THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

14 January 2008

Our ref: ICAEW Rep 10/08

Mr Stig Enevoldsen
Chairman
EFRAG
Avenue des Arts 13-14
1210 Brussels
Belgium

By email: commentletter@efrag.org

Dear Stig

PROPOSED ANNUAL IMPROVEMENTS

The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on EFRAG's draft comments on the IASB exposure draft of *Proposed Improvements to International Financial Reporting Standards*, published by EFRAG in October 2007.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

We agree with most of the key views expressed by EFRAG, in particular the doubts expressed regarding the proposals under Issue 4, Statement of compliance with IFRSs, and Issue 30, Definition of a derivative. However, we would urge EFRAG to think again about its draft response in relation to Issue 28, Advertising and promotional activities. In our view, promotional material and advertisements should be expensed at the point when an entity ceases to have control of the asset. This will be the point at which the promotional material is distributed or the advertisement is published. We consider that there is a risk that commentators will not have understood the full implications of this significant change in accounting. Accordingly, we have recommended that the proposal be withdrawn and re-exposed separately after further consultation.

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I attach as Appendix A our responses to the specific questions raised by EFRAG, and as Appendix B our submission to the IASB on the proposals.

Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

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APPENDIX A
RESPONSES TO EFRAG QUESTIONS

Issue 10: Sale of assets held for rental

EFRAG would particularly welcome your comments on the views expressed on the changes to IAS 7. Is the asymmetry described a concern? EFRAG is concerned about whether it is appropriate to make a change of this kind through the Annual Improvements Project. Do you have a view on this issue?

In our view the supposed asymmetry is not a concern; we consider the change to be appropriate.

Issue 19: Government loans with a below-market rate of interest

Do you agree that the IASB should be asked to include additional guidance on the issues referred to above? Are there any other situations, concerning the requirement to impute interest on government loans, where in your view application guidance is needed?

No, we do not agree that further guidance is necessary.

Issue 28: Advertising and promotional activities

The Annual Improvements process is supposed to be used for relatively minor changes in accounting standards; more substantial changes to IFRS should be the subject of standalone amendments projects. We would welcome views as to whether this proposed amendment is a minor amendment. For example, do you believe it will change practice significantly?

We consider that the proposal represents a significant and inappropriate change in principle, and should be withdrawn for that reason.

Issue 30: Definition of a derivative

Do you agree with the proposal to amend IAS 39 by removing from the definition of a derivative the exclusion relating to contracts linked to non-financial variables that are specific to a party to the contract? If not, why?

We do not agree with the IASB proposal, as explained in our submission to the IASB, attached as Appendix B.

Issue 35: Property under construction or development for future use as investment property

EFRAG would particularly welcome your comments on the views expressed on the possibility to revalue assets under construction under IAS 16. Do you believe that such a possible change of substance should be part of the annual improvement project?

We are not convinced that EFRAG's understanding of the application of IAS 16 is correct.

In our view IAS 16 permits the remeasurement of properties as a separate class of assets, an approach widely applied in the UK. Consequently, in our view, there is no change to IAS 16.

APPENDIX B

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 09/08

PROPOSED IMPROVEMENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

Memorandum of comment submitted in January 2008 by The Institute of Chartered Accountants in England and Wales in response to the IASB exposure draft 'Proposed Improvements to International Financial Reporting Standards', published in October 2007

INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the Exposure Draft of *Proposed Improvements to International Financial Reporting Standards*, issued by the International Accounting Standards Board in October 2007.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

MAJOR POINTS

Support for the initiative

4. We welcome the Board's initiative in establishing a streamlined process for dealing efficiently with a collection of miscellaneous, non-urgent but necessary minor amendments to IFRSs. Although we understand that some commentators have raised concerns about whether some of the issues addressed are sufficiently 'minor' to be dealt with as part of an 'annual Improvements' process, we are content with the scope of the issues addressed in the Exposure Draft apart from those referred to in paragraphs 5 and 6 below.

Scope of the proposals

5. We would expect the Board to be very responsive to the views of commentators when finalising amendments which, whilst minor in scope, represent a change to a principle found in a current standard. We view items 28 (advertising and promotional activities) and 30 (definition of a derivative) as falling within this category. When reviewing the responses to the Exposure Draft the Board should consider whether the implications of such changes have been sufficiently understood and subject to an appropriate degree of scrutiny. As explained below, our preferred option is for these proposals to be withdrawn and re-exposed at a later date.

6. As explained in paragraph A4.1 in the Appendix, we do not agree with the proposal to require an entity that cannot make an unreserved statement of compliance with IFRSs to describe how its financial statements would have been different if prepared in full compliance with IFRSs. We fully understand the Board's determination to protect the IFRS brand, but there are complex issues involved that need to be more fully explored - outside of an annual improvements process - before the Board can hope to implement an effective brand protection strategy. Moreover, we do not believe that the present proposals would be at all effective.

