XX November 2008

International Accounting Standards Board
30 Cannon Street
London
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United Kingdom

DRAFT COMMENT LETTER

Comments should be sent to Commentletter@efrag.org by 21 November 2008

Dear Sir or Madam

Exposure Draft of proposed Improvements to IFRSs

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Exposure Draft *Improvements to IFRSs*. 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 the definitive interpretations/amendments on the issues.

Our detailed comments on the ED are set out in the appendices to this letter. To summarise, we agree with most of the proposals in the ED, although we sometimes see a need for some rewording or for an additional amendment to make the issue clearer. Our main areas of disagreement are:

- Issue 3: IFRS 8 *Operating Segments – Disclosures of information about Segment Assets.* The IASB proposes to amend the basis for conclusion so that only those assets and liabilities that are included in the measure of the segment's assets and segment's liabilities that are used by the chief operating decision maker shall be reported for that segment. EFRAG is particularly concerned at the suggestion that this objective should be achieved by changing only the Basis for Conclusions. We refer to paragraphs 16 and 17 for further comments.

- Issue 8: IAS 38 *Intangible Assets – Measuring the fair value of an intangible asset acquired in a business combination.* The IASB proposes to amend the description of valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination that are not traded in active markets. EFRAG believes these proposed amendments attempt to clarify something that is already clear. We believe that, if IFRS are to remain high-level, principle-based standards, it is important that 'clarifications' of this kind are not made. We refer to paragraph 37.

- Issue 12: IAS 39 *Financial Instruments – Recognition and Measurement – Bifurcation of an embedded foreign currency derivative.* The IASB is proposing to replace the notion of a commonly used currency in IAS 39.AG33(d) by a reference to the characteristics of a functional currency as set out in paragraph 9 of IAS 21 *The effects of Changes in Foreign Exchange Rates*. The intention in doing this is to clarify which currencies could be considered "commonly used" in a particular economic environment (and therefore would be treated as embedded derivatives that are closely related to the host contract). We do not support the proposed amendments because we do not think they result in greater clarity. Our detailed concerns are set out from paragraphs 59-62.

We hope that you find our comments helpful. If you wish to discuss them further, please do not hesitate to contact Frederiek Vermeulen or me.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix 1 — Responses to the invitation to comment

Issue 1: IFRS 2 *Share-based payment*: Scope of IFRS 2 and the revised IFRS 3

1 The existing IFRS 3 defines a business combination as the "bringing together of separate entities or business into one reporting entity", without mentioning control explicitly. It follows that the formation of a joint venture and (some) common control transactions meet the definition of a business combination. IFRS 3R changed the definition and defines a business combination as "a transaction or event in which an acquirer obtains control of one more business". Thus, the new definition focuses on obtaining control of "businesses". It also no longer refers to "entities". This change means that the formation of a joint venture no longer meets the definition of a business combination.

2 Paragraph 5 of IFRS 2 and a subsequent clarification in IASB Update make it clear that IFRS 2 does not apply "to transactions in which the entity acquired goods as part of the net assets acquired in a business combination" as defined in IFRS 3. Thus the formation of a joint venture was, prior to IFRS 3R, clearly excluded from the scope of IFRS 2. That was also true of certain common control transactions.

3 As the IASB did not intend to change the existing accounting under IFRS 2 for the formation of joint ventures or common control transactions, it is proposing to amend paragraph 5 of IFRS 2 to reflect that intention.

<u>EFRAG's comment</u>

4 EFRAG agrees with the proposed amendment.

5 In addition EFRAG notes that paragraph 5 of IFRS 2 has been interpreted in practice as meaning that the following transactions are also not included in the scope of IFRS 2:

(a) Transactions involving acquisitions of minority interest (NCI) after control is achieved.

(b) Acquisition of significant influence.

The basis for the above interpretation appears to be that such transactions also met existing IFRS 3's definition of a business combination.

6 Given the change in the definition of a business combination, we think it would be helpful if the IASB clarified whether the above transactions are now within the scope of IFRS 2.

Issue 2: IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* – Disclosures required for non-current assets (or disposal groups) classified as held for sale or discontinued operations

7 It would seem that there is some uncertainty as to whether the disclosure requirements of standards other than IFRS 5 apply, in the absence of specific exclusions, to non-current assets (or disposal groups) classified as held for sale or discontinued operations in accordance with IFRS 5.

