of isolating the specific words in paragraph 48D, we think the Committee should be able to clarify the standard without changing or interpreting any underlying principles. Instead of focussing on which view is correct, the focus should be on clarifying what constitutes a "partial disposal." We think that the references to "partial disposal" in paragraphs 48C, 48D and 49 taken together are confusing and result in divergent views. These paragraphs have been amended several times from the original standard including those in the more recent consequential amendments discussed in paragraphs 60A and 60B. The Annual Improvements process should involve revisiting how paragraphs 48-49 have evolved from the original standard and identifying the intentions of the Board when making these amendments.

11. In response to the comments included in the two letters disagreeing with the Committee's decision not to add this issue to AIP the staff notes that this issue might benefit from further discussion by the Committee. However, in light of the discussions that took place at the Committee's July 2010 meeting and the

divergence of views within the Committee, it seems very unlikely that the Committee could reach a consensus on this issue on a timely basis.

12. The staff also note that a working group set up by National Standard Setters which is looking at IAS 21 issues has been alerted and is aware of this issue.

Staff recommendation

13. As a result, the staff does not recommend any changes to the tentative agenda decision.

Questions for the Committee

14. The staff recommends the Committee respond to the following questions:

Staff recommendation and proposed wording of the final agenda decision
1. The staff recommends that the Committee finalise its tentative agenda decision not to add the issue to its agenda and not to recommend the Board to add this issue to *Annual Improvements*. Does the Committee agree with the recommendation? 2. The appendix includes the staff's proposed wording for the final agenda decision which is slightly changed from the published tentative agenda decision. Does the Committee agree with proposed wording?

Appendix – Proposed wording for agenda decision

A1. The Staff proposes the following wording for the agenda decision. [Deleted text is struck through and new text is underlined.]

IAS 21 *The Effects of Changes in Foreign Exchange Rates* — Repayments of investments/CTA

The Committee received a request for guidance on the reclassification of the foreign currency translation reserve (FCTR) when a repayment of a foreign investment occurs. The request specifically sought guidance on whether ~~a repayment of an investment is considered to be an absolute reduction or a proportionate reduction~~FCTR should be recycled for transactions in which there is a reduction in; the proportionate (relative) equity ownership interest in a foreign operation; or the absolute amount of an entity's ownership interest in a foreign operation, even if there is no reduction in the proportionate equity ownership interest in the foreign operation.

The Committee noted that paragraph 48D of IAS 21 requires that an entity treats 'any reduction in an entity's ownership interest in a foreign operation' as a partial disposal, apart from those reductions in paragraph 48A that are accounted for as disposals. How an entity applies the requirements in paragraph 48D is largely dependent on whether it interprets 'any reduction in an entity's ownership interest in a foreign operation' to mean an absolute reduction or a proportionate reduction.

The Committee considers that different interpretations could lead to diversity in practice in the application of IAS 21 on the reclassification of the FCTR when repayment of investment in a foreign operation occurs. However, the Committee ~~[~~decided~~]~~ neither to add this issue to its agenda nor to recommend the Board to address this issue through Annual Improvements because it did not think it would be able to reach a consensus on the issue on a timely basis.