Other concerns

7. As set out in the Appendix, we have a number of reservations about and disagreements with the detailed proposals. In particular, we disagree with the following proposals:

   (a) *IAS 19 Employee Benefits - Curtailments and negative past service cost* We agree that there has been divergence in practice in this area. However, we do not agree with the proposed amendment and doubt in any case that it entirely achieves the objective set out in the final sentence of BC9. (See paragraph A14.1)

   (b) *IAS 28 Investments in Associates - Impairments of investment in associates* We do not believe that it would be appropriate to recognise reversals of impairment losses. (See paragraph A 23.1)

   (c) *IAS 36 Impairment of Assets - Disclosure of estimates used to determine recoverable amount* We do not agree that the same disclosures should be given for fair value less costs to sell as are required for value in use when discounted cash flows are used to calculate fair value less costs to sell. (See paragraph A27.1)

   (d) *IAS 38 Intangible Assets - Advertising and promotional activities* We do not agree that the standard should be amended to state that an entity incurs an expense for goods when it has access to those goods; nor that an entity should be allowed to recognise a prepayment only until it has access to the related goods. (See paragraph A28.1)

   (e) *IAS 39 Financial Instruments: Recognition and Measurement - Definition of a derivative* We do not agree that the exclusion relating to contracts linked to non-financial variables that are specific to a party to the contract should be removed from the definition of a derivative. (See paragraph A30.1)

   (f) *IAS 41 Agriculture* We do not agree with the proposal to insert the words 'and harvest' into the definition of 'biological transformation'. (See paragraph A40.2)

Specific questions

8. Our answers to the specific questions raised by the Board are set out in the Appendix.

APPENDIX: ANSWERS TO DETAILED QUESTIONS

IFRS 1 First-time Adoption of International Financial Reporting Standards

Issue 1: Restructure of IFRS 1

The Board proposes to restructure IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The main change proposed is to remove some transitional provisions relating to particular IFRSs from the main body of the IFRS to appendices. The restructuring will not alter the technical content of IFRS 1. However, some transitional provisions have been removed as they are no longer relevant.

Question 1: Do you agree with the Board's proposed restructuring of IFRS 1? If not, why?

A1.1 We agree with the proposed restructuring of IFRS 1, and with the removal of the date-specific transitional provisions.

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Issue 2: Plan to sell the controlling interest in a subsidiary

The Board proposes to amend IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* by adding paragraph 8A to clarify that assets and liabilities of a subsidiary should be classified as held for sale if the parent has a sale plan involving loss of control of the subsidiary.

Question 2: Do you agree with the proposal to add paragraph 8A to IFRS 5 to clarify that assets and liabilities of a subsidiary should be classified as held for sale if the parent has a sale plan involving loss of control of the subsidiary? If not, why?

A2.1 In our comments on ED 4 we noted that the proposals would lead to a rules-based standard under which classification is driven - in line with US GAAP - by management intent rather than by commitment. We continue to have a number of reservations about the appropriateness of IFRS 5 in the IFRS canon. However, the proposal is consistent in the context of IFRS 5 as it stands.

IFRS 7 Financial Instruments: Disclosures

Issue 3: Presentation of finance costs

The Board proposes to amend the guidance on implementing IFRS 7 *Financial Instruments: Disclosures*. There is a potential conflict between that guidance and IAS 1 *Presentation of Financial Statements* (as revised in 2007). IAS 1 precludes the presentation of

net finance costs (or a similar term) in the statement of comprehensive income unless the finance costs and finance revenue included in the net total are disclosed. Paragraph IG13 of the guidance on implementing IFRS 7 indicates that total interest income and total interest expense* could be included as a component of finance costs. The Board proposes to resolve the potential conflict by amending paragraph IG13.

Question 3: The Board proposes to amend paragraph IG13 of IFRS 7* Financial Instruments: Disclosures *to resolve the potential conflict with IAS 1. Do you agree with the proposal? If not, why?

A3.1 We agree that there is a potential conflict between IAS 1 and IFRS 7 and with the proposed amendment.

IAS 1 Presentation of Financial Statements

Issue 4: Statement of compliance with IFRSs

The Board proposes to insert in IAS 1 *Presentation of Financial Statements* (as revised in 2007) disclosure requirements for entities that refer to International Financial Reporting Standards (IFRSs) in describing the basis on which their financial statements are prepared but are not able to make an explicit and unreserved statement of compliance with IFRSs. Such an entity would be required to make disclosures about how its financial statements would have been different if prepared in full compliance with IFRSs.

The International Auditing and Assurance Standards Board (IAASB) published in July 2007 an exposure draft of Proposed International Standard on Auditing (ISA) 700 (Redrafted) *The Independent Auditor's Report on General Purpose Financial Statements*. The IAASB included in its exposure draft proposed guidance for auditors on their evaluation of the description of the financial reporting framework in the financial statements. It also included proposed guidance for auditors on addressing the effect that such a description may have on the auditor's opinion. The IAASB prepared its proposed guidance on the basis of the Board's proposed amendment to IAS 1 included in this annual improvements exposure draft.

Question 4: Do you agree with the proposal to require an entity that cannot make an unreserved statement of compliance with IFRSs to describe how its financial statements would have been different if prepared in full compliance with IFRSs? If not, why?

A4.1 We share the Board's concerns in this area; our strong preference is for adoption throughout the world of IFRS as issued by the IASB. However, we believe that the proposed amendment will be ineffective. We have sympathy with the alternative views of Messrs Leisenring and McGregor set out on page 62 of the Exposure Draft:

(a) A requirement in IFRSs for an entity to disclose that it has not complied with IFRSs is tantamount to condoning non-compliance with IFRSs and, as such, undermines the credibility of IFRSs.

(b) The objective of including the requirement is unlikely to be achieved because there is no reason to believe that entities that have failed to comply with other IFRS requirements will comply with this proposed requirement. Moreover, it is hard to imagine an entity disclosing that it has failed to meet this disclosure requirement.

