xx March 2009

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Dear Sir / Madam

DRAFT COMMENT LETTER

Comments should be sent to Commentletter@efrag.org by 25 February 2009

Re: Exposure Draft of Proposed Amendments to IFRIC 9 and IFRIC 16

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Exposure Draft of proposed amendments to IFRIC 9 *Reassessment of Embedded Derivatives* and IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*. This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that will 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 proposed amendments are set out in the appendix, however, to summarise:

- We agree that a consequential amendment is required to ensure that the scope of IFRIC 9 remains the same as it was before the IASB changed the definition of a business combination in the revised IFRS 3 *Business Combinations* and we agree with the amendment being proposed, which is that the scope of IFRIC 9 is amended to make it clear that IFRIC 9 does not apply to embedded derivatives in contracts acquired in a business combination, a combination of entities under common control or the formation of joint ventures. However, we also believe that acquisitions of associates should be excluded from the scope of IFRIC 9. We agree that the amendment should be applied prospectively for annual periods beginning on or after 1 July 2009.

- We agree with the proposed amendment to IFRIC 16, which would remove the restriction that the hedging instrument cannot be held by the foreign operation whose net investment is being hedged. However, we believe that effective date requirements for this amendment need further clarification.

We hope that you find our comments helpful. If you wish to discuss them further, please do not hesitate to contact Svetlana Boysen or myself.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix — Responses to the invitation to comment

Proposed amendment to IFRIC 9 *Reassessment of Embedded Derivatives*

Question 1 – Amendment arising from IFRS 3 (as revised in 2008)

The Board proposes to amend paragraph 5 of IFRIC 9 to exclude from its scope embedded derivatives in contracts acquired in combinations of entities or business entities under common control and in the formation of joint ventures. Do you agree with the proposal? If not, why?

1 We agree that a consequential amendment is required to ensure that the scope of IFRIC 9 remains the same as it was before the IASB changed the definition of a business combination in the revised IFRS 3 *Business Combinations.*

2 Existing IFRIC 9 does not apply to the acquisition of contracts with embedded derivatives in a business combination. Existing IFRIC 9 was issued in 2006, at which time IFRS defined 'a business combination' as a "bringing together of separate entities or business into one reporting entity". As a result, the formation of a joint venture and (some) common control transactions met the definition of a business combination at the time IFRIC 9 was issued and was therefore outside the scope of IFRIC 9.

3 When IFRS 3 was revised in 2008, the definition of a business combination was changed to "a transaction or event in which an acquirer obtains control of one or more businesses". 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 and common control transactions no longer meet the definition of a business combination; and are thus within the scope of IFRIC 9. However, when the IASB revised the definition of a business combination it did not intend such transactions to be brought back within the scope of IFRIC 9. This proposed amendment would have the effect of taking the formation of a joint venture and (some) common control transactions back outside the scope of IFRIC 9.

4 In addition, we understand that, prior to IFRS 3 Revised, acquisitions of associates were excluded from the scope of IFRIC 9 because they were treated as being within the scope exemption for business combinations. However, acquisitions of associates are not business combinations under the new definition, and are now within IFRIC 9's scope.

5 Paragraphs 20 and 23 of IAS 28 *Investments in Associates* require entities to account for the acquisition of an associate based on the principles in IFRS 3. IFRS 3 Revised requires entities to assess embedded derivatives whether they should be separated from the host contract in accordance with IAS 39 based on the conditions at the time of the acquisition of the subsidiary. It follows that IAS 28 would require entities to follow the same guidance with regard to the assessment of embedded derivatives acquired as part of the associate.

6 In view of the above, it seems that it would be consistent to exclude acquisitions of associates in addition to the formations of joint ventures and some common control transactions) from the scope of IFRIC 9 as a consequential amendment from the revisions to IFRS 3.

Question 2 – Effective date

The proposed amendment to IFRIC 9 would be effective for annual periods beginning on or after 1 July 2009 with prospective application, and would require an entity that applies IFRS 3 (revised 2008) for an earlier period to disclose that fact and apply the amendment to IFRIC 9.

