IAS 1 "PRESENTATION OF FINANCIAL STATEMENTS"

1. GENERAL COMMENTS

We generally support the proposed revisions to IAS 1. We also have comments on:

* the specific questions asked by the IASB;

* differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook* that we believe are better addressed in the Australian Standards;

* issues raised by Australian constituents during the consultation process; and

* other issues identified by the AASB and AASB staff.

2. SPECIFIC QUESTIONS

1 Do you agree with the proposed approach regarding departure from a requirement of an International Financial Reporting Standard or an Interpretation of an International Financial Reporting Standard to achieve a fair presentation (see proposed paragraphs 13-16)?

Our preference would be for the "true and fair override" to be removed and to always require adherence to accounting standards, with additional disclosure in cases where the management or governing body considers this is warranted to achieve a fair presentation. However, we acknowledge the pragmatism of the IASB's approach, which allows for various regimes.

We note that paragraph 10 defines a fair presentation as presenting the effects of transactions in accordance with the definitions and recognition criteria for the elements of financial statements. Paragraphs 13 and 15 permit departure from a requirement of an IFRS or IFRIC where the application of the IFRS or the IFRIC is inconsistent with the objective of financial statements. We recommend that the basis for a departure from the requirement of an IFRS or an IFRIC be directly related to fair presentation as described in paragraph 10.

2 Do you agree with prohibiting the presentation of items of income and expense as 'extraordinary items' in the income statement and the notes (see proposed paragraphs 78 and 79)?

We strongly support this proposal. All revenues and expenses belong within the 'ordinary' activities of the entity, and specific revenues and expenses that require disclosure are covered by IAS 1.80.

We have some difficulty in interpreting paragraph 76, and in particular the interaction between paragraphs 76 and 79. Paragraph 76 requires the disclosure of additional subtotals on the face of the income statement where the presentation is relevant to an understanding of the entity's financial performance. Paragraph 79 prohibits the presentation of an item of income or expense as arising from outside the entity's ordinary activities. Some entities may wish to isolate a specific item of income or expense on the face of the statement of financial performance. An example of such an isolation is an entity that owns an investment property and presents a subtotal after all income and expenses other than the net gains or losses from fair value adjustments arising under the fair value option and disclosed under IAS 40 "Investment Property", paragraph 67(d). On the one hand, it could be argued that this is an appropriate disclosure under paragraph 76, and on the other hand it could be argued that this presents the net gain or loss from fair value adjustments as if that net gain or loss were outside the entity's ordinary activities.

3 *Do you agree that a long-term financial liability due to be settled within twelve months of the balance sheet date should be classified as a current liability even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue (see proposed paragraph 60)?*

No. Although this proposal may be considered to be consistent with the principle in IAS 10 "Events After the Balance Sheet Date" that events that occur after the balance sheet date and are indicative of conditions that arose after the balance sheet date should not be recognised on the face of the financial statements, we believe that this is a classification issue. Provided the agreement to refinance is settled before the financial report is authorised for issue, the liability should continue to be classified as long term. In these circumstances, to do otherwise would be potentially misleading.

4 *Do you agree that:*

- *(a) a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date, even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach (see proposed paragraph 62)?*
- *(b) if a lender was entitled to demand immediate repayment of a loan because the entity breached a condition of its loan agreement, but agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:*
  - *(i) the entity rectifies the breach within the period of grace; or*
  - *(ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified (see proposed paragraphs 63 and 64)?*

No. Please refer to our comments on question 4.

5 *Do you agree that an entity should disclose the judgments made by management in applying the accounting policies that have the most significant effect on the amounts*

of items recognised in the financial statements (see proposed paragraphs 108 and 109)?

Yes. However, we are concerned that if this disclosure is contained within the audited financial statements it may tend to 'boilerplate' rather than provide useful disclosures. Further, we are concerned that the disclosure might be difficult to implement in a meaningful way for large diversified entities. We recommend that there be some guidance, including examples, to assist preparers in complying with this disclosure proposal in a useful manner. We also suggest that the matter may need to be re-visited in the context of the IASB's project covering management reporting in relation to financial reports (MD&A).

6 Do you agree that an entity should disclose key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year (see proposed paragraphs 110-115)?

Yes, provided it is made clear that the key assumptions about the future relate to the impact of those assumptions on the existing position of the reporting entity and that the requirement is not seeking forecasted information. We consider that the significance of the key assumptions may be best demonstrated using sensitivity analysis.