Issue 5: Current/non-current classification of convertible instruments

IAS 1 requires a liability to be classified as current if the entity does not have an unconditional right to defer settlement for at least twelve months from the end of the reporting period. The *Framework* states that settlement includes conversion of the liability into equity. Consequently, the liability component of a convertible instrument that the entity could be required to settle in shares at any time would be classified as current. The Board proposes to limit the requirement for an entity to have an unconditional right to defer settlement to settlement by transfer of cash or other assets.

Question 5: Do you agree with the proposal to clarify that the potential settlement of a liability by the issue of equity is not relevant to its classification as current? If not, why?

A5.1 We agree. The current standard is flawed by giving the term 'settlement' too wide a meaning. The potential settlement of a liability by the issue of equity is not relevant to its classification as current, because such a settlement is not an outflow of resources. The proposed change clarifies this.

Issue 6: Current/non-current classification of derivatives

The Board proposes to amend IAS 1 to address inconsistent guidance in IAS 1 regarding the current/non-current classification of derivatives. The guidance included in paragraph 71 of IAS 1 might be read by some as implying that financial liabilities that are classified as held for trading in accordance with IAS 39 are required to be presented as current. The Board expects the criteria set out in paragraph 69 of IAS 1 to be used to assess whether a financial liability should be classified as current or non-current. The Board also noted that a similar concern exists in respect of current assets in paragraph 68.

Question 6: Do you agree with the proposal to amend the examples in paragraphs 68 and 71 of IAS 1 to remove the potential implication that financial assets and

financial liabilities that are classified as held for trading in accordance with IAS 39 are required to be presented as current? If not, why?

A6.1 We do not believe that deleting the references to IAS 39 in paragraphs 68 and 71 is sufficient to resolve the issue being addressed. We agree that the guidance in IAS 1 regarding current assets and liabilities suggests that all held-for-trading derivatives should be classified as current irrespective of how long they may be outstanding. However, any financial instrument classified as held-for-trading under IAS 39 would, in our view, also meet the definition of 'held primarily for the purposes of trading' in paragraph 69(b) of IAS 1.

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

Issue 7: Status of implementation guidance

The Board proposes to amend IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to clarify the status of implementation guidance. The Board has been advised that paragraph 7 of IAS 8 could be misinterpreted as requiring the mandatory application of implementation guidance.

Question 7: Do you agree with the proposal to amend paragraphs 7, 9 and 11 of IAS 8 to clarify the status of implementation guidance? If not, why?

A7.1 We do not believe that the existing wording could be misinterpreted. However, the proposed amendment makes the status of the Implementation Guidance completely clear.

IAS 10 Events after the Reporting Period

Issue 8: Dividends declared after the end of the reporting period

The Board proposes to amend IAS 10 *Events after the Reporting Period* to clarify why a dividend declared after the reporting period does not result in the recognition of a liability.

Question 8: Do you agree with the proposal to amend paragraph 13 of IAS 10 to clarify why a dividend declared after the reporting period does not result in the recognition of a liability at the end of the reporting period? If not, why?

A8.1 We agree with the proposal. It is clearly not the intention of IAS 10 to imply that, in circumstances where there is an established pattern of paying a dividend, a liability should be recognised for dividends not declared until after the balance sheet date.

IAS 16 Property, Plant and Equipment

Issue 9: Recoverable amount

The Board proposes to amend IAS 16 *Property, Plant and Equipment* to remove the perceived inconsistency between the definition of recoverable amount and the term 'recoverable amount' used in other IFRSs.

Question 9: Should the definition of recoverable amount in IAS 16 be amended to remove the perceived inconsistency with 'recoverable amount' used in other IFRSs? If not, why?

A9.1 We do not necessarily oppose the proposed amendment. However, we are not convinced it is necessary. IAS 16 does not itself require the use of recoverable amount, except to the extent that it cross refers to IAS 36 *Impairment of Assets* in IAS16.63, so the definition in IAS 16 is redundant in the light of IAS 36. If an amendment is required, deleting the definition in IAS 16 would be simpler and equally effective.

Issue 10: Sale of assets held for rental

The Board also proposes to amend IAS 16 to address presentation issues arising from assets held for rental to others that are routinely sold in the course of its ordinary activities. The Board proposes a consequential amendment to IAS 7 *Statement of Cash Flows* in respect of this issue. The proposed amendment to IAS 7 is included in the IAS 7 chapter of this exposure draft.

Question 10: Do you agree with the proposal to amend paragraph 68 of IAS 16 and paragraph 14 of IAS 7? If not, why?

A10.1 We agree.

IAS 17 Leases

Issue 11: Classification of leases of land and buildings

The Board proposes to amend IAS 17 *Leases* to address a perceived inconsistency between the specific classification guidance for leases of land and buildings and the general lease classification guidance in IAS 17.

Question 11: Do you agree with the proposal to amend paragraphs 14 and 15 of IAS 17 to eliminate a perceived inconsistency between the specific classification guidance for leases of land and buildings and the general lease classification guidance in IAS 17? If not, why?

A11.1 In our view the effect of the current wording in IAS 17 is that all leases of land are classified as operating leases, a reading endorsed in the rejection notice on this topic set out in the March 2006 edition of IFRIC Update. The Board's proposals may be read as applying the general guidance in paragraphs 8-12 of IAS 17 to leases of land, with the effect that long leases of land may be finance leases. If this is the Board's intention, we concur, but the Board should for the avoidance of doubt explain in the basis for conclusions to the standard that this is a change to its previous stance.

