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ED 159 sub 9

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Professor David Boymal
The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

15 January 2008

Dear David

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

I am enclosing a copy of the PricewaterhouseCoopers response to the International Accounting Standards Board's *Exposure Draft of Proposed Improvements to International Financial Reporting Standards.* The letter reflects the views of the PricewaterhouseCoopers network of firms and as such includes our own comments on the matters raised in the Exposure Draft.

We would welcome the opportunity to discuss our views at your convenience. Please contact me on (03) 8603 2249 if you would like to discuss this further.

Yours sincerely

D.G. Smith

Debbie Smith
Partner
Assurance

PricewaterhouseCoopers is committed to providing our clients with the very best service. We would appreciate your feedback or suggestions for improvement. You can provide this feedback by talking to your engagement partner, calling us within Australia on 1800 792 111 or visiting our website http://www.pwcfeedback.com.au/

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First Annual Improvements Project
International Accounting Standards Board
30 Cannon Street
London
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7 January 2008

Dear Sir or Madam,

Exposure Draft: Proposed Improvements to International Financial Reporting Standards

We are responding to your invitation to comment on the above Exposure Draft on behalf of PricewaterhouseCoopers.

Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the Exposure Draft. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Overall comment

We support the IASB's introduction of an annual improvements project as a means of addressing those minor, yet essential, changes to existing standards that may not warrant separate exposure drafts on a standalone basis. Furthermore, we believe that this project further supports the IASB's objective of developing and promoting the use of a single set of high quality accounting standards that may be used by companies across the globe.

Proposed amendments outside the scope of an annual improvements project

However, in our view, we believe that certain proposed amendments are not "minor," and are significant enough to be the subject of individual exposure drafts. Specifically, we believe the amendment to IAS 1 with respect to additional disclosure requirements where an entity is unable to make an explicit and unreserved statement of compliance with IFRS is not a matter to be dealt with as part of the annual improvements process. As outlined in our response in Appendix A to the specific question posed on this amendment, we agree with the principle underlying this proposal, but we believe that this issue should not be addressed by the Board. Rather, it is a matter that requires the enforcement power of securities regulators around the world.

We believe that the amendment proposed to IAS 39 with respect to the definition of a derivative is also outside the scope of this project, but don't think it should be pursued further in a separate deliberative process. For the reasons stated in Appendix A to this letter, it will have a significant impact on derivative accounting by inappropriately bringing a wide range of contracts into the scope of the definition.

There are further proposed amendments that we believe should not be addressed in the annual improvements project for the reasons stated in Appendix A to this letter. We believe that the Board should follow due process and deal with these matters separately to allow full debate of the issues. These include:

- The amendment proposed to IFRS 5 with respect to classification of a subsidiary's assets and liabilities as held for sale where there is a sale plan in place involving loss of control.
- The amendment proposed to IAS 16 (and subsequent amendment to IAS 7) with respect to the sale of assets held for rental.
- The amendment proposed to IAS 19 with respect to employee entitlement to benefits.
- The amendment proposed to IAS 38 with respect to recognition of an expense or an asset for advertising and promotional expenditure.

Proposed amendments that require further change

With the exception of the matters raised above, we believe that the remainder of the amendments included within the exposure draft are within the scope of the annual improvements process. However, in some cases, we believe that the amendments proposed do not fully achieve their objective as currently drafted. The amendments in question are included in Appendix B to this letter along with our suggestions to the Board.

Proposed implementation and effective date

It is unclear why the Board has proposed that early adoption of the amendments would only be permissible if an entity also adopted IAS 1 (as revised in 2007) early. There does not appear to be a sufficient link between the proposed amendments and the revised version of IAS 1. Thus, the Board should remove the proposed requirement for early adoption of the revised IAS 1 where annual improvement amendments are adopted early.

Responses to questions raised by the IASB

Responses to specific questions raised in each section of the exposure draft are contained in Appendix A and B to this letter. Please note that where we are in agreement with a proposed amendment, we have chosen not to specifically respond to the related question posed. Therefore, the responses contained in the appendices are solely in relation to amendments where we have matters to bring to the Board's attention.

If you have any questions in relation to this letter please do not hesitate to contact Richard Keys (020 7212 4555) or David Schmid (+1 973 236 7247).

Yours faithfully

PricewaterhouseCoopers LLP

Appendix A - Proposed amendments outside the scope of an annual improvements project

IFRS 5, 'Non-current Assets Held for Sale and Discontinued Operations
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 that the proposed amendment to IFRS 5 is in line with both the principles outlined in the proposed IAS 27 (revised 2007) with respect to loss of control of a subsidiary and the economic entity model proposed in the revisions to IFRS 3. However, we believe that the Board needs to further consider the implications for the principles in IFRS 5 and the usefulness to investors of the proposed modified reporting prior to amending the standard.