As with question 5, we are also concerned that if this disclosure is contained within the audited financial statements it may tend to 'boilerplate' rather than useful disclosures. Further, we are concerned that the disclosure might be difficult to implement in a meaningful way for large diversified entities. We recommend that there be some guidance, including examples, to assist preparers in complying with this disclosure proposal in a useful manner. We also suggest that the matter may need to be re-visited in the context of the IASB's project covering management reporting in relation to financial reports (MD&A).

3. OTHER COMMENTS

Paragraph	**Comment**
Throughout	We recommend the use of the term 'financial report' rather than 'financial statements' to distinguish between specific financial statements, such as the income statement, and the overall report which includes the individual statements and the explanatory notes.
Throughout	The term 'management' is used with dual meanings. Management may mean the senior personnel involved in the day-to-day management of the entity (for example, paragraph 7, 105) or the governing body such as the Board of Directors (for example, paragraphs 13, 18). We recommend that the term 'management' be replaced by the term 'entity' unless the intention is to refer to the senior personnel running the entity on a day-to-day basis. Alternatively, in many cases the term 'management' can be eliminated by restructuring the relevant paragraph.

Paragraph	Comment
7 – 9	Paragraphs 7 and 8 refer to disclosures that might be included in a discussion and analysis. Paragraph 9 states that these disclosures are outside the scope of IFRSs. We question whether paragraph 9 is appropriate given the Board's new project covering management reporting in relation to financial reports?
18 – 19	This section provides no guidance as to the application of other Standards when financial statements are not prepared on a going concern basis. For example, it is not clear how the measurement requirements contained in IAS 2 "Inventories" are applied in general purpose financial statements prepared on a liquidation basis. We recommend that disclosure be required not only of uncertainties about the entity's ability to continue as a going concern, but also the steps being taken to address those uncertainties and any mitigating factors.
22 – 23	We recommend that this section note that the presentation of financial statements is an accounting policy and should comply with the relevant sections in IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors".
24 – 27	Materiality is a key concept in the determination and application of accounting policies. We recommend the inclusion of additional guidance as to the meaning and application of the materiality concept (see for example the guidance in IASB Framework, paragraphs 29 and 30, and AASB 1031 "Materiality", paragraphs 4.1, 4.1.3 to 4.1.10). The aggregation of individually immaterial amounts may be material in total. We recommend that the section explain that where individually immaterial amounts are aggregated and the resulting amount is material, this aggregation becomes a material class and disaggregation appropriate to the context is required.
28 – 32	Paragraph 31 refers to the net disclosure of some gains and losses. It is unclear whether this paragraph is sufficient to provide the "permission" required by paragraph 29 before revenues and expenses are offset. We recommend that IAS 1 clarify the distinction between revenues/expenses and gains/losses. For those jurisdictions that did not have this distinction before the adoption of IASs, the lack of guidance may lead to a lack of comparability between entities.
47 – 48	Where the reporting period is not one year, we recommend that an entity be required to disclose that the comparative amounts for line items on the balance sheet may not be directly comparable. For example, for many entities the level of inventory holdings changes over twelve months because of holdings of different seasonal products and consequent change in demand. As a result, inventory in January may not be comparable with (say) inventory in July.

Paragraph	Comment
52	We would argue that a liquidity basis is appropriate for financial institutions because of the nature of the business (dealing in financial assets and liabilities), rather than because of the existence or otherwise of a clearly identifiable operating cycle. The reasoning in this paragraph suggests that, where a financial institution could identify an operating cycle, that financial institution should apply the current/non-current classification. Further, based on this paragraph, an entity without a clearly identifiable operating cycle could argue that the liquidity basis should be applied. We recommend that the reference to supplying goods and services within a clearly defined operating cycle be deleted.
54(d)	To allow for assets that are restricted for the length of the operating cycle, we recommend that the restrictions on a cash or cash equivalent asset be extended to "<u>for the greater of</u> at least twelve months <u>or the length of the operating cycle</u> from the balance sheet date".
54 – 57	*Operating cycle* Paragraph 54 refers to "the entity's operating cycle" and no guidance is provided where the entity has a number of operating cycles. Further, an entity may have an operating cycle of less than twelve months. It is unclear whether operating assets or liabilities that are expected to be realised or settled within twelve months but after the length of the operating cycle should be classified as current or non-current. We recommend that requirements similar to those in AASB 1040 "Statement of Financial Position" (paragraphs 4.3 to 4.4.4) be included in IAS 1 in order to clarify the requirements. Some entities may have an extremely long operating cycle. An example of such an entity would be one that manages a plantation forest. It is unclear whether such an entity should classify as current or as non-current an item of property, plant and equipment that is used in the production process and has a life less than the length of the operating cycle.
54(d), 65(i)	We recommend that these paragraphs refer to "cash <u>asset</u>" rather than to "cash" to avoid the possibility that an overdraft might be classified as an asset under the requirements of IAS 7 "Cash Flow Statements", paragraph 8.
56	Paragraph 56 clarifies that current assets include the current portion of non-current financial assets. Further, paragraph 59 clarifies that the current portion of a non-current liability should be classified as current. In the case of non-current depreciable assets, it is unclear whether the portion to be depreciated over the next twelve months should be classified as current. In our view, it should not be permitted to identify part of a non-current depreciable asset as current.
57(a)	We suggest that this paragraph be amended to "is expected to <u>arise and</u> be settled ..". This will ensure that liabilities are only classified as current under this paragraph where they are related to the operating cycle rather than merely being for a term less than the length of the operating cycle.