Issue 12: Contingent rents

IAS 17 requires contingent rent relating to an operating lease to be estimated at the inception of the lease and recognised on a straight-line basis over the lease term. However, because of perceived ambiguities in the IFRS, current practice has been to recognise contingent rent relating to an operating lease in the manner prescribed for finance leases (ie as incurred). The Board proposes that contingent rent relating to an operating lease should be recognised as incurred. This would achieve consistency in the treatment of contingent rent for finance and operating leases.

Question 12: Do you agree with the proposal that contingent rent relating to an operating lease should be recognised as incurred? If not, why?

A12.1 We agree.

IAS 18 Revenue

Issue 13: Costs of originating a loan

The Board proposes to amend the guidance accompanying IAS 18 *Revenue* to remove an inconsistency with IAS 39 *Financial Instruments: Recognition and Measurement*. The inconsistency relates to the definition of costs incurred in originating a financial asset that should be deferred and recognised as an adjustment to the effective interest rate. The proposed amendment states that the transaction costs to be applied to the accounting for financial asset origination fees in accordance with IAS 18 are those defined in IAS 39.

Question 13: Do you agree with the proposed amendment to the guidance on IAS 18 to explain that the definition of the transaction costs to be applied to the accounting for financial asset origination fees are those defined in IAS 39? If not, why?

A13.1 We agree with the proposal to refer to transaction costs as defined in IAS 39 (instead of direct costs) in paragraph 14(a)(i) of the Appendix to IAS 18.

A13.2 However, paragraph 14(a)(ii), uses the words 'related direct costs'; and paragraph 14(a)(iii), uses the term 'related transaction costs incurred' . We suggest that these paragraphs should also be amended for consistency (although we accept that paragraph 14(a)(iii) is already consistent with IAS 39).

IAS 19 Employee Benefits

Issue 14: Curtailments and negative past service cost

The Board proposes to amend IAS 19 in respect of plan amendments. Ambiguous definitions of negative past service costs and curtailments have resulted in diverse accounting for plan amendments that reduce existing benefits. This proposed amendment clarifies that when a plan amendment reduces benefits for future service, the reduction relating to future service is a curtailment and any reduction relating to past service is negative past service cost. The Board also proposes to delete a reference to materiality in paragraph 111 of IAS 19.

Question 14: (a) Do you agree that IAS 19 should be amended to clarify that when a plan amendment reduces benefits for future service, the reduction relating to future service is a curtailment and any reduction relating to past service is negative past service cost? If not, why?

A14.1 We agree that there has been divergence in practice in this area. However, we do not agree with the proposed amendment and doubt in any case that it entirely achieves the objective set out in the final sentence of BC9.

A14.2 The defined benefit obligation reflected in accounts relates entirely to past service, so it is not clear how there can be any gain or loss to recognise from a reduction in benefits for future service. Our understanding is that the only amount to be recognised as a curtailment would be any unrecognised actuarial gains and losses and past service cost, recognised in accordance with paragraph 109(c). In our view, the Board should make this very clear, as there will otherwise be continued divergence, since those applying the standard will not know how to calculate the gain or loss in respect of an item not found in the accounts. This could be done, for example, by either changing paragraph 98(e), which as currently worded focuses on a single amendment that affects both past and future service benefits, to distinguish more clearly between past and future; or amending the first sentence of paragraph 111A to state clearly that the "effect" to be recognised as a curtailment will be only the recognition of any previously unrecognised amounts caught by paragraph 109(c).

Question 14: (b) Do you agree that the Board should delete the following sentence from paragraph 111 of IAS 19: 'An event is material enough to qualify as a curtailment if the recognition of a curtailment gain or loss would have a material effect on the financial statements.'? If not, why?

A14.3 We do not see the need to remove references to materiality in paragraph 111. We accept that the similar statement IAS 1 is applicable, but remain concerned that the proposed changes might be seen as requiring entities as having to treat smaller, non-material pension impacts of business disposals as curtailments. Moreover, the effect of replacing the word 'material' with 'significant' is unclear, as 'significant' is not to our knowledge defined in IFRS.

A14.4 We believe that a further change should also be made, to the definition of past service cost and revised paragraph 97. At present, negative past service cost is defined as arising only from a reduction in benefits and a positive past service cost only from an improvement. In some cases this definition may not fit, for example when benefits are improved by granting members greater flexibility in how they take their pension but the expectation is that the impact will be to reduce the entity's pension cost. We suggest that the final sentence of the definition be amended to omit the two sections of the text in brackets and that the proposed final sentence of paragraph 97 should not be added. The word 'negative' should also be omitted from paragraph 111A.

Issue 15: Plan administration costs

The Board proposes to amend the definition of return on plan assets in IAS 19 to require the deduction of plan administration costs only to the extent that such costs have not been reflected in the measurement of the defined benefit obligation.

Question 15: Do you agree with the proposal to amend the definition of return on plan assets in paragraph 7 of IAS 19 to require the deduction of plan administration costs only to the extent that such costs have not been reflected in the measurement of the defined benefit obligation? If not, why?