Paragraph 6 of IFRS 5 states that an entity classifies "*a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use*." In the circumstance where an entity holds an interest of 51% in a subsidiary and subsequently sells 2% of its holding, resulting in loss of control, we do not believe that classification as held for sale fits with the definition set out in paragraph 6, as the interest in the subsidiary is not principally recovered through sale given the significant proportion of continuing involvement.

Furthermore, where the assets and liabilities of the subsidiary are classified as held for sale and the criteria in paragraph 32 of IFRS 5 have been met, the subsidiary would also be presented as a discontinued operation. However, this would be inconsistent with the overall objective of separately highlighting discontinued operations as set out in BC62 of IFRS 5, that is, "*providing users with information that is relevant in assessing the ongoing ability of the entity to generate cash flows*." Where an entity partially disposes of an interest in a subsidiary, the remaining interest held will still generate future cash flows for the entity. As a result, we believe that there needs to be further consideration of the effect of the proposed amendment on the principles in IFRS 5.

Therefore, we believe that a separate project focusing on potential amendments to IFRS 5 is warranted. Given that this standard is the result of the short-term convergence project that the Board has with the FASB, we recommend that this project be coordinated with the FASB and its proposed FSP 144-c, "Classifying and Accounting for a Depreciable Asset as Held-for-Sale When an Equity Method Investment Is Obtained.".

IAS 1, 'Presentation of Financial Statements'
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?

Where a set of financial statements does not fully comply with IFRS as published by the IASB, we agree with the Board that highlighting differences between IFRS as applied in those financial statements and IFRS as published by the IASB is useful information for the users of those statements. However, we believe that such a requirement can only be effectively implemented and enforced by the global regulator community.

For example, a jurisdiction which carves out or amends certain IFRS requirements can easily carve out this amendment, if implemented. Whilst audit requirements might require the auditor to consider whether such disclosures are necessary for fair presentation, even if not required by the financial reporting framework, the jurisdiction could equally carve out such associated audit requirements as well. The financial statements, and the audit, would then accord with local law. It is up to regulators to determine the appropriate response, which may be of particular relevance in the case of cross border listings. We note the recent decision by the SEC to require either financial statements in full compliance with IFRS as issued by the IASB or reconciliation to US GAAP.

We believe that limiting the requirement to only narrative disclosure leads to the risk that users may not understand or fully appreciate the impact of differences, particularly where they are from another jurisdiction. We believe listed entities, particularly those that are listed in markets outside their own jurisdiction, should be required to quantify differences, where practicable, as this would provide users with more valuable information. However, again, this can only be enforced by securities regulators. In the case of non listed entities such reconciliation may seem excessive.

We note that the IAASB has currently proposed amendments to ISA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements," that would require auditors to consider the implications for their audit report where sufficient disclosure was not made by an entity. Our response to the IAASB on these proposed amendments includes comments similar to our comments above.

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

We believe that this matter should be the subject of a separate exposure draft to more broadly consider an accounting principle for property, plant and equipment where an entity's business model is to use (but not necessarily rent out) an asset and then sell it.

As part of this broader project, we believe that the Board should ensure that any amendments it proposes to IAS 7 mirror those proposed to IAS 16.

IAS 19, '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?

No, we do not believe that the intention of the Board is clear from the current suggested wording and believe that the proposal will lead to a change in classification for a wide range of existing benefits. As the measurement bases for short term benefits and other long term benefits are different any change in classification could have a significant impact on reporting.

It is unclear whether or not the term "becomes entitled" should be interpreted as referring to vesting. Consider the example of a lump sum payment, under a deferred compensation plan, payable at the earlier of the third anniversary of the balance sheet date or on leaving service. One interpretation of the proposal would be that as at the balance sheet date the employee is entitled to the benefit because it would be payable immediately if he leaves. Under this interpretation, the liability would be measured at its undiscounted amount as per paragraph 10 of IAS 19. However, this would be out of line with current practice which would classify the payment as other long term benefits and value the liability at its present value allowing for early payment resulting from expected employee turnover.

It is also not clear whether the Board intended to align the accounting for short-term and long-term employee benefits under IAS 19 with the distinction between current and non-current liabilities under IAS 1. We do note that this would be inconsistent with the SIC rejection dealing with the measurement of the termination indemnity arrangements in Italy. The rejection concluded that the liability should reflect the expected leaving date.

Given the fundamental impact the amendment could have on current accounting, we do not believe that this is a minor amendment within the scope of the annual improvements process and should, instead, be the subject of a separate exposure draft to enable full debate of the issues.

IAS 38, 'Intangible Assets'

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?

No. This is an area where there is divergent practice and it touches on a more fundamental question relating to the distinction between an expense and an asset. For example, the proposed guidance would require a retailer who distributes catalogues to its customers to recognise an expense when it has access to those catalogues, although those catalogues arguably meet the definition of an asset until they are distributed to customers. Therefore, we do not believe that this is a minor amendment within the scope of the annual improvements process. Instead, we believe that the issue of when it is appropriate to recognise an expense or an asset with respect to expenditure should be the subject of a separate exposure draft to enable full debate of the issues.