Paragraph	Comment
61	A current obligation may be classified as non-current where there is an agreement to refinance or 'roll over' the obligation. We recommend that IAS 1 clarify whether this agreement must be with the same counter-party as the current obligation that is potentially being classified as non-current.
65	We recommend that IAS 1 state that where an entity elects to separate one of the items required to be disclosed on the face of the balance sheet into components, the total of that item need not be disclosed.
66	To ensure a minimum level of structure of the balance sheet, we recommend that the following sub-totals be required: • when the entity uses the current/non-current classification, current assets, non-current assets, current liabilities and non-current liabilities; and • under all classifications, total assets, total liabilities and total equity.
72(a)	We recommend that, for partly-paid shares, disclosure of the amount outstanding per share and any calls be required by class of share. We recommend disclosure of any amounts that may be called in the event of the winding-up of the entity. We recommend that options be specifically identified as a class of equity.
76	We strongly recommend that IAS 1 specifically permit income and expenses to be shown disaggregated on the face of the income statement. We recommend that profit or loss before income tax expense be disclosed on the face of the income statement. It is not clear whether the paragraph 76(a) requirement to disclose "revenue" requires total revenue to be disclosed, or whether a disaggregation of total revenue is acceptable without dissection of the total. Finance costs is not defined. Does 'finance costs' mean borrowing costs?
76, 92(b)	We are concerned that the line items 'profit or loss' and 'net profit or loss' have such similar titles. This is likely to lead to confusion when references are made to one or the other line item. For example, paragraph 92(b) refers to 'profit or loss' whereas a reference to 'net profit or loss' may be more appropriate. We urge the IASB to clarify whether paragraph 92 is dealing with changes in equity before or after minority interests.

Paragraph	Comment
80 – 82	As drafted, paragraph 80 appears to require the disclosure of material revenues and expenses, whether or not they would be classified as exceptional, unusual or non-recurring. In contrast, paragraph 82 lists items that are frequently classified as exceptional, unusual or non-recurring. To reduce the likelihood that this section is used as the basis for entities to resurrect exceptional or extraordinary disclosures, we recommend that: • paragraph 80 excludes items of income and expense where disclosure is already required by another Standard; • the list in paragraph 82 is limited to those items that are not the subject of another Standard or an Interpretation; and • paragraph 76 prohibits the disclosure of a sub-total before items disclosed under paragraph 80.
83 – 87	Some of our constituents are of the view that this section permits a classification of expenses that is either by nature or by function or a hybrid of nature and function. If this is not intended, we recommend that paragraph 83 explicitly state that a hybrid classification is not acceptable.
88 – 89	The meaning of "disclose additional information on the nature of expenses" is unclear. We recommend that paragraph 88 contain a list of required disclosures applicable to all entities regardless of whether they classify expenses by nature or by function. Although the existing disclosure requirements are by nature, entities disclosing expenses by nature may not disclose these particular expenses. The disclosure of cost of goods sold is not required of all entities. We recommend that this disclosure be required regardless of whether an entity discloses expenses by nature or by function. We recommend that IAS 1 clarify that where an entity has included a cost such as depreciation in another item such as inventory, that cost becomes classified as inventory and is not disclosed as depreciation expense.
90	We recommend that dividends per share be required to be disclosed in the same location as earnings per share. Further, we recommend that this requirement be transferred to paragraph 116, to ensure that all dividend-related disclosures are in one location and that this requirement is not in a section dealing with expenses.
91	Paragraph (a) refers to a separate component of the financial statements commencing with 'the profit or loss for the period'. Does this requirement refer to 'profit or loss' (paragraph 76(f)) or 'net profit or loss' (paragraph 76(h))? Paragraph (b) refers to revenues and expenses that are 'required …' by other standards. Paragraph 94 refers to revenues and expenses that are 'required or permitted …' by another Standard. We recommend a consistent approach. Paragraph (c) refers to the 'cumulative effect of changes in accounting policy and the correction of errors'. Are these effects to be combined if, say, two accounting policies are changed and one error is corrected in the same period?