A15.1 We are not convinced that the revised definition is necessary, as IAS 19.107 states that 'In determining the expected and actual return on plan assets, an entity deducts expected administration costs, other than those included in the actuarial assumptions used to measure the obligation'.

A15.2 IAS 19.107 recognises that administration costs may either be included as part of the defined benefit obligation or deducted from the return on pension plan assets. We are content for the standard to recognise both treatments.

Issue 16: Replacement of term 'fall due'

The Board proposes to replace the term 'fall due' in the definitions of short-term employee benefits and other long-term employee benefits.

Question 16: Do you agree with the proposal to replace in IAS 19 the term 'fall due' with the notion of employee entitlement in the definitions of short-term employee benefits and other long-term employee benefits? If not, why?

A16.1 We do not believe that the Board's proposal will resolve this issue without creating other difficulties. It is possible that the change will lead to a change in classification for a wide range of existing benefits. As the measurement bases for short-term benefits and long-term benefits are different, any change in classification could have a significant impact.

A16.2 It is also not clear whether the term "becomes entitled" refers to vesting or not. For example, assume a lump sum payment under a deferred compensation plan is payable on the fourth anniversary or on leaving service. One interpretation of the term would be that at an intervening balance sheet date, the payment would be classified as short-term, as the employee is entitled to the benefit (as it would be payable immediately if the employee leaves). This runs against current practice, which would result in the classification of the payment as long-term and a valuation allowing for the possibility of early payment from expected employee churn. The answer under the new interpretation would be consistent with IAS 1; however, it would be inconsistent with previous SIC guidance regarding the measurement of vested post-employment benefits, where a liability should reflect the expected leaving date.

A16.3 We suggest that this issue is considered further as part of the Board's wider project on pensions accounting.

Issue 17: Guidance on contingent liabilities

The Board proposes to remove from IAS 19 the reference to recognition in relation to contingent liabilities.

Question 17: Should the reference in IAS 19 to recognising contingent liabilities be removed? If not, why?

A17.1 We agree.

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

Issue 18: Consistency of terminology with other IFRSs

The Board proposes to amend IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* to conform terminology used by IAS 20 to the equivalent defined or more widely used terms. The Board proposes consequential amendments to IAS 41 *Agriculture* in respect of this issue. The proposed consequential amendments to IAS 41 are included in the IAS 41 chapter of this exposure draft.

Question 18: Do you agree with the proposal to conform terminology used by IAS 20 to the equivalent defined or more widely used terms? If not, why?

A18.1 We agree.

Issue 19: Government loans with a below-market rate of interest

The Board also proposes to amend IAS 20 to remove an inconsistency with IAS 39 *Financial Instruments: Recognition and Measurement*. The proposed amendment clarifies that the benefit of a loan received from a government with a below-market rate of interest should be quantified by the imputation of interest in accordance with IAS 39.

Question 19: Do you agree with the proposed amendments to IAS 20 to clarify that the benefit of a loan received from a government with a below-market rate of interest should be quantified by the imputation of interest in accordance with IAS 39? If not, why?

A19.1 We agree.

IAS 23 Borrowing Costs

Issue 20: Components of borrowing costs

The Board proposes to amend IAS 23 *Borrowing Costs* (as revised in 2007) to refer to the guidance in IAS 39 *Financial Instruments: Recognition and Measurement* on effective interest rate when describing the components of borrowing costs.

Question 20: Do you agree with the proposal to amend paragraph 6 of IAS 23 to reference to the guidance in IAS 39 Financial Instruments: Recognition and Measurement relating to effective interest rate when describing the components of borrowing costs? If not, why?

A20.1 We agree.

IAS 27 Consolidated and Separate Financial Statements

Issue 21: Measurement of subsidiary held for sale in separate financial statements

The Board proposes to amend IAS 27 *Consolidated and Separate Financial Statements* (as amended in 2007) to require investments in subsidiaries that are accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* in the parent's separate financial statements to continue to be accounted for on that basis when classified as held for sale (or included in a disposal group that is classified as held for sale).

Question 21: Do you agree with the proposal to require investments in subsidiaries that are accounted for in accordance with IAS 39 in the parent's separate financial statements to continue to be accounted for on that basis when classified as held for sale (or included in a disposal group that is classified as held for sale)? If not, why?

A21.1 We agree.

IAS 28 Investments in Associates

Issue 22: Required disclosures when investments in associates are accounted for at fair value through profit or loss

The Board proposes to amend IAS 28 to clarify the disclosures required of an investor in an associate that accounts for its interest in the associate at fair value in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* with changes in fair value recognised in profit or loss. The Board proposes consequential amendments to IFRS 7 *Financial Instruments: Disclosures* and IAS 32 *Financial Instruments: Presentation* in respect of this issue. The proposed consequential amendments to IFRS 7 and IAS 32 are included in the respective chapters of this exposure draft.

Question 22: Do you agree with the proposal to clarify the disclosures required of an investor in an associate that accounts for its interest in the associate at fair value in accordance with IAS 39, with changes in fair value recognised in profit or loss? If not, why?

A22.1 We agree with the Board's proposed approach, which is to remove the disclosure requirements from IAS 32 and IFRS 7, and to identify the specific disclosure it deems necessary.

Issue 23: Impairment of investment in associate

The Board proposes to amend IAS 28 to clarify the circumstances in which an impairment charge against an investment in an associate should be reversed.

Question 23: Do you agree with the proposal to amend paragraph 33 of IAS 28 to clarify the circumstances in which an impairment charge against an investment in an associate should be reversed? If not, why?