We further note that setting out a 'bright line' as to when an expense or asset should be recognised may encourage entities to structure transactions so as to fit that 'bright line' rather than accounting for transactions on the basis of their substance. Referring back to the above catalogue example, a retailer could merely structure delivery to reflect the point in time at which it wished to recognise an expense rather than when the catalogues ceased to be an asset.

Finally, if the Board intends to proceed with the amendment as proposed, it should, at a minimum, clarify that the proposed guidance applies only to advertising and promotional expenditures.

IAS 39, 'Financial Instruments: Recognition and Measurement'

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?

No, we disagree with the amendment proposed, and we do not believe that this is a minor amendment within the scope of the annual improvements process.

The amendment proposed is a fundamental and substantive change to the definition, resulting in a change to the accounting for a large number of contracts. We note the following as examples of contracts that would be affected:

- 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
- 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)
- 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 rather than fair value measurement.

As indicated above, if the Board wants to pursue this amendment, it should be done in a separate process distinct from the annual improvements project.

Appendix B - Proposed amendments that require further change

IAS 1, 'Presentation of Financial Statements'
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, if the objective of the classification as current is to reflect the liquidity or solvency position of the entity as indicated in BC7. However, we note that this is inconsistent with the requirement in IAS 32 to classify as a financial liability a financial instrument that the issuer can settle by issuing a variable number of shares. As outlined in paragraph 21 of IAS 32, the instrument is considered a liability even though settlement may occur through issue of equity as the entity is using its own equity instruments as a currency.

IAS 18, 'Revenue'
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 with the proposed amendment to paragraph 14(a)(i) and note that the Board should also make an equivalent amendment to paragraph 14(a)(ii) of the Appendix as follows:

> *"(ii) Commitment fees received by the entity to originate a loan when the loan commitment is outside the scope of IAS 39*
>
> *If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of IAS 39, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related ~~direct~~ transaction costs (as defined in IAS 39), is deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry. Loan commitments that are within the scope of IAS 39 are accounted for as derivatives and measured at fair value."*

This would then result in consistency between the guidance in paragraphs 14(a)(i) and 14(a)(ii).

IAS 19, 'Employee Benefits'
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 that the amendment addresses the current inconsistency between the guidance in paragraph 7 and 107 of the standard. However, it is not clear whether the choice of including plan administration costs in expected return on assets or in measurement of the defined benefit obligation excludes taxes. If the intention is to exclude taxes, we believe the Board should clarify whether this means all taxes or only income taxes payable by the fund.

IAS 38, 'Intangible Assets'
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?

We believe that the existing guidance is well understood and applied in practice. Units of production amortisation is routinely applied in the extractive industries and other areas where intangible assets are consumed by usage. The final sentence of paragraph 98 contains relevant guidance that should be retained in the standard. However, the Board may want to clarify that the unit of production amortisation method is acceptable. We suggest that the Board amends that sentence as follows:

" 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"

IAS 39, 'Financial Instruments: Recognition and Measurement'
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?

The wording of the amendment as proposed 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. Therefore, we would propose the following changes to the amendments to paragraph AG30(g):

" However, a prepayment option for which the exercise price ~~compensates~~ <u>reimburses</u> 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'
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?

Yes, we agree with the proposal to include investment property under construction within the scope of IAS 40. However, we believe that further amendment is required to IAS 40 to properly effect this change in scope.

The Board should amend the guidance in paragraph 53 to clarify that an entity should apply the fair value model where fair value becomes reliably measurable. This would be consistent with the Board's comments in BC1 which states " ..the use of fair values has become more widespread and valuation techniques have become more robust." It would also be consistent with the requirement in paragraph 53 of IAS 39 regarding investments in unquoted equity instruments where entities are required to remeasure at fair value if fair value becomes reliably measurable. Accordingly, we would propose the following changes to paragraph 53:

"53. There is a rebuttable presumption that an entity can reliably determine the fair value of an investment property on a continuing basis. However, in exceptional cases, there is clear evidence when an entity first acquires an investment property ~~(or when an existing property first becomes investment property following the completion of construction or development, or after a change in use)~~ that the fair value of the investment property is not reliably determinable on a continuing basis. This arises when, and only when, comparable market transactions are infrequent and alternative reliable estimates of fair value (for example, based on discounted cash flow projections) are not available. In such cases, an entity shall measure that investment property using the cost model in IAS 16. The residual value of the investment property shall be assumed to be zero. ~~The entity shall apply IAS 16 until disposal of the investment property~~. <u>If a reliable measure becomes available for an investment property for which such a measure was not previously available, that investment property shall be remeasured at fair value.</u> "