ED 159 sub 2

Deloitte.

Mr David Boymal
The Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS STREET WEST VIC 8007

30 November 2007
Our Ref: DR:DT

Dear David

Exposure Draft ED 159 *Proposed Improvements to Australian Accounting Standards*

Thank you for the opportunity to comment on the Australian Accounting Standards Board (AASB) Exposure Draft ED 159 *Proposed Improvements to Australian Accounting Standards* (ED 159), which incorporates the International Accounting Standards Board *Exposure Draft of Proposed Improvements to International Accounting Standards* (referred to as 'the exposure draft').

Our response to the AASB's specific matters for comment in ED 159 are contained in Appendix A. Our response to the questions raised by the IASB in the exposure draft are contained in Appendix B.

Overall comments on the proposals

Whilst we are supportive of the IASB's and the AASB's endeavours to deal with miscellaneous, non-urgent but necessary minor amendments to Accounting Standards in an efficient way, we are concerned that some of the proposed amendments go beyond the agreed scope of the annual improvements project.

For example, the following proposed amendments have the potential to significantly change existing accounting practice and, therefore, cannot reasonably be categorised as miscellaneous minor amendments:

- additional disclosure requirements for entities that cannot make an explicit and unreserved statement of compliance with IFRSs
- deletion of guidance on the classification of leases of land and buildings
- advertising and promotional activities

- change in the accounting treatment for property under construction or development for future use as an investment property
- increase in the scope of the definition of a derivative (removal of the exclusion relating to non-financial variables that are specific to a party to the contract)

In our opinion, these matters should have more appropriately been handled by the IASB by way of the normal exposure process, not as part of the annual improvements project.

When it comes to our position on the proposed amendments, we are supportive of all proposed amendments, with the exception of the following:

- additional disclosure requirements for entities that cannot make an explicit and unreserved statement of compliance with IFRSs (Question 4)
- deletion of guidance on the classification of leases of land and buildings (Question 11)
- replacement of the term 'fall due' with the term 'entitlement' in relation to employee benefit obligations (Question 16)
- disclosures required of an investor in an associate, and a venturer in a jointly controlled entity, that accounts for its interest at fair value (Questions 22 and 25)
- recognition of expenditure on an intangible item (Question 28(a))
- recognition of prepayments (Question 28(b))
- change in the accounting treatment for property under construction or development for future use as an investment property (Question 35)

Our position on the proposed amendments is discussed in more detail in Appendix B.

<u>The context of our Australian submission</u>

Due to the later IASB submission deadline for the exposure draft, the global firm of Deloitte Touche Tohmatsu has not finalised its views in relation to the matters raised in the IASB's exposure draft. Therefore, the views presented in this document in relation to ED 159 should be read in this context and may not necessarily represent the view of the global firm of Deloitte.

Yours sincerely

Darryn Rundell
Partner
Deloitte Touche Tohmatsu

Deloitte.

Appendix A – Response to specific matters for comment raised by the AASB

(a) ***any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:***

(i) ***not-for-profit entities;***

(ii) ***public sector entities***

We are not aware of any specific not-for-profit or public-sector issues with the proposals, other than:

- we do not believe it would be appropriate to require not-for-profit entities or public sector entities (and in addition, entities preparing a special purpose financial report) to disclose how their financial statements would have been different if prepared in full compliance with IFRS (in the event that the IASB's proposal is adopted). Non-compliance with IFRS by such entities is a direct result of the inclusion of Aus. paragraphs in the Australian equivalents to IFRS and Australia's differential reporting regime and, accordingly, there would be little or no value in requiring such entities to explain or elaborate on the nature and extent of their non-compliance with IFRS
- the AASB will need to give consideration to whether the proposed amendments (if adopted) will necessitate amendment to any Aus. Paragraphs in the Australian equivalents to IFRS and/or the Australian specific Accounting Standards. For example, the proposed amendment to IAS 39 in relation to the definition of a derivative will impact upon AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*.

(b) ***whether the proposals are in the best interests of the Australian economy***

We believe that it is in the best interests of the Australian economy to issue an equivalent Australian Accounting Standard to ensure full convergence with IFRS.

In order to ensure that the maximum benefits of the convergence process are obtained, there must be no change made by the AASB to the IASB IFRS when issuing an Australian Standard, other than any amendments applicable to not-for-profit and public-sector entities that are considered absolutely necessary.

Appendix B – Response to specific questions raised by the IASB

IFRS 1 ***First-time Adoption of International Financial Reporting Standards***

Restructuring of IFRS 1

Question 1

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

We have no concerns with the proposed amendments to IFRS 1 on the basis that such amendments are unlikely to be of relevance to Australian entities (i.e., because very few Australian entities will be regarded as 'first time adopters' in the future).

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

Plan to sell the controlling interest in a 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?

Yes, we agree.

