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Australian Accounting Standards Board

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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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Dear David

Exposure Draft Improvements to International Financial Reporting Standards

The Australian Accounting Standards Board (AASB) has considered the proposals in Exposure Draft *Improvements to International Financial Reporting Standards* and is pleased to provide its comments. In formulating its views the AASB sought and considered the views of Australian constituents. The AASB generally supports the proposals in the Exposure Draft and has confined its comments to the more significant proposals about which it has concerns.

The AASB supports the objectives of the IASB's annual improvements process. However, the AASB believes that a number of the proposed amendments are not of a minor and miscellaneous nature and could have a significant effect on current practice. These items include:

- the proposal to require additional disclosures for entities that cannot make an explicit and unreserved statement of compliance with IFRSs (Question 4);
- the proposed recognition of revenue from sales of assets held for lease (Question 10);
- the proposed deletion of guidance on the classification of leases of land and buildings (Question 11);
- the proposed treatment of advertising and promotional expenditure (Question 28);
- the proposed change to the definition of a derivative (Question 30);
- the proposed replacement of the term 'fall-due' with the term 'entitlement' in relation to employee benefit obligations (Question 16); and

- the proposed change in the accounting treatment for property under construction or development for future use as an investment property (Question 35).

The AASB considers that these proposals go beyond the stated objective and have the potential to erode support for the annual improvements process.

The AASB considers that if there is a dissenting opinion on the IASB to a proposal it must be potentially controversial and that proposal should not be included in the annual improvements process.
The AASB is also concerned that in some instances the ED indicates an intention to "clarify" existing IFRS, with the implication that entities adopting a changed approach as a result would be correcting an error and considers that the clarification is of the IASB's intention and should not necessarily result in correction of an error treatment. If the Board intends that items be treated as a correction of an error its intention should be stated explicitly.

Our detailed comments are included in the Appendix.

Please feel free to contact me (dboymal@aasb.com.au) if you require any further information in respect of these items.

Yours sincerely,

David Boymal

David Boymal
Chairman

APPENDIX

Items which should not have been included as Annual Improvements

(a) Question 4 Compliance Statements

The AASB does not support the adoption of this proposal to require the disclosures of entities that are unable to make explicit and unreserved statements of compliance with IFRSs for the reasons expressed by the dissenting IASB members. The AASB considers it inappropriate to effectively condone non-compliance with IFRSs because it undermines the integrity of the IFRSs.

The AASB considers that this proposal is essentially seeking to protect the credibility of the IASB's brand and processes and, as such, it is a wider and more substantive issue that should be addressed separately from the annual improvements process. It is more appropriate that this issue is addressed at a national standard setter level rather than at an individual reporting entity level. The AASB considers that this is a reporting framework issue and that it is inappropriate to require individual reporting entities to address the problem.

If the IASB proceeds with the proposals the AASB would prefer that each reporting entity refer to a document prepared by the national standard setter that identifies the differences between national GAAP and IFRSs rather than each reporting entity undertaking the process of identifying differences.

(b) Question 10 Sale of Assets Held for Lease

While supporting the proposed amendment, the AASB considers that the adoption of the proposal may have a significant impact on current practice. Accordingly, the AASB considers that it is inappropriate to amend this requirement in the context of the annual improvements process and that a more thorough due process is needed.

(c) Question 11 Guidance on Lease Classification

The AASB questions whether it is appropriate to remove the guidance at this stage when the leases project is on the IASB's active agenda. Our constituents have expressed the view that the existing guidance relating to the classification of leases of land and buildings is helpful.

The AASB considers that the purpose of the proposed amendment is not clear particularly when considered in conjunction with the IFRIC agenda rejection statement (IAS 17-4: March 2006) in relation to 500-year leases and which has now been included in the "guide" version of the IFRS bound volume.
If the IASB is to continue with these proposals, it should be made clear whether there is an intention to change current practice and the IFRIC guidance and, if so, an appropriate basis for conclusion should be provided. Additionally, providing explicit guidance on the transitional requirements for the change in accounting treatment would be highly desirable.