8 The IASB is therefore proposing to amend IFRS 5 to clarify that IFRS 5, and other IFRSs that specifically refer to non-current assets (or disposal groups) classified as held for sale or discontinued operations, set out all the disclosures required in respect of those assets or operations. Additional disclosures about such assets (or disposal groups may be necessary to comply with the general requirements of IAS 1).

<u>EFRAG's comment</u>

9 EFRAG agrees with the IASB's conclusion that this is an issue that needs to be addressed. We also agree with the proposed solution.

Issue 3: IFRS 8 *Operating Segments* – Disclosures of information about Segment Assets

10 According to paragraph 23 of IFRS 8 *Operating Segments* an entity shall report a measure of total assets for each reportable segment. However, paragraph 25 seems to contradict paragraph 23 by stating "...only those assets... that are included in the measures of the segment assets...that are used by the chief operating decision maker shall be reported for that segment".

11 Paragraph BC35 re-iterates the message in paragraph 26 by stating that the standard requires a measure of segment assets to be disclosed regardless of whether those measures are reviewed by the chief operating decision maker. BC35 goes on to say that this is what US GAAP requires.

12 However, it is <u>not</u> what US GAAP requires and the IASB wishes its standard to be in line with US GAAP on this issue. It is proposing to do this by amending BC35 to make it clear that only those assets that are included in the measure of the segment's assets and segment's liabilities that are used by the chief operating decision maker shall be reported for that segment.

<u>EFRAG's comments</u>

13 EFRAG agrees with the IASB's decision to ensure that IFRS and US GAAP are the same on this issue. The key principle underlying IFRS 8 is that a 'through the eyes of management' approach is to be applied in reporting segment information. EFRAG supports that approach. It is a logical consequence of adopting that approach that segment assets should be disclosed only when they are amongst the information presented to the Chief Operating Decision Maker (CODM). That is the objective of the amendment being proposed.

14 We understand that some users are concerned that this amendment will result in a loss of valuable information. We do not believe it will because, if segment assets are material or are important to the management of the business in some other way, they will be part of the information presented to the CODM—and as a result will be required to be disclosed under this amendment. On the other hand, if segment assets are both immaterial and perceived by the CODM to be unimportant for the management of the business, we would have thought that they contain no informational value for users either.

Question to constituents

15 EFRAG would particularly welcome comments from respondents as to whether or not disclosures about segment assets should only be provided if presented to the Chief Operating Decision Maker? Are there circumstances in which, although segment assets are both immaterial and perceived by the CODM to be unimportant for the management of the business, their disclosure would still provide useful information? What are those circumstances?

16 EFRAG disagrees with the Board's proposal that the change described above should be achieved by amending only the Basis for Conclusions. In our view, the Basis for Conclusions should only explain the reasoning behind what is required by the standard; it should as a result contain neither requirements nor guidance, and should also not contradict things said in the standard. For those reasons, we believe a change also needs to be made to the standard itself (ie to paragraph 25 of the standard).

17 We would also like to point out that amending only the Basis for Conclusions would in any case have no effect in the European Union because the Basis for Conclusions are not endorsed.

Issue 4: IAS 7 *Statement of Cash Flows* – Classification in the cash flow statement of expenditures on unrecognised assets

18 Practices apparently differ as to the classification of cash flows for expenditures incurred with the objective of generating future cash flows when those expenditures are not recognised as assets. Examples of such expenditure include R&D expenditure that has not been capitalised and uncapitalised oil and gas exploration and evaluation expenditure. Some entities classify such expenditures as cash flows from operating activities while others classify them as cash flows from investing activities. The IASB decided that IAS 7 *Statement of Cash Flows* should be amended to make it clear that only expenditures that result in a recognised asset can be classified as a cash flow from investing activity.

<u>EFRAG's comment</u>

Question to constituents

19 This is an issue that EFRAG has debated at some length, with some members believing it is important that the cash flow classification follows the accounting treatment (so investment in unrecognised assets would be recognised as operating) so not to confuse users and others thinking it should reflect the economics (so investment in unrecognised assets would be recognised as investing) because users need to understand it is an investment in the future and not a normal operating cost. EFRAG's understanding is that the proposed amendment is consistent with what the IASB is proposing in its discussion paper on Financial Statement Presentation. EFRAG would be very interested in hearing constituents' views on which is the most useful way of presenting such information in the cash flow statement.