Paragraph	**Comment**
103 – 109	We recommend that these paragraphs are transferred to IAS 8 so that all requirements relating to accounting policies are in the same Standard.
Issues not covered	We recommend that where an entity changes its name, the entity be required to disclose the former name to facilitate users' access to the financial statements of previous periods. Where the operating cycle has a material effect on the distinction between current and non-current assets, we recommend that disclosure of the length of the operating cycle be required. To assist in the assessment of auditor independence, we recommend that entities be required to disclose payments to auditors and related practices of auditors separated between payments for auditing and for other services, with a break-up by nature of the other services. We recommend that entities be required to disclose any imputation credits if they operate in jurisdictions with taxation imputation systems.

4. EDITORIAL COMMENTS

Paragraph	**Comment**
14(c), 15(a)	We recommend that these paragraphs be amended to ensure that only necessary departures from a requirement of an IFRS or an IFRIC are made, by amending the first line to read: "the <u>requirement of the</u> Standard or Interpretation ...".
17	We recommend that a more appropriate location for this paragraph is immediately after paragraph 11.
39	We recommend that the reference to IAS 8 include the effects of errors as well as changes in accounting policies.
50	Delete 'within' in line 3.

AASB comments on proposed improvements to IAS 2 "Inventories"

1. GENERAL COMMENTS

We generally support the proposed revisions to IAS 2. We also have comments on:

* the specific questions asked by the IASB;

* differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook* that we believe are better addressed in the Australian Standards;

* issues raised by Australian constituents during the consultation process; and

* other issues identified by the AASB and AASB staff.

2. SPECIFIC QUESTIONS

1 Do you agree with eliminating the allowed alternative of using the last-in, first out (LIFO) method for determining the cost of inventories under paragraphs 23 and 24 of IAS 2?

We strongly support this proposal for the reasons outlined in paragraph A5 of the Basis for Conclusions to the proposed revised IAS 2.

2 IAS 2 requires reversal of write-downs of inventories when the circumstances that previously caused inventories to be written down below cost no longer exist (paragraph 30). IAS 2 also requires the amount of any reversal of any write-down of inventories to be recognised in profit or loss (paragraph 31) Do you agree with retaining those requirements?

We support retaining the existing recognition requirements. However, we consider that the requirements have little application in practice, except perhaps in the case of inventories with a long life cycle that remain as inventories over a number of reporting periods. Accordingly, we consider that the requirements to disclose the write downs and the reversals [paragraphs 34(c) and (d)] should be re-considered and, if retained, justified in the Basis for Conclusions. If the amounts concerned are of particular relevance they would be disclosed under paragraph 80 of IAS 1.

3. OTHER COMMENTS

The following comments include differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook*, and issues raised by constituents during the consultation process.

Paragraph	**Comment**
11	In discussing the factors to be considered for determining normal operating capacity, we consider that it would be beneficial to add reference to: * the volume of production which the production facilities are intended by their designers and by management to yield under the working conditions normally prevailing; * the budgeted level of activity for the current reporting period and for the ensuing reporting period; and * the level of activity achieved both in the current reporting period and in previous reporting periods.
16	We support the proposed additions to the commentary in relation to service providers in that they clarify two key points that may otherwise lead to divergent accounting practices.
21 & 21A	We support the proposed additions incorporating the SIC-1 "Consistency – Different Cost Formulas for Inventories". We consider that the example in paragraph 21A is helpful, but is not in the nature of a main principle and, accordingly, should not be in bold type (see Preface, paragraph 14).
27	In discussing the factors to be considered for determining selling price for the purpose of estimating the net realisable value of inventories, we consider that it would be beneficial to add reference to: * any existing contracts for future sales of items of inventory; * the general pattern of sales, inventories and discounts; and * fluctuations in the price of materials which will affect the selling price of items of inventory or where the raw materials are expected to be sold in their unprocessed state. Specifically in relation to estimating the net realisable value of spare parts held for sale or for use in after-sales service, we consider it would helpful to mention the need to consider past and future inventory movements relative to the total number of units in existence on which the spares can be used and also to the approximate date by which the last of those units can be expected to have gone out of service. Since net realisable value may be estimated using formulas, we consider that it may also be helpful to discuss this issue and to note that the formula would normally take into account, as appropriate, the age, past movements, expected future movements and estimated scrap values of the inventories. We consider that it may also be beneficial to include discussion of the situations in which the net realisable value of inventory is likely to be less than the cost, including:

