FRC

Accounting Standards Board

Aldwych House, 71-91 Aldwych, London WC2B 4HN
Telephone: 020 7492 2300 Fax: 020 7492 2399
www.frc.org.uk/asb

Stig Enevoldsen
European Financial Reporting Advisory Group
Avenue Des Arts 13-14
1210 Brussels
Belgium

Commentletter@efrag.org

3 November 2008

Dear Stig

EFRAG's Draft Comment Letter on the IASB's ED 'Improvements to IFRSs'

Thank you for providing the Board with the opportunity to comment on your draft response to the International Accounting Standards Board's (IASB) exposure draft (ED) 'Improvements to IFRSs'.

The Board has responded directly to the IASB and a copy of our letter is attached.

The Board broadly agrees with the comments EFRAG has made and a number of them underscore the points we have raised in our comment letter to the IASB. In response to the questions you have asked of constituents, we have set out our comments in an attachment to this letter.

There are a number of points raised in the draft EFRAG response which are likely to be considered by the IASB as beyond the scope of the improvements programme and, therefore, may not be addressed on the grounds of due process requirements not being met. We think it would be helpful for EFRAG to specifically note this and call for the IASB to deal with those issues in other parts of its technical work programme. Otherwise there is a danger that those issues will not be addressed comprehensively.

Should you have any queries regarding our response please contact me, or Mario Abela, Project Director, on +44 20 7492 2442 or by email m.abela@frc-asb.org.uk.

Yours sincerely

Ian Mackintosh
Chairman
DDI: 020 7492 2434
Email: i.mackintosh@frc-asb.org.uk

Detailed Responses to Questions

Question 1 (Segment Assets) 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?
ASB Comment In our view, the requirement to provide segment asset information should be consistent with the basis of reporting to the CODM. We note that this is consistent with the requirements of US GAAP and the intention of the IASB. Whilst there may be circumstances where information about segment assets would be useful to users of the financial statements, we agree with the IASB that where an entity does not report on that basis internally it would potentially impose unreasonable costs on preparers. Accordingly, based on weighing up the costs and benefits, we support the proposed amendment to IFRS 8. We think clear and compelling evidence needs to be provided to demonstrate the decision-usefulness of such information, for users of the financial statements, to justify any requirement for entities to report segment assets where they are not reported to their CODM. We do not necessarily agree with EFRAG's comment that there is an inconsistency between the requirements as set out in paragraph 25 of IFRS 8 and the Basis for Conclusions, as proposed. Any misinterpretation arises from the inconsistency between the *current* wording of the Basis for Conclusions and paragraph 25. However, we do agree that it is difficult for preparers make sense of this requirement in the standard and it is perhaps unreasonable to expect them to arrive at the same conclusion set out in the Basis of Conclusions that if segment assets are not reported to the CODM they effectively assigned a zero value. For those reasons, we agree that the standard itself needs to be clarified and not just the Basis for Conclusions.

Question 2 (Cash flows for Unrecognised Assets) 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. 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 *EFRAG's draft comment letter on the IASB ED of proposed Improvements to IFRS 6* 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.
ASB Comment As a general principle we would argue that the accounting treatment should reflect the economic substance of the transaction or other event. However, there will be occasions where accounting treatment because of its imprecision will not adequately reflect the underlying economic substance. When this is the case it is important that there is consistency in treatment to ensure the needs of users of the financial statements are well served. We believe that expenditure on unrecognised assets falls into this category. That is, it may well be the case that the expenditure is "investing" in nature and will give rise to "future economic benefits" but our recognition and measurement may not be precise enough to distinguish those expenditures for the purposes of capitalisation. Accordingly, our position on this amendment is that the IASB needs to be consistent in its approach and we refer to the comments we have made in our response to the IASB (see page 5)

Question 3 (Unit of Accounting for Impairment Testing of Goodwill) EFRAG would particularly welcome constituent's views on whether the implementation of the proposed amendment would be difficult in respect of existing goodwill allocation.
ASB Comment We support the proposed amendment in the ED and we do not believe additional disclosures are necessary. Any impairment that results from a change in the unit of accounting for goodwill impairment will trigger disclosures under the standard that should be sufficient in explaining to users of the financial statements the nature of the impairment and the basis on which it was determined.

Question 4 (Scope Exemption to IAS 39) 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.
ASB Comment We acknowledge that there may well be an issue regarding contracts for the acquisition of an associate and agree that the matter should be raised with the IASB. However, in our view, changing the scope of IAS 39 to exclude such transactions goes beyond the issue the IASB is seeking to address through its proposed amendment. For that reason, it is likely that in order to satisfy due process requirements the IASB would have to re-expose this amendment. As noted in your response, acquiring an associate does not constitute a *business combination* as defined in IFRS 3 so it would therefore be difficult to sustain an argument that the EFRAG amendment arises as a consequence of IFRS 3R.

Question 5 (Cash Flow Hedge Accounting) 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 the hedged item 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?
ASB Comment We are satisfied with the amendment to paragraph 97 of IAS 39 proposed by the IASB. It is not clear to us that the proposed wording is confusing or is likely to lead to a diversity of practice. We do not support the change proposed by EFRAG because it effectively restates the existing wording by substituting "asset acquired or liability assumed" with more ambiguous wording of "hedged item". In our view, the key is point is about the economic effects that occur over the life of the hedging transaction. For that reason "hedged forecast cash flows" is a reasonable basis for achieving alignment between the hedging transaction and when any impact should be recognised in comprehensive income.

Other Comments
There are a couple of points we would like to make on the draft comment letter that are not addressed in the questions asked of constituents. These are outlined below. • ***Principal/Agent:*** paragraph 24 states that "we do not believe the matter should be dealt with only by including material in an appendix…" We do not believe that statement is correct. Paragraphs 7 and 8 make it clear that to qualify as revenue "only the gross inflows of economic benefits received and receivable by the entity *on its own account*", if the entity does not control those economic benefits then it is acting as an agent (as there is no increase in equity). The appendix to IAS 18 merely serves to reinforce that overall principle and provide guidance in its application. • ***Intangible Assets acquired in a business combination*:** we have a specific concern about the application of the guidance set out in paragraph 36 of IAS 38 (please refer to page 8 of our comments to the IASB). It would be helpful for EFRAG to consider this issue when it finalises its response.