20 The IASB explains in the basis for conclusions that it believes that "only an expenditure that results in a recognised assets can be classified as a cash flow from investing activity". However, when dealing (in its 2007 Improvements to IFRSs project) with another issue involving the classification of cash flows relating to the purchase of

assets (the amendment to IAS 7 – Assets held for rental to others), the IASB used a rather different rationale: "users of financial statements would consider these gains and the proceeds from an entity's sale of goods in the course of its ordinary activities differently in their evaluation of an entity's past results and their projections of future cash flows." EFRAG believes these arguments could be contradictory. It would particularly welcome constituents' views on this issue.

Issue 5: IAS 18 *Revenue* – Determining whether an entity is acting as a principal or as an agent

21 The IASB has been informed that there is some uncertainty as to how to determine whether an entity is acting as a principal or as an agent in accordance with IAS 18 *Revenue* for situations in which an entity employs a second entity to meet the requirements of a customer under a sales contract.

22 The IASB is proposing to provide guidance on the subject by adding some examples to the Appendix of IAS 18. Those examples are based on the principle that an entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services.

EFRAG's comments

23 EFRAG agrees that there is uncertainty on this issue and that guidance is needed. We also agree with the essence of the clarification proposed.

24 However, we do not believe the matter should be dealt with only by including material in an appendix that does not form part of the standard. In our view, the principle underlying the clarification proposed should be included in the standard itself. That principle could then be illustrated in the appendix through the examples in the proposed clarification.

25 In addition to those examples. we think it would be useful to discuss also the situation when the entity has the primary responsibility for providing the goods and services desired by the customer to fulfil the order by, for example, being responsible for acceptability of the products or services ordered or purchased by the customer or by being responsible for the design, content or other specifications of the products or services involved.

Issue 6: IAS 36 *Impairment of Assets* – unit of accounting for goodwill impairment

26 According to paragraph 80 of IAS 36, goodwill arising from a business combination shall be allocated to a cash generating unit, or a group of cash generating units, which is/are expected to benefit from the synergies of the business combination. Paragraph 80 goes on to say that such unit or group of units shall, inter alia, "not be larger than an operating segment determined in accordance with IFRS 8." However, paragraph 12 of IFRS 8 permits two or more operating segments to be aggregated into a single segment in certain circumstances, and there is apparently some uncertainty as to whether IAS 36.80 refers to an operating segment before or after aggregation.

27 The IASB proposes to amend paragraph 80(b) to make it clear that the required unit for goodwill impairment in IAS 36 is not larger than the operating segment level as defined in paragraph 5 of IFRS before the permitted aggregation.

EFRAG's comments

28 EFRAG agrees that this is an issue that needs to be addressed and we also agree with the proposed amendment. However, we also note that this clarification could have implications for impairments recognised in the past and wonder whether additional disclosures are needed to ensure users are aware of this effect

Question to constituents

29 EFRAG would particularly welcome constituent's views on whether the implementation of the proposed amendment would be difficult in respect of existing goodwill allocation.

Issue 7: IAS 38 *Intangible Assets* – Additional consequential amendments arising from the revised IFRS 3

30 When the IASB revised IFRS 3 *Business Combinations* (ie when it issued IFRS 3R) it changed the standard to state that, if an intangible asset acquired in a business combination can be identified – in other words if it meets the separability criterion – or arises from contractual or other legal rights, sufficient information exists to measure reliably the fair value of that asset. At the same time, the IASB amended IAS 38 to reflect this decision.

31 The IASB has since concluded that the amendments it made to IAS 38 do not fully reflect in a clear enough fashion the change to IFRS 3R. It is therefore proposing further amendments to IAS 38 to make clear that, if an intangible asset is separable only with another asset, it must still be recognised separately from goodwill.

EFRAG's comment

32 Although EFRAG agrees that the guidance on this issue should be consistent in both standards, we are concerned about having the same guidance in two places in IFRS, especially as one set of guidance contains examples and the other that does not. We think this could lead to some confusion. Our preference therefore would be to consolidate the guidance on initial recognition and measurement of an intangible asset acquired in a business combination in one single IFRS.

33 EFRAG does not agree with the proposal that this amendment should apply for annual periods beginning on or after 1 July 2009; such an effective date makes no allowance for endorsement processes such as the one in the EU. We think the same effective date should be applied for all the amendments in the Annual improvements 2008 project to keep things simple for preparers (with earlier adoption possible). We think that date should be 1 January 2010.

Issue 8: IAS 38 *Intangible Assets* – Measuring the fair value of an intangible asset acquired in a business combination

34 IFRS 3R requires an intangible asset acquired in a business combination to be measured at fair value at the date of the acquisition. Paragraphs 39-41 of IAS 38 provide some guidance on how to do that. However, there are apparently several concerns about that guidance.