Paragraph	Comment
	* a fall in selling price;
	* physical deterioration of inventories;
	* obsolescence of product;
	* a decision, as part of an entity's marketing strategy, to manufacture and sell products for the time being at a loss;
	* miscalculations or other errors in purchasing or production; and
34(c)	As noted above in relation to specific question 2, we recommend that paragraph 34(c) should be re-considered and, if retained, justified in the Basis for Conclusions. We consider that the disclosure is unlikely to provide useful information.

4. EDITORIAL COMMENTS

None

IAS 8 "ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS"

1. GENERAL COMMENTS

We generally support the proposed revisions to IAS 8. We also have comments on:

* the specific questions asked by the IASB;

* differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook* that we believe are better addressed in the Australian Standards;

* issues raised by Australian constituents during the consultation process; and

* other issues identified by the AASB and AASB staff.

2. SPECIFIC QUESTIONS

1 Do you agree that the allowed alternative treatment should be eliminated for voluntary changes in accounting policies and corrections of errors, meaning that those changes and corrections should be accounted for retrospectively as if the new accounting policy had always been in use or the error had never occurred (see paragraphs 20, 21, 32 and 33)?

We support the elimination of the choice in reporting voluntary changes in accounting policy and corrections of errors.

We agree that the effect of a voluntary change in an accounting policy should be accounted for retrospectively, given the criteria that need to be satisfied in order to make such a change. However, we could accept the effect of change in accounting policy being recognised as a revenue or an expense in the period in which the change is made, provided there is adequate disclosure.

We disagree with the proposal relating to errors. We consider that the effect of an error should always be recognised as a revenue or an expense in the period the error is discovered.

The IASB is presently considering the format of the performance statement. Accordingly, we recommend that the scope of that project be extended to make provision for the effect of voluntary changes in accounting policies and the correction of errors to be recognised within the performance statement. Given that the IASB's debate to date has discussed methods of reporting value changes that occurred in periods other than the period in which the change is recognised, it appears sensible to consider the presentation of voluntary changes in accounting policy and the correction of errors within the performance statement.

2 *Do you agree with eliminating the distinction between fundamental errors and other material errors (see paragraphs 32 and 33)?*

We strongly support this proposal. The distinction between fundamental errors and material errors is not clearly delineated, and we consider that the disclosures proposed under revised IAS 8 and the disclosures of revenues and expenses required by IAS 1.80 provide sufficient information to users.

3. OTHER COMMENTS

The following comments include differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook*, and issues raised by constituents during the consultation process.

Paragraph	**Comment**
4	We note that there is no requirement for the application of a Standard or Interpretation to reflect the substance of a transaction rather than the form. This is required in the voluntary selection of accounting policies used in the absence of a particular Standard or Interpretation [paragraph 5(b)(ii)]. We recommend that a requirement to reflect the substance of a transaction be inserted in paragraph 4.
5(b)(iv)	We recommend that this sub-paragraph be deleted. We appreciate that prudence is mentioned in the IASB's framework, and we suggest that this apsect of the framework be re-considered. The concept of prudence is inconsistent with the definition of reliability and with the requirement for reliable information to be free from error. Prudence is generally interpreted to require a bias whereas reliability is defined as being "neutral, ie free from bias" [paragraph 5(b)(iii)].
11(b)	We recommend that this paragraph be deleted. The paragraph addresses two types of transactions and other events: (a) those that did not occur previously, and (b) those that were immaterial in the past. Transactions and other events that did not occur previously are "transactions and other events that differ in substance from those previously occurring" and are covered by paragraph 11(a). In relation to transactions and other events that were immaterial in the past, two situations can arise. First, the entity has an accounting policy for those transactions and events but does not apply the policy because the transactions and events are immaterial. In that case, the application of the existing policy does not require a mention in paragraph 11(b). If the transactions and other events become material, and <u>at the same time</u> the entity changes the accounting policy, the requirements relating to the adoption of the new accounting policy should apply. The second possible situation is that the entity determined that the transaction or other event was immaterial without developing an accounting policy as a basis for the determination of materiality. In that case, the entity is adopting an