A23.1 We do not agree with the clarification proposed by the IASB. As the standard is currently written, the equity method does identify goodwill, and it would therefore be consistent with full consolidation not to permit reversal of impairment of goodwill. This view is in turn consistent with the alternative view expressed by Mr Tatsumi Yamada on page 119 of the Exposure Draft. The Board's proposal to regard an investment in an associate as a single asset appears to anticipate changes to the equity method of accounting that have not been implemented.

IAS 29 Financial Reporting in Hyperinflationary Economies

Issue 24: Consistency of terminology with other IFRSs

The Board proposes to amend IAS 29 *Financial Reporting in Hyperinflationary Economies* to update the description of historical cost financial statements in paragraph 6 and to conform terminology in IAS 29 to the equivalent defined or more widely used terms.

Question 24: Do you agree with the proposal to update the description of historical cost financial statements in paragraph 6 IAS 29 and to conform terminology in IAS 29 to the equivalent defined or more widely used terms? If not, why?

A24.1 We agree.

IAS 31 Interests in Joint Ventures

Issue 25: Required disclosures when interests in jointly controlled entities are accounted for at fair value through profit or loss

The Board proposes to amend IAS 31 *Interests in Joint Ventures* to clarify the disclosures required of a venturer in a jointly controlled entity that accounts for its interest in the jointly controlled entity at fair value in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* with changes in fair value recognised in profit or loss. The Board proposes consequential amendments to IFRS 7 *Financial Instruments: Disclosures* and IAS 32 *Financial Instruments: Presentation* in respect of this issue. The proposed consequential amendments to IFRS 7 and IAS 32 are included in the respective chapters of this exposure draft. A similar amendment is proposed in respect of the required disclosures when investments in associates are accounted for at fair value through profit or loss. Details of the proposed amendments to IAS 28 *Investments in Associates*, the invitation to comment and the respective basis for the Board's proposal are included in the IAS 28 chapter in this exposure draft.

Question 25: Do you agree with the proposal to clarify the disclosures required of a venturer in a jointly controlled entity that accounts for its interest in the jointly controlled entity at fair value in accordance with IAS 39, with changes in fair value recognised in profit or loss? If not, why?

A25.1 We agree.

IAS 34 Interim Financial Reporting

Issue 26: Earnings per share disclosures in interim financial reports

The Board proposes to amend IAS 34 *Interim Financial Reporting* to require the presentation of basic and diluted earnings per share only when the entity is within the scope of IAS 33 *Earnings per Share*.

Question 26: Do you agree with the proposal to amend paragraph 11 of IAS 34 to require the presentation of basic and diluted earnings per share only when the entity is within the scope of IAS 33? If not, why?

A26.1 We agree.

IAS 36 Impairment of Assets

Issue 27: Disclosure of estimates used to determine recoverable amount

The Board proposes to amend IAS 36 *Impairment of Assets* to require the same disclosures to be given for fair value less costs to sell as are required for value in use when discounted cash flows are used to calculate fair value less costs to sell.

Question 27: Do you agree with the proposal to amend paragraph 134(e) of IAS 36 to require the same disclosures to be given for fair value less costs to sell as are required for value in use when discounted cash flows are used to calculate fair value less costs to sell? If not, why?

A27.1 We do not agree. The Board notes that the disclosures required by IAS 36 when value in use is used to determine recoverable amount differ significantly from those required when fair value less costs to sell is used. These differing requirements are said to be inconsistent for those occasions when a similar valuation methodology (discounted cash flows) has been used. However, paragraphs 25-27 of IAS 36, in considering acceptable methods of calculating fair value less costs to sell, do not discuss the discounted cash flow method. By requiring the same disclosures for value in use and fair value less costs to sell estimated using discounted cash flows, the Board would be requiring disclosure of a methodology not discussed in the relevant section of the standard.

IAS 38 Intangible Assets

Issue 28: Advertising and promotional activities

IAS 38 requires expenditure on advertising or promotional activities, training activities and start-up activities, and on relocating or reorganising part or all of an entity, to be recognised as an expense as incurred. Divergent interpretations have developed about when such expenses are incurred. This proposed amendment clarifies the meaning of 'as incurred' in this context. It also makes clear that an entity may recognise a prepayment for goods or services as an asset only until that entity has access to the goods or has received the services.

Question 28: (a) Do you agree that IAS 38 should emphasise that an entity should recognise expenditure on an intangible item as an expense when it has access to the goods or has received the services? If not, why?

Question 28: (b) Do you agree that paragraph 70 of IAS 38 should be amended to allow an entity to recognise a prepayment only until it has access to the related goods or has received the related services? If not, why?

A28.1 We strongly disagree with the Board's proposals. In our view, promotional material and advertisements should be expensed at the point when an entity ceases to have control of the asset. This will be the point at which the promotional material is distributed or the advertisement is published. In our view there is a risk that commentators will not have understood the full implications of this significant change in accounting. Accordingly, we recommend that the proposal be withdrawn and re-exposed separately after further consultation.

Issue 29: Unit of production method of amortisation

The Board also proposes to amend IAS 38 by removing the last sentence of paragraph 98 which states:

'There is rarely, if ever, persuasive evidence to support an amortisation method for intangible assets with finite useful lives that results in a lower amount of accumulated amortisation than under the straight-line method.'