35 The first concern relates to whether the guidance in paragraph 40 of the standard permits the entities to use valuation multiples to measure the fair value of an intangible asset acquired in a business combination. The IASB is proposing to amend paragraph 40 to clarify that an entity can use multiples.

36 Secondly, some apparently believe that the wording of paragraph 41 of the standard does not permit the use of a number of the valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination that are not traded in active markets. Again, the IASB is proposing to amend paragraph 41 to make it clear that it is not intended to be restrictive.

<u>EFRAG's comments</u>

37 Although EFRAG has no difficulty with the content of the amendments proposed, we do not believe that either is necessary.

38 The proposed amendment to paragraph 40 of IAS 38 is in EFRAG's opinion unnecessary because there is nothing in the paragraph to suggest that the use of multiples *is* prohibited. Similarly, in our view the proposed amendment to paragraph 41 is attempting to make clear something that we believe is already clear; that the wording of paragraph 41 is not restrictive. We want IFRS to be principle-based and written at a high-level. Adding text to existing standards to make clear things that are already clear is not in our view consistent with that. Even though the Annual Improvements process is a very stream-lined way of making amendments, the IASB has to draw the line somewhere.

39 Having said that, EFRAG agrees with the view expressed during the IASB's consultations with valuation professionals that there is a need for clear guidance in IFRSs on how to measure intangible assets in a business combination. However, we accept that that is beyond the IASB's Improvement Project and should be dealt with separately.

Issue 9: IAS 39 *Financial Instruments: Recognition and Measurement* – Scope Exemption for business combination contracts

40 Paragraph 2(g) of IAS 39 states that "contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date" are outside the scope of IAS 39. The IASB has observed a diversity in practice in the way this paragraph is being interpreted and, as a result, is proposing to clarify the paragraph to eliminate that diversity. The main questions being raised about the paragraph are:

(a) What type of contracts does this scope exemption apply to? Only binding contracts such as forwards or also options?

(b) Can the scope exemption be applied to transactions that are similar to business combinations, such as those to acquire an interest in an associate?

41 The IASB is proposing to clarify that the scope exemption in paragraph 2(g) applies only to binding contracts (ie forward contracts) between an acquirer and a vendor in a business combination to buy an acquiree at a future date. In support of this conclusion the IASB points out that currently exercisable option contracts that will result in control over an entity are excluded from the scope of IAS 39 by paragraph 2(a) on the grounds

that IAS 27 would require consideration of such contracts in determining whether one entity controls another. On the other hand, the IASB points out that, since non-currently exercisable potential voting rights are not under IAS 27A considered in determining control, they would not meet the definition of a business combination in IFRS 3; thus such instruments are not excluded from the derivative accounting in accordance with IAS 39.

42 The IASB concluded that paragraph 2(g) should not be applied by analogy to investments in associates and similar transactions. The basis for conclusion (paragraph BC 6) explains this decision as follows "The concern that the structure of a business combination transaction may result in different accounting treatments without the exemption in paragraph 2(g) does not arise in the case of investments in associates because an investment in an associate does not represent an acquisition of the constituent assets of the investee."

<u>EFRAG's comments</u>

43 EFRAG agrees with the IASB's conclusions that this scope exemption should apply only to binding contracts. We share the IASB's reasoning in reaching its conclusions.

44 However we think it would be clearer if paragraph 2(g) was amended to describe the type of contract that is being referred to and under which circumstances this exemption applies, rather than just mentioning a 'forward contract" (which in any case is not a defined term in IFRS). The sort of wording we have in mind is as follows:

(g) any ~~forward~~ contract that results from an agreement entered into before the acquisition date (i.e. before the date the acquirer obtains control of the acquiree <u>while, for example, necessary regulatory and legal processes are being completed</u>) <u>obligating</u> an acquirer and a vendor, in a business combination, to buy or sell an acquiree at a future date and at a specified price (or on a specified price basis).

45 The second issue is whether the scope exemption can be applied to transactions that are similar to binding contracts to acquire control of another entity, such as a contract to acquire an interest in an associate. EFRAG understands that the IASB concluded that the scope exemption is not needed for contracts to acquire an interest in an associate because, unlike in case of business combinations which can be structured as either an acquisition of net assets or as an acquisition of equity instruments, a contract to acquire an associate is always an acquisition of equity instruments. A contract to acquire equity instruments at a future date meets the definition of a derivative in IAS 39 and should be accounted for as such. Therefore, the issue that accounting may differ depending on the structure of the contract to acquire interest in a business combination does not arise for acquisitions of interest in an associate.