Paragraph	Comment
	accounting policy for the first time, and the change in accounting policy provisions are not relevant. IAS 8 could identify that, under this situation, this is a 'first time adoption' and therefore it cannot be a change in accounting policy. Under either situation, IAS 8 should clarify the correct treatment of 'catch-up' adjustments. For example, if a transaction that was immaterial now becomes material, do the transitional provisions in an applicable IFRS apply, or should any catch up adjustments be recognised as if they were errors on the grounds, that if a material catch-up adjustment is required, an error must have been made in the past?
13, 21 and 33	These paragraphs propose that, where comparative information cannot be restated for a particular prior period, that period is exempt from the requirement to restate comparative information. The purpose of restating comparative information is to "provide useful information for trend analysis of income and expenses" (paragraph A8(b)). Having some prior periods restated and other prior periods not restated does not achieve the stated purpose. We recommend that either all prior periods are restated or, if this would require undue cost or effort, no prior periods are restated.
19(d)	We are concerned with the potentially onerous nature of the proposal to require the estimate of the effects of the requirements on the entity of a new Standard that has not yet come into effect. This seems to be contrary to the usual practice of issuing a Standard some time before mandatory application in order to provide preparers with time to understand the requirements of the new Standard and to identify the effect. The proposal fails to recognise that entities may need to put in place new or upgraded systems for collecting and analysing information before they can implement new accounting policies. We acknowledge that there is effectively an "undue cost or effort" override built into paragraph 19(d), however, we consider that this override may need to be invoked frequently. The same override is used in other standards on the basis that it will rarely be invoked. We have a concern that paragraph 19(d) may generally "devalue" the notion of the undue cost or effort override in the eyes of users of the standards.
31 – 35	This section is drafted as if an error made in the past can never have an effect in the period in which the error is discovered. This may not always be the case. For example, a depreciable asset may be incorrectly classified as land on acquisition and, accordingly, depreciation will not have been charged in the past. We consider that the depreciation expense of the current period deserves disclosure as much as the "correction" depreciation retrospectively applied to the prior periods affected. We recommend that the section is amended accordingly.
32	We recommend that entities be explicitly required to correct an error in the period in which the entity discovers that the error has been made.

AASB comments on proposed improvements to IAS 10 "Events After the Balance Date"

1. GENERAL COMMENTS

We generally support the proposed revisions to IAS 10. However, we do not support the implications of Example 12 to IAS 37 – please refer to OTHER COMMENTS.

2. SPECIFIC QUESTIONS

None

3. OTHER COMMENTS

Paragraph	Comment
11 & 12 Example 12 Appendix C to IAS 37	The proposed improved IAS 10, paragraph 11 prohibits dividends declared after the balance sheet date from being recognised as liabilities at the balance sheet date. Paragraph 12 explains that the dividends are not recognised as liabilities because they do not meet the criteria of a present obligation in IAS 37 Provisions, Contingent Liabilities and Contingent Assets. Example 12 in Appendix C of the proposed improved IAS 37 explains that a dividend announced before balance sheet date and subject to shareholder approval after the balance sheet date is also not a liability, on the basis that shareholder approval is the obligating event. In Australia, the power to declare and pay dividends depends on the constitution of the entity concerned. The directors of some companies can "declare" and pay a dividend without the approval of shareholders. The directors of some companies can "announce" a dividend subject to the approval of shareholders. In the case of declarations or announcements occurring after the balance sheet date (dealt with in the proposed improved IAS 10), the AASB agrees that there is no liability. In the case of announcements made before the balance sheet date and subject to shareholder approval after the balance sheet date (dealt with in Example 12 of the proposed improved IAS 37), the AASB considers that there is a liability. Accordingly, the AASB disagrees with the proposed amendment to IAS 37. The AASB considers that the announcement gives rise to a constructive obligation[1] to pay the dividend consistent with the principle in IAS 37 that an entity has a constructive obligation to recognise a restructuring provision where it has a formal plan and raises a valid expectation about the restructuring. By announcing the dividend, the entity is obliged to pay it because the announcement raises a valid expectation among shareholders that the dividend will be paid. This is particularly the case where past behaviour indicates that announced dividends are always paid.