However, for the purpose of clarification, we suggest that the proposed paragraph 8A in IFRS 5 is amended as follows (new text underlined):

> "8A An entity that is committed to a sale plan involving loss of control of a subsidiary, which meets the criteria in paragraphs 6 to 8 to be classified as held for sale, shall classify all the assets and liabilities of that subsidiary as held for sale, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale."

Consequential amendment from IAS 41: Point-of-sale costs

See our answer to question 38.

IFRS 7 *Financial Instruments: Disclosures*

Presentation of finance costs

Question 3

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

Yes, we agree with the proposal to clarify that interest income is not part of finance costs.

Consequential amendment from IAS 28 and IAS 31: Disclosure requirements for investments in associates and interest in jointly controlled entities accounted for at fair value through profit or loss

See our answer to questions 22 and 25.

IAS 1 *Presentation of Financial Statements*

Statement of compliance with IFRSs

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?

We do not agree with the proposed amendment. IFRS should provide guidance only in respect of entities applying full IFRS and should not provide guidance for other accounting frameworks even if similar to IFRS.

Current/non-current classification of convertible instruments

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?

Yes, we agree. We believe that the proposed amendment better reflects the nature of the liability as well as the liquidity and solvency position of the entity, as concluded by the IASB.

Current/non-current classification of derivatives

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?

Yes, we agree. We believe that the criteria set out in IAS 1.66 and 69 should be applied to decide if financial instruments classified as held for trading should be presented as current or non-current.

IAS 2 *Inventories*

Consequential amendment from IAS 41: Point-of-sale costs

See our answer to question 38.

IAS 7 *Statement of Cash Flows*

Consequential amendment from IAS 16: Sale of assets held for rental

See our answer to question 10.

IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Status 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?

Yes, we agree.

IAS 10 *Events after the Reporting Period*

Dividends declared after the end of the reporting period

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?

Yes, we agree. This is consistent with IAS 32 *Financial Instruments: Disclosure and Presentation.*

IAS 16 *Property, Plant and Equipment*

Recoverable amount

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?

Yes, we agree. We welcome the use of consistent terminology.

Sale of assets held for rental

Question 10

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

Yes, we agree with the IAS 16 amendment in principle. We believe that this will better reflect the activities of an entity that generates revenue from renting and subsequently selling the same assets. Also, we propose that the Board should clarify that 'held for sale' in the context of IAS 16 paragraph 68A does not refer to 'held for sale' as defined in IFRS 5.

Consequential amendment from IAS 40: Property under construction or development for future use as investment property

See our answer to question 35.

IAS 17 *Leases*

Classification of leases of land and buildings

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?

We do not agree with the proposed deletion. We believe that the current guidance in IAS 17 paragraphs 14 and 15 is not inconsistent with the general guidance on the classification of leases in paragraph 7-13 in IAS 17 and provides guidance on application of the general classification principles to leases of land.

Contingent rents

Question 12

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

Yes, we agree.

IAS 18 *Revenues*

Costs of originating a loan

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?

Yes, we agree. We believe any inconsistencies within IFRSs should be avoided.

IAS 19 *Employee Benefits*

Curtailments and negative past service cost

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?

Yes, we agree. However, we suggest adding guidance explaining the meaning of IAS 19 paragraph 111(b) and how an entity shall make the distinction between a reduction of benefits that relates to future services and one that relates to past services since this distinction can cause significant differences to amounts recognised in profit or loss.

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?

Yes, we agree.

We note, however, that materiality is used elsewhere in IAS 19 (e.g. in paragraph 67 in respect of attributing benefit to periods of service). We suggest replacing all references to materiality and using the terms 'significant' or 'significantly' instead.

Plan administration costs

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?

Yes, we agree on the basis that it avoids double-counting of costs.

While we agree that double-counting of costs should be avoided we question whether there would be a measurement difference in the amount of the defined benefit liability to be recognised under paragraph 54, in particular if the limit in paragraph 58 is applicable, if the plan administration costs are accounted for through the actuarial assumptions used to determine the defined benefit obligation or if they are taken into account through the return on plan assets.

Replacement of term 'fall due'

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?

We do not agree with the proposed amendment. We believe that the replacement of the term 'fall due' with the term 'entitled' does not add clarity to what the Board's intentions are. It also creates confusion with respect to the definition of the term 'vest' in Appendix A of IFRS 2 *Share-based Payment* that states 'to become an entitlement'. This implies both terms have the same meaning. In our opinion, the Board should consider alternative wording.

Additionally, entitlement could also exist for post-employment benefits when the related employee services are rendered by the employees, but the employees cannot obtain settlement within twelve months.

We therefore suggest amending the proposed wording in IAS 19 paragraphs 7 as follows (new text underlined):

> "[...]
> Short-term employee benefits are employee benefits (other than termination benefits) to which the employee becomes entitled <u>and is able to obtain settlement</u> within twelve months after the end of the period in which the employee renders the related service.
>
> *Other long-term employee benefits* are employee benefits (other than post-employment benefits and termination benefits) to which the employee does not become entitled <u>and is not able to obtain settlement</u> within twelve months after the end of the period in which the employee renders the related service.
> [...]"