(d) Question 16 'Fall Due'

The AASB considers that this proposal is likely to have a significant impact on the financial statements of entities and should be considered as part of a more thorough due process.

Some constituents disagree with the proposal on the grounds that it would result in measuring many benefits that are in substance long-term in nature at their nominal amounts. The AASB considers that this would be inconsistent with the principles underlying IAS 19 *Employee Benefits* that requires measurement of long-term items on the basis of the present value of expected future cash flows.

If the IASB proceeds with these proposals further guidance is required, particularly in relation to the interpretation of the phrase "the end of the period in which the employees render the related service". For example, in Australia employees are entitled to long service leave after 10 years of service. The proposals are unclear as to whether the employee benefit comprises 10 individual years of service which would result in long term classification, or whether it comprises a 10-year service period which would result in short term classification, because an entitlement arises immediately the service period is completed.

(e) Question 28(a) Expenditure on an Intangible Item

A new term 'access to those goods' is introduced in IAS 38 *Intangible Assets*, paragraph 69. As prepayment assets are recognised when an entity has control of the item it is not clear whether 'access to' is to be read as equivalent to 'control'. Having access to an asset can be distinctly different from having control of that asset. For example, an entity may have access to a building in which it leases space without controlling the building.

The AASB believes that:

(i) if expenditures satisfy the recognition and measurement criteria for an asset based on control, that asset should be recognised;

(ii) an expense should be recognised as the services embodied in the asset are consumed or become impaired.

If the proposals are continued in their current form, the AASB agrees with the dissenting member's opinion, because on the basis of the wording of the Standard it is not clear that brochures are intangible assets.

(f) Question 28(b) Amortisation

The AASB considers that removing the rebuttable presumption about straight-line depreciation may result in divergent practice and requests for interpretation and guidance as to whether a particular method is an appropriate/acceptable basis of amortisation.

(g) Question 30 Definition of a Derivative

The AASB considers that the proposed changes to the definition of a derivative have the potential to make a significant impact on current practice. For example, if adopted the proposal is likely to have a significant impact on entities that have performance clauses embedded in service contracts that are linked to EBITDA and revenue hurdles. The adoption of this change is also likely to impact on the definition of financial risk in IFRS 4 *Insurance Contracts*. Accordingly, the AASB considers that it is inappropriate to amend the definition of a derivative in the context of the annual improvements process and that a more thorough due process is needed. The AASB is also concerned about the transitional requirements for such a change in practice.

(h) Question 35 Investment Property under Construction

The effect of the proposed amendment is that an entity that has elected to apply the fair value method of accounting for investment property in accordance with IAS 40 *Investment Property* would also be required to apply fair value in respect of investment property under development. This amendment may lead entities to exercise a different accounting policy choice under IAS 40. For example, prior to the proposed amendment an entity may have applied the cost method required by IAS 16 *Property, Plant and Equipment* to investment properties under development. Such an entity may address its concerns about being required to use the fair value method for properties under development by choosing to apply the cost method as permitted in IAS 40 in respect of all of its investment properties. That is, fewer entities may choose to apply fair value measurement to investment property, which the AASB considers would be an unfortunate outcome. If the proposals are accepted the AASB considers that it would not be appropriate that an entity currently applying the fair value method under IAS 40 would not have the opportunity to reconsider that decision. Alternatively, investment property under construction could be treated as a separate class of asset for which an IAS 40 policy choice could be made separately from that made in respect of investment property.

Other items

(a) Question 2 Plan to sell Controlling Interest in Subsidiary

The AASB considers that the proposed amendment should be clarified so that it is clear that paragraph 8A is referring to a 'sale plan' that meets the criteria in paragraphs 6 to 8 of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to be classified as held for sale.

(b) Question 7 Status of Implementation Guidance

The first sentence of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, paragraph 9, is potentially confusing as it states that "Implementation Guidance includes for Standards… Guidance on Implementation… ." As the paragraph is presently drafted one is a subset of the other although the same words are used. The AASB suggests using more distinct terms (such as Implementation Aids) to help minimise the potential for confusion as to the similarity and meaning of these terms.