1 A constructive obligation is an obligation that derives from an entity's actions where:

4. EDITORIAL COMMENTS

None

(a) by established practice, published policies or a sufficiently specific statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities [paragraph 10 of IAS 37]

IAS 16 "PROPERTY, PLANT AND EQUIPMENT"

1. GENERAL COMMENTS

We generally support the proposed revisions to IAS 16. We also have comments on:

* the specific questions asked by the IASB;
* differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook* that we believe are better addressed in the Australian Standards;
* issues raised by Australian constituents during the consultation process; and
* other issues identified by the AASB and AASB staff.

2. SPECIFIC QUESTIONS

1 *Do you agree that all exchanges of items of property, plant and equipment should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably (see paragraphs 21 and 21A)?*

We support the general proposition that all exchanges of property, plant and equipment (regardless of whether the assets are similar) are measured at fair value. We do not have knowledge of the example(s) that IAS 16 relies upon to require the exception to the general proposition. Without knowledge of the example(s) we must reject the inclusion of the exception to the general proposition "except when the fair value of neither of the assets exchanged can be determined reliably". We would contend that rational behaviour precludes for-profit entities (and for that matter not-for-profit entities) entering into transactions for property, plant and equipment without knowing the economics of the arrangement. We would argue that the property, plant and equipment acquired (and, where applicable, identifiable liabilities assumed) are always measurable in an exchange of items of property, plant and equipment, and must be measured at the acquisition date at their fair value as at the acquisition date.

Even if we accept the proposed choice, we consider that paragraph 21A (and all references to paragraph 21A) are unnecessary.

In addition, we object to the expression in paragraph 21 "if it is more clearly evident" because it introduces another potential criterion, when the expression "if it is more reliable" is more consistent with the Framework.

2 *Do you agree that all exchanges of intangible assets should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably? (See the amendments in paragraphs 34-34B of IAS 38, Intangible Assets, proposed as a consequence of the proposal described in Question 1.)*

(Note that the Board has decided not to amend, at this time, the prohibition in IAS 18, Revenue, on recognising revenue from exchanges or swaps of goods or services of a similar nature and value. The Board will review that policy later in the context of a future project on the Recognition of Revenue).

Our answer to Question 2 is the same as our answer to Question 1. We support the general proposition that all exchanges of intangible assets (regardless of whether the assets are similar) are measured at fair value. We do not have knowledge of the example(s) that you rely upon to require the exception to the general proposition. Without knowledge of the example(s) we must reject the inclusion of the exception to the general proposition "except when the fair value of neither of the assets exchanged can be determined reliably". We would contend that rational behaviour precludes for-profit entities (and for that matter not-for-profit entities) entering into transactions for intangible assets without knowing the economics of the arrangement. We would argue that the intangible assets acquired (and, where applicable, identifiable liabilities assumed) are always measurable in an exchange of items of intangible assets, and must be measured at their fair value as at the acquisition date.

3 Do you agree that depreciation of an item of property, plant and equipment should not cease when it becomes temporarily idle or is retired from active use and held for disposal (see paragraph 59)?

We consider that this proposal should be better articulated. For example, where a temporary idle period was always intended, and was built into the estimate of the useful life of the asset, we consider that depreciation should not cease.

Furthermore, as discussed in IAS 16, paragraph 43, depreciation may represent the consumption of an asset based on one or more factors including usage and technical obsolescence. If an asset is being depreciated based on usage it seems reasonable to cease depreciating during an idle period. However, to the extent that an asset is being depreciated based on technical obsolescence, the idle period will not lessen the need to depreciate.

3. OTHER COMMENTS

The following comments include differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook*, and issues raised by constituents during the consultation process.