Guidance on contingent liabilities

Question 17

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

Yes, we agree.

IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

Consistency of terminology with other IFRSs

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?

Yes, we agree.

Government loans with a below-market rate of interest

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?

Yes, we agree.

IAS 23 *Borrowing Costs*

Components of borrowing costs

Question 20

Do you agree with the proposal to amend paragraph 6 of IAS 23 to refer 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?

Yes, we agree. We also agree with the deletion of the reference to ancillary costs. We believe that these amendments will improve consistency between IAS 23 and IAS 39.

IAS 27 *Consolidated and Separate Financial Statements*

Measurement of subsidiary held for sale in separate financial statements

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?

Yes, we agree.

IAS 28 *Investments in Associates*

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

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?

We do not agree with the proposed amendment. The reason for allowing such investors to apply the fair value option in respect of their associates is that they manage their investments in associates like 'normal' financial instruments. We do not think that, from the perspective of those entities, the nature of those investments in associates is different to that of other financial instruments accounted for under IAS 39 and hence, we believe that there should be no additional disclosure requirements.

Impairment of investment in associate

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?

Yes, we agree.

IAS 29 *Financial Reporting in Hyperinflationary Economies*

Consistency of terminology with other IFRSs

Question 24

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

Yes, we agree.

IAS 31 *Interests in Joint Ventures*

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

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?

See our answer to question 22.

IAS 32 *Financial Instruments: Presentation*

Consequential amendment from IAS 28 and IAS 31: Required disclosures when investments in associates and interests in jointly controlled entities are accounted for at fair value through profit or loss

See our answers to questions 22 and 25.

IAS 34 *Interim Financial Reporting*

Earnings per share disclosures in interim financial reports

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?

Yes, we agree.

IAS 36 *Impairment of Assets*

Disclosure requirements of estimates used to determine recoverable amount

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?

Yes, we agree.

Consequential amendment from IAS 41: Point-of-sale costs

See our answer to question 38.

IAS 38 *Intangible Assets*

Advertising and promotional activities

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?

We do not agree with the proposed amendments. We believe that the expenditure should be recognised when the item is first used, i.e. the expenditure should be capitalised until the benefit implicit in the item is consumed by the entity controlling it.

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?

We do not agree for the reasons set out in our answer to question 28(a).

Unit of production method for amortisation

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?

Yes, we agree with the principle of the proposed amendment. However, we believe that the IASB should provide some examples to clarify what is or is not allowed in connection with the amortisation method.

IAS 39 *Financial Instruments: Recognition and Measurement*

Definition of a derivative

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?

Yes, we agree.

The amendment will have significant impact on entities that have performance clauses embedded in service contracts that are linked to EBITDA and revenue hurdles. Guidance should be inserted in the Standard to make it clear that these kinds of clauses are caught within the definition of derivatives. Guidance should then be provided to help entities ascertain whether these kinds of clauses are closely related.

Additionally, we suggest amending the definition of financial risk in IFRS 4 *Insurance Contracts* Appendix A to bring it in line with the amended definition of a derivative as follows (deleted text struck through):

financial risk	The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable~~, provided in the case of a non-financial variable that the variable is not specific to a party to the contract~~.

Reclassification of financial instruments into or out of the classification of at fair value through profit or loss

Question 31(a)

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

Yes, 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?

Yes, we agree.

Designating and documenting hedges at the segment level

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?

Yes, we agree.

Applicable effective interest rate on cessation of fair value hedge accounting

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 should be used, when applicable, to remeasure the financial instrument in accordance with paragraph AG8? If not, why?

Yes, we agree.

Treating loan prepayment penalties as closely related embedded derivatives

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 compensates 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?

Yes, we agree.

IAS 40 *Investment Property*

Property under construction or development for future use as investment property

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?

We do not agree. We believe that this amendment might result in an unnecessary hardship for some entities. Also, we do not believe that it will be necessarily be possible to ascertain the fair value of property under construction or development for future use as an investment property. Accordingly, we suggest permitting an option to measure such property either at fair value or using the cost model.

Consistency of terminology with IAS 8

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?

Yes, we agree.

Investment property held under lease

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?

Yes, we agree.

IAS 41 *Agriculture*

Point-of-sale costs

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?

Yes, we agree. We welcome the use of consistent terminology.

Discount rate for fair value calculations

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?

Yes, we agree. We believe that tax consequences are part of a purchase decision.

However, we question whether there should also be an amendment to the rules for the determination of 'value in use' in IAS 36 *Impairment of Assets* to allow entities to consider the tax consequences of using an asset.

Additional biological transformation

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?

Yes, we agree, as willing buyers and willing sellers will take into account the fact that an asset is still alive.

Examples of agricultural produce and products

Question 41

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

Yes, we agree.

Consequential amendment from IAS 20: Consistency of terminology with other IFRSs

See our answer to question 18.