The Board has been informed that in practice the words 'rarely, if ever' in paragraph 98 are interpreted as 'never'. The project by the International Financial Reporting Interpretations Committee on service concessions highlighted situations where using the unit of production method of amortisation would be appropriate. However, where the expected pattern of consumption of the future economic benefits in the asset is weighted to the end of the asset's life, paragraph 98 is perceived as restricting an operator from using this method. The Board proposes an amendment to IAS 38 to resolve the issue.

Question 29: Do you agree with the proposal to remove the last sentence of paragraph 98 of IAS 38 regarding the amortisation method used for intangible assets? If not, why?

A29.1 We agree that deleting the last sentence of IAS 38.98 achieves the Board's intention of permitting use of the unit of production method. However, it may also open the door to other methods not acceptable to the Board. It may therefore be more appropriate for the Board to provide an express endorsement of the unit of production method.

IAS 39 Financial Instruments: Recognition and Measurement

Issue 30: Definition of a derivative

The Board proposes to amend the definition of a derivative. The definition in IAS 39 excludes contracts linked to non-financial variables that are specific to a party to the contract. The proposed amendment would remove that exclusion. As a result, contracts linked to non-financial variables specific to a party to a contract within the scope of IAS 39 would be classified as derivatives.

Question 30: Do you agree with the proposal to amend IAS 39 by removing from the definition of a derivative the exclusion relating to contracts linked to non-financial variables that are specific to a party to the contract? If not, why?

A30.1 We do not agree with this proposal. Changing the definition of a derivative within the scope of IAS 39 will affect a wider range of contracts than those within the scope of IFRS 4. The analysis in the Exposure Draft is insufficient to determine what will or will not meet the changed definition. Moreover, the words to be removed can prove useful in other contexts - for example, in considering where to draw the between the financial asset model and the intangible asset model under IFRIC 12. We do not believe that a change should be made until all its possible implications have been considered, and accordingly recommend that this proposal be withdrawn and re-exposed separately after further consideration.

A30.2 We believe, for example, that a change in definition would have a material impact regarding:

- Real estate management fees where the fees are based on income generated by the underlying property;
- Lease contracts where payments are based on performance measures specific to the lessee (e.g. earnings performance);
- Loans with variable interest rates that are based on the performance of the borrower (e.g. an interest step-up feature in the event that the borrower failed to meet liquidity ratios such as interest cover);
- Loans with repayment or interest schedules that are linked to earnings performance of the borrower;
- Loans where the interest rate is linked to profit from the sale of assets held by the borrower;
- Property development loans where the interest rate is linked to profit on or the ultimate sale of the development;
- Certain financial options that are triggered by non-financial variables that are specific to a party to the contract (e.g. an option to acquire equity that is triggered by default under an agreement or by a specific earnings target being met);
- Residual value guarantees (e.g. where a leasing company guarantees the value of a car at the end of the lease term);
- Pharmaceutical industry contracts (e.g. where payments to be received for providing a new drug are dependent on the success rate of that drug);
- Mobile phone service provider arrangements (e.g. where distributors are compensated by service providers dependent on the length of contract term agreed with the end customer); and
- Service concession arrangements where lease payments are dependent on performance of the infrastructure asset.

As these examples illustrate, requiring an entity to fair value its own business risk or its own future profit streams is inappropriate. Where these contracts are currently measured at amortised cost, we believe the adjustments currently required by paragraph AG8 would provide a better measure of changes in the contract's value than fair value measurement.

Issue 31: Reclassification of derivatives into or out of the classification of at fair value through profit or loss

The Board proposes to clarify in what circumstances specific financial instruments start or cease to be accounted for at fair value through profit or loss.

Question 31: (a) Do you agree with the proposal to amend IAS 39 to clarify definitions of a financial instrument classified as held for trading? If not, why?

A31.1 We agree.

Question 31: (b) Do you agree with the proposal to insert in IAS 39 paragraph 50A to clarify the changes in circumstances that are not reclassifications into or out of the fair value through profit or loss category? If not, why?

A31.2 We agree.

Issue 32: Designating and documenting hedges at the segment level

The Board proposes to remove the apparent conflict between paragraph 73 and the requirements of IFRS 8 *Operating Segments*.

Question 32: Do you agree with the proposal to amend paragraph 73 of IAS 39 to remove the references to segments and segment reporting? If not, why?

A32.1 We agree.

Issue 33: Applicable effective interest rate on cessation of fair value hedge accounting

The Board proposes to clarify that the effective interest rate calculated on cessation of fair value hedge accounting in accordance with paragraph 92 should be used to remeasure the hedged item when paragraph AG8 applies.

Question 33: Do you agree with the proposal to amend paragraph AG8 of IAS 39 to clarify that the revised effective interest rate calculated in accordance with paragraph 92 shall be used, when applicable, for the purposes of the remeasurement of the financial instrument in accordance with paragraph AG8? If not, why?

A33.1 We agree.

Issue 34: Treating loan prepayment penalties as closely related embedded derivatives

The Board proposes to remove an inconsistency between paragraphs AG30(g) and AG33(a) with respect to embedded prepayment options. The proposed amendment clarifies that prepayment options, the exercise price of which compensate the lender for loss of interest by reducing the economic loss from

reinvestment risk, as described in paragraph AG33(a), are closely related to the host debt contract.