46 An implication of not extending the scope exemption to such contracts is that a contract to acquire an associate will be accounted for as a derivative (i.e. at fair value through profit or loss); yet when the investment in the associate is made, the investment will be accounted for in the consolidated financial statements using the equity method (ie by recognizing in profit or loss the investor's share of the associate's profit or loss, rather than changes in fair value). Some commentators argue that this change in measurement basis on completing the acquisition of the interest in the associate results in information that is not helpful; or easily understandable.

47 At the same time, we understand that some entities currently designate the derivative (ie the contract to acquire an interest in an associate) as a hedging instrument of the variability in the consideration to be paid for the acquisition of highly probable acquisition of shares (in accordance with the guidance in IAS 39 Implementation Guidance F2.5 *Cash flow hedges: 'all in one' hedge*). The gains or losses on the derivative are deferred in other comprehensive income and effectively counter effect the fair value of acquired shares at the date when the transaction takes place to result in recording the acquisition of an associate at the price fixed in the contract.

Question to constituents

48 EFRAG has not reached a conclusion on this second issue; ie on whether the scope exemption should be extended to a contract to purchase an associate. EFRAG would welcome views from constituents as to whether they believe the scope exemption in paragraph 2(g) should be extended to contracts to acquire an associate. An explanation of the reasoning behind the view stated would also be useful.

Issue 10: IAS 39 *Financial Instruments: Recognition and Measurement* – Application of the fair value option

49 According to paragraph 11A of IAS 39, (subject to certain restrictions that are not relevant here) if an entity has a contract that contains one or more embedded derivatives, it may designate the entire hybrid (combined) contract as a financial asset or financial liability at fair value through profit or loss. The IASB has been informed that there is a diversity in practice as to whether this fair value option can be applied to all contractual arrangements with embedded derivatives, including those where the host contracts are outside the scope of IAS 39.

50 The IASB is proposing to clarify that the fair value option applies only to financial instruments within the scope of IAS 39 that contain embedded derivatives. The IASB's reasoning is that the fair value option was developed for application only to financial instruments within the scope of IAS 39 in order to avoid the complexities that would otherwise arise (in identifying embedded derivatives, deciding whether they require separation, and separating and measuring them separately) and the IASB did not consider an exemption to this rule in developing the requirements of paragraph 11A.

<u>EFRAG's comments</u>

51 EFRAG agrees that the existing wording is ambiguous. We also agree with the proposed clarification. In EFRAG's view, the proposed amendment clarifies what EFRAG believes was rightly the IASB's intention.

Issue 11: IAS 39 *Financial Instruments: Recognition and Measurement* – Cash flow hedge accounting

52 If a hedged forecast transaction results in the recognition of a financial asset or a financial liability, paragraph 97 of IAS 39 requires the associated gains or losses on hedging instruments to be reclassified from equity to profit or loss as a reclassification adjustment (ie recycling) in the same period or periods during which the asset acquired or liability assumed affects profit or loss.

53 It has been noted that this wording might be problematical in situations when, for example, an entity applies hedge accounting to hedges of cash flows associated with a time period that is shorter than the time to maturity of the instrument. In such circumstances, paragraph 97 can be interpreted to suggest that the gains and losses on the hedging instrument should be reclassified to profit or loss over the time until maturity of the instrument rather than a shorter time period when hedged cash flows affect profit or loss. This is not the intention of IAS 39.

54 The IASB therefore proposes to amend paragraphs 97 and 100 of IAS 39 to clarify that the gains or losses on the hedging instrument should be reclassified from equity to profit or loss in the period that the hedged forecast cash flows affect profit or loss.

<u>EFRAG's comment</u>

55 EFRAG agrees that there is an issue with the wording in paragraph 97. However, although it agrees that the proposed amendment addresses some possible misinterpretations of paragraph 97, it believes the wording might create confusion in other situations. That is because the recognised hedged financial instruments might affect profit or loss in periods in which there are no cash flows arising in relation to the instruments. This would, for example, be the case when the financial instrument that was the hedged item in a cash flow hedge is measured at fair value through profit or loss after initial recognition for the instrument is being measured at (amortised) cost and impairment losses are being recognised in profit or loss on the instrument. We understand that the intention is that gains and losses on the hedging instrument should be reclassified into profit or loss at such times.