Paragraph	**Comment**
6 and 46	We do not support the amended definition of "residual value" in proposed paragraph 6 that requires the residual value of an asset to be reviewed as at each reporting date, regardless of whether the asset is measured at cost or at a revalued amount. Presently, paragraph 46 comments that, when the cost basis of measurement is used, the residual value is estimated at acquisition date and is not subsequently increased for changes in prices. We consider that the present paragraph 46 articulates an important principle, namely an anti-abuse measure, which quarantines the Income Statement and the Balance Sheet from the effect of a changed depreciable amount caused by a change in the price of the residual value of an item of property, plant and equipment. Our experience before we

Paragraph	Comment
	introduced the equivalent of the existing paragraph 46 was that entities revalued the residual value to the point where the depreciable amount was zero and avoided the need to depreciate. We would recommend the principle expressed in the present definition of "residual value" be retained, that is when property, plant and equipment is not revalued, the estimate of residual value is expressed in terms of the amount expected as at the date of acquisition and not some future value which would take into account the effect of inflation on asset prices. However, we would recommend that the present paragraph 46 be changed to acknowledge that residual value may still be (a) decreased or (b) increased for reasons other than changes in prices.
12	We agree that a component approach to depreciation and to the treatment of expenditure to renew a component of an item of property, plant and equipment should be applied to all property, plant and equipment, thereby achieving greater consistency with existing commentary about identifying separate assets based on them having different useful lives.
16	The unchanged paragraph 16 comments that, where payment for an item of property, plant and equipment is deferred beyond normal credit terms, its cost is the cash price equivalent, which implies that the deferred payment amount is effectively discounted at a rate specific to the asset. We agree that the estimated cash flows used to measure payment for an item of property, plant and equipment deferred beyond normal credit terms be discounted to their present value to reflect the time value of money. If the cash flows were not discounted, two payments for an item of property, plant and equipment deferred beyond normal credit terms giving rise to the same cash flows but with different timings would be reported at the same value, although rational economic appraisal would regard them as different. Accordingly, we recommend that when determining an asset's cost at its acquisition date, paragraph 16 be changed to explicitly require that any deferred settlement cash consideration is discounted to its present value and the discount rate used to determine the discounted cash consideration must be the pre-tax rate (or rates) that reflect(s) the current market assessment of the time value of money and the risks specific to the asset.

Paragraph	Comment
15(e), 20A and 20B	The proposed deletion of paragraph 15(e) and the proposed addition of paragraphs 20A and 20B (which restate the principle in the former paragraph 15(e)) provide additional guidance on the principle that the cost of an item of property, plant and equipment includes the costs of dismantling and removing the asset and restoring the site on which the asset is located as measured in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets". We support the thrust of the guidance, but recommend that this issue would be best addressed as a separate project, consistent with the FASB's "Asset Retirement Obligations" project – Statement No. 143 because the guidance leaves a large number of issues unanswered. For example, consider an entity operating a forest estate where its licensing agreement requires it to remove any assets at the end of production and restore the land component of the forest estate. In the process of meeting its licensing obligation the entity will remove fencing that can be sold. It is not clear to us whether the income from the sale of the fencing is netted off against the costs of dismantling and removing the asset and restoring the site on which the asset is located to arrive at a net cost.
22A	We support the proposed addition of paragraph 22A to require that expenditure incurred in replacing or renewing a component of an item of property, plant and equipment be accounted for as the acquisition of a separate asset and that the component asset that was subject to the replacement or the renewal be written off.
22C and 22D	We support the proposed addition of paragraphs 22C and 22D that a component that requires inspection to enable its continuing use is treated as a separate component for depreciation purposes.
23	The proposed amended paragraph 23 replaces "the originally assessed standard of performance" with the "standard of performance assessed immediately before the expenditure was made" in describing the criterion for determining whether subsequent expenditure relating to an item of property, plant and equipment should be capitalised. We can see no benefit arising from the change and consequently, we do not support the change.
28	The criteria for a voluntary change in accounting policy are articulated in IAS 8 " Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies". IAS 16 allows changes between the cost basis and the fair value basis. However, IAS 16 limits the choice to: • fair value; or • historical cost, namely, the treatment in accordance with IAS 16.28, which is the "original" historical cost less any accumulated depreciation and accumulated impairment losses. We contend that measurement at fair value provides information that is more relevant than measurement at historical cost. Accordingly, we recommend that when IAS 16 allows changes from fair value to cost, the provision of relevant information requires that the cost be measured as the property, plant and equipment's carrying amount at the date the revaluation was discontinued less

Paragraph	Comment
	any subsequent accumulated depreciation and subsequent accumulated impairment losses. This is similar to the notion of "deemed cost" in the IASB's ED 1 "First-time Application of International Financial Reporting Standards".
49 and 52	We agree with the proposal that review "periodically" means that reviews of the useful life and depreciation method of an item of property, plant and equipment must