Question 34: Do you agree with the proposal to amend paragraph AG30(g) of IAS 39 to clarify that prepayment options, the exercise price of which compensate the lender for loss of interest by reducing the economic loss from reinvestment risk, as described in paragraph AG33(a), are closely related to the host debt contract? If not, why?

A34.1 We agree that an amendment is required. However, the proposed wording of the amendment is confusing and the type of prepayment option being referred to is unclear. If the intention is to clarify that prepayment options that reimburse the lender for loss of interest income are closely related to the host debt contract, then the reference to reinvestment risk should be removed. It is unclear why reduction of economic loss from reinvestment risk is relevant in this context. Further, the reference to paragraph AG33(a) should be deleted given that this paragraph provides no guidance on reinvestment risk. The Board might consider as wording for paragraph AG30(g):

" However, a prepayment option for which the exercise price ~~compensates~~ reimburses the lender for loss of interest ~~by reducing the economic loss from reinvestment risk, as described in paragraph AG33(a),~~ is closely related to the host debt contract."

IAS 40 Investment Property

Issue 35: Property under construction or development for future use as investment property

The Board proposes to remove an inconsistency within IAS 40. At present, if an existing investment property is redeveloped, the property is accounted for using IAS 40. However, if a property is purchased for the purpose of constructing or developing a future investment property, the property is within the scope of IAS 16 *Property, Plant and Equipment* until it is complete.

The Board proposes to remove from the scope of IAS 16 property under construction or development for future use as an investment property and to include it within the scope of IAS 40. As part of these amendments, such property will be within the definition of investment property. As a result, where an entity uses the fair value model in IAS 40, changes in the fair value of such property will be included in the statement of comprehensive income. The Board proposes consequential amendments to IAS 16 in respect of this issue. The proposed consequential amendments to IAS 16 are included in the IAS 16 chapter of this exposure draft.

Question 35: The exposure draft proposes to include property under construction or development for future use as an investment property within the scope of IAS 40. Do you agree with the proposal? If not, why?

A35.1 We welcome this amendment, which will allow entities with development properties that are later held as investments to be consistently revalued through the profit and loss account. We believe, however, that to reflect properly the change in scope, IAS 40.53 also needs amending to clarify that an entity should apply the fair value model where fair value becomes reliably measurable. This would align with the Board's comments in IAS 40.BC1 and would ensure consistency with IAS 39.53 regarding investments in unquoted equity instruments, where entities are required to remeasure at fair value if it becomes possible to measure fair value reliably.

Issue 36: Consistency of terminology with IAS 8

The Board proposes to amend paragraph 31 of IAS 40 to ensure consistency with the text of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Question 36: Do you agree with the proposal to conform terminology used in paragraph 31 of IAS 40 to the terminology used in IAS 8? If not, why?

A36.1 We agree.

Issue 37: Investment property held under lease

The Board proposes to amend IAS 40 to make clear how an investment property under lease should be recorded.

Question 37: Should paragraph 50(d) of IAS 40 be amended to clarify the accounting for investment property held under a lease? If not, why?

A37.1 We agree.

IAS 41 Agriculture

Issue 38: Point-of-sale costs

IAS 41 requires a biological asset to be measured at its fair value less estimated point-of-sale costs unless its fair value cannot be measured reliably. The term ‘point-of-sale costs’ is not used in other IFRSs. The Board proposes to replace ‘point-of-sale costs’ with ‘costs to sell’. This amendment would make IAS 41 consistent with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 36 *Impairment of Assets*. The Board proposes consequential amendments to IFRS 5, IAS 2 *Inventories* and IAS 36 in respect of this issue. The proposed consequential amendments to IFRS 5, IAS 2 and IAS 36 are included in the respective chapters of this exposure draft.

Question 38: Do you agree with the proposal to replace the terms 'point-of-sale costs' and 'estimated point-of-sale costs' in IAS 41 with 'costs to sell'? If not, why?

A38.1 We are content with the proposed change. However, we note that 'costs to sell' may well have a broader meaning than 'point-of-sale costs'.

Issue 39: Discount rate for fair value calculations

The Board also proposes to remove a requirement that the discount rate used to determine fair value should be a pre-tax rate. The proposed amendment requires a current market-determined rate to be used but permits this to be a pre-tax or post-tax rate according to the valuation methodology used to determine fair value.

Question 39: Do you agree with the proposed amendment to IAS 41 to permit either a pre-tax or a post-tax discount rate to be used according to the valuation methodology used to determine fair value? If not, why?

A39.1 We agree.

Issue 40: Additional biological transformation

The Board also proposes to remove the prohibition on taking 'additional biological transformation' into consideration when calculating fair value using discounted cash flows.

Question 40: Do you agree with the proposal to remove the exclusion of 'additional biological transformation' from paragraph 21 of IAS 41? If not, why?

A40.1 We agree with the proposal to amend paragraph 17 by inserting the words 'in its present location and condition'. We also agree with the proposal to amend paragraph 21.

A40.2 We do not agree with the proposal to insert the words 'and harvest' into the definition of 'biological transformation'. Harvesting is a process carried out by man, so it is not a biological transformation. The reason for the proposal is obscure, and its effect can only be confusing.

Issue 41: Examples of agricultural produce and products

The Board also proposes to revise the examples of agricultural produce and products that are the result of processing after harvest.

Question 41: Do you agree with the proposed amendments to the examples in paragraph 4 of IAS 41? If not, why?

A41.1 We agree.

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