(c) Question 12 Contingent Rentals

This proposed amendment relates to an issue raised with the IASB by the AASB which suggested that the reference to 'lease payments' in IAS 17 *Leases*, paragraph 33, should be changed to 'minimum lease payments' that are defined in paragraph 4 as:

> "payments over the lease term that the lessee is or can be required to make, excluding contingent rent, costs for services or taxes to be paid by and reimbursed to the lessor, together with, for a lessee, any amounts guaranteed by the lessee or by a party related to the lessee …".

The difference between the AASB's suggestion and the IASB's proposal to use

> "lease payments (excluding costs for services, taxes to be paid by and reimbursed to the lessor and contingent rent)"

is that minimum lease payments includes any amounts guaranteed by the lessee or by a party related to the lessee. It is not clear from the ED why the IASB has chosen not to use 'minimum lease payments' in paragraph 33. There does not seem to be any technical reason to exclude amounts guaranteed by the lessee or by a related party to the lessee from the requirement in paragraph 33, particularly when paragraph 35 requires disclosure of "minimum lease payments" as defined.
The AASB also considers that the potential conflict between the first sentence of BC4 which is definitive as to how IAS 17 should be interpreted and BC 5, which acknowledges that there is ambiguity about the requirements, should be removed.

(d) Question 14 Curtailments and Negative Past Service Costs

Following the proposed change to the definition of past service costs in IAS 19 *Employee Benefits*, paragraph 7, further changes are likely to be needed in paragraph 97. The explanation in the first two sentences in paragraph 97 are consistent with the existing paragraph 7 which, given the reference to 'increase', relate to positive past service costs. As the definition of past service costs is now neutral (with the replacement of 'increase' by 'change') it would be appropriate to also amend the first sentence in paragraph 97 to refer specifically to positive past service costs. Paragraph 96 should also be considered to address the negative past service cost issue.

The AASB also notes that due to differences in current practice, full retrospective application of the proposals may be difficult, particularly where the corridor method has been applied.

The AASB does not agree with the proposal to replace "material" with "significant" in paras IAS 19.111(a) and (b) as the term is undefined and may be interpreted using guidance from IAS 28, which we consider to be inappropriate.

(e) Question 15 Plan Administration Costs

The AASB supports this proposal to amend and clarify the treatment of plan administration costs in the definition of 'return on plan assets' in IAS 19 *Employee Benefits*. However, we note that BC75 also requires amendment.

The AASB suggests that the IASB also make amendments to the definition to clarify the treatment of 'any tax payable by the plan'. The IFRIC rejection statement relating to this issue (IAS 19-3: March 2007) has not assisted Australian consistuents in resolving the issues in relation to the treatment of a number of taxes, none of which are unique to Australia. Having considered the economics of the taxes paid by the plan and the objectives of IAS 19, the AASB is of the view that many of these taxes are more appropriately considered part of the defined benefit obligation rather than return on plan assets. Given that the IASB is proposing that administration costs be treated as either return on plan assets or part of defined benefit obligation, it is not clear why taxes paid by the plan should be considered differently. If the IASB considers that these taxes should be treated differently from administration costs it would be approriate to include the rationale for that view in the basis for conclusions.

In view of the significance of the issue to Australian constituents, the AASB has recently formed an interpretations advisory panel to address the treatment of taxes paid by a plan. In the event that the IASB does not address this issue, it may be necessary for the AASB to issue an Australian specific interpretation.

(f) Question 38 Point of Sale Costs

The proposed definition of 'costs to sell' in IAS 41 *Agriculture*, paragraph 5, is not as helpful to the user as the description presently included in IAS 41, paragraph 14. The AASB considers that the examples of the types of costs could be retained in conjunction with moving to the term 'costs to sell' subject to minor amendments to the existing wording of paragraph 14.

(g) Question 39 Discount Rates

The AASB supports this proposed amendment which will resolve a long-standing problem raised by foresters in Australia who use measurement models that employ post-tax discount rates. If this proposal is adopted the implications for determining 'value in use' in IAS 36 *Impairment of Assets* should also be considered.