Do you agree that this amendment should apply for annual periods beginning on or after 1 July 2009 with prospective application? If not, why?

7 The proposed amendment is consequential to the changes made in IFRS 3 Revised. Therefore, we agree that the effective date and transitional arrangements of the proposed amendment shall be identical to IFRS 3 Revised, i.e. it shall be applied prospectively for annual periods beginning on or after 1 July 2009 and, if IFRS 3 Revised is applied from an earlier date, this amendment shall be too.

Proposed amendment to IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*

Question 1 – Removal of the restriction on the entity that can hold hedging instruments

The Board proposes to amend paragraph 14 of IFRIC 16 to remove the restriction on the entity that can hold hedging instruments.

Do you agree with the proposal? If not, why?

8 When developing IFRIC 16, the IFRIC concluded that a financial instrument cannot be a hedging instrument of the net investment in a foreign operation holding this instrument. This is because it was considered that the gains and losses arising from this instrument would be included in the group's functional currency translation reserve as part of the consolidation process, and therefore hedge accounting would not be needed. However, it has been brought to IFRIC's attention that this conclusion is incorrect – part of the foreign exchange difference arising from such instruments would be included in the consolidated profit or loss.

9 In this ED, the IFRIC proposes that entities should be able to designate a financial instrument as a hedging instrument of the net investment in a foreign operation that holds this instrument and report gains and losses on the instrument in equity in the consolidated financial statements to the extent the hedge is effective. We understand that, if entities are able to designate such a financial instrument as a hedging instrument following all the hedge accounting requirements in IAS 39 *Financial Instruments: Recognition and Measurement* and IFRIC 16, there is no reason to prohibit hedge accounting for such a hedge.

10 Therefore, EFRAG supports the proposed amendment.

Question 2 – Effective date

IFRIC 16 is effective for annual periods beginning on or after 1 October 2008 with prospective application. The Board concluded that this amendment should apply in the same way.

Do you agree that this amendment should apply for annual periods beginning on or after 1 October 2008 with prospective application? If not, why?

11 The IASB proposes that the amendment should be applied prospectively for annual periods beginning on or after 1 October 2008, which are the same effective date and transitional arrangements as for IFRIC 16.

12 Generally, we do not support backdating the effective date of standards. Standards with backdated effective dates can be a particular problem in jurisdictions that require legal endorsement of any changes to IFRS before they can be applied. In this particular case, the nine month delay between the time existing IFRIC 16 (which includes the restriction regarding instruments hedging net investments in a foreign operation holding these instruments) was issued and the time the amendment that removes this restriction is issued (if it is adopted) is likely to result in a significant difference between their EU endorsement dates too.

13 Having said that, we recognise that backdating the effective date of this amendment could be beneficial because it should enable entities to follow the “correct” version of IFRIC 16 right away.

14 However, we note that designating hedge accounting on a date in the past is not in conformity with the contemporaneous designation requirements under the hedge accounting rules in IAS 39. Therefore, we think further guidance is needed on how entities could make use of the backdating of this proposed amendment and make a designation on a date in the past that would be considered in accordance with IFRS.

15 For example, under existing IFRS (including existing IFRS 16) if an entity wishes to designate a position as a hedge that attracts hedge accounting with effect from 1 October 2008, the entity would have had to have the designation documentation in place on 1 October 2008. However, it is unlikely that entities will have had such documentation in place for hedges that involve instruments hedging a net investment in a foreign operation holding such instruments as early as 1 October 2008. This is because hedge accounting was not allowed for such a hedge at that time and the entity could not possibly have anticipated this amendment because the IASB discussed it for the first time during its January meeting. That would suggest that, despite the effective date of the amendment being backdated to 1 October 2008, the reality is that entities are unlikely to be able to use the amendment prior to late January when entities might have started designating in anticipation of the amendment.

16 If, however, the intention is to exempt entities from the necessity of having the designation documentation in place until a certain date when they implement this amendment, it seems important to specifically state this fact and that this deviation from the hedge accounting requirements in IAS 39 can only be applied in this particular case by exception.