Question to constituents

56 One possibility might be to amend the wording in paragraph 97 to state that the gains and losses on the hedging instrument should be reclassified from equity to profit or loss in the period that <u>the hedged item</u> affects profit or loss. Such wording seems to reflect the intention of the requirement on when to reclassify gains and losses on hedging instruments deferred in equity to profit or loss more generally. Do constituents think this amendment would work? Or do they think there could be difficulties with interpreting paragraph 97 if it was amended this way?

Issue 12: IAS 39 *Financial Instruments: Recognition and Measurement* – Bifurcation of an embedded foreign currency derivative

57 IAS 39 requires the separation of embedded derivatives from host contracts that are not accounted for at fair value through profit or loss—unless the embedded derivative is considered closely related to the host contract, in which case separation is prohibited.

58 Paragraph AG33(d) of IAS 39 specifies the circumstances in which foreign currency derivatives embedded in other contracts are considered closely related. Paragraph AG33(d)(iii) states that an embedded derivative will be closely related to the host contract if it is denominated in a currency that is commonly used in contracts to buy or sell non-financial items in the economic environment where the transaction takes place.

59 There would appear to be some uncertainty as to the evidence an entity requires to present to support the notion that the use of a currency is common. The IASB is

therefore proposing to amend paragraph AG33(d) to clarify the position. The proposed amendment involves replacing the notion of a common commonly used currency with a reference to the characteristics of a functional currency as set out in paragraph 9 of IAS 21 *The Effects of Changes in Foreign Exchange Rates.*

<u>EFRAG's comments</u>

60 Although EFRAG also understands that it is not always clear what currencies could be considered "commonly used" in a particular economic environment, we do not support the proposed amendment, primarily because we do not believe the proposed amendment achieves a greater clarity. Our concerns are as follows:

(a) The basis for conclusions for the proposed amendment explains (in paragraph BC18) that paragraph AG 33(d) is intended to exempt preparers from separating embedded foreign currency derivatives if the embedded derivatives are integral to the arrangement and hence bear a close economic relationship to the terms of the contract; that is, embedded foreign currency derivatives that have been entered into for reasons that are clearly not based on achieving a desired accounting result or for speculative purposes. If this is indeed the intention the proposed amendment does not achieve it because it covers only some but not all types of currencies that could potentially be in line with this reasoning.

(b) In paragraph BC19, the IASB mentions that contracts denominated in the following foreign currencies are likely to be integral to the contractual arrangement:

(i) the functional currency of any substantial party to that contract,

(ii) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions),

(iii) a local currency of any substantial party to that contract,

(iv) a liquid international currency used by parties domiciled in small countries as a convenient means of exchange,

(v) a hard currency used by an entity operating in a hyperinflationary economy to protect against inflation, or

(vi) a foreign currency commonly used in local business transactions - for example, when monetary amounts are viewed by the general population not in terms of the local currency but in terms of another related currency.

We question whether the proposed amendment's reference to the characteristics of the functional currency in IAS 21 would cover all these examples, and in particular the last three.

(c) Furthermore, we are not convinced that the six examples mentioned above sufficiently clarify proposed new paragraph BC18's notion of "integral to the arrangement and hence bear a close economic relationship to the terms of the contract; that is, embedded foreign currency derivatives that have been entered into for reasons that are clearly not based on achieving a desired accounting result or for speculative purposes". We think that many other types of currencies would meet this description.

61 In our view, in order to achieve a better clarity in this area, one needs to identify a general reason why in certain circumstances it is appropriate not to separate foreign currency embedded derivatives and not to account for them at fair value through profit or loss. Paragraph BC18 in the basis for conclusions makes such an attempt. However, as we mentioned above, that reasoning is neither reflected in the examples that follow nor in the proposed amendment to the Standard.

62 We noted in our response to the DP *Reducing Complexity in Reporting Financial Instruments* that the existing requirements regarding embedded derivatives generally lack an underlying principle and the issue addressed here is an example of that. We believe that it is important for the IASB to reconsider the accounting for embedded derivatives generally, including this issue in particular, to make this area of reporting more principle-based.

63 For all of the above reasons, we would prefer the current wording in AG33(d)(iii) to be retained or a more principle-based approach to be developed.

Appendix 2 – Changes to the Annual Improvements Process

64 From next year, the IASB will publish most of the individual amendments on its website well in advance of their publication in the form of an Exposure Draft. Constituents will be able to provide feedback on the individual proposed amendments at this stage. In addition, the IASB will publish once a year an omnibus ED containing all individual amendments. EFRAG welcomes this change as we think it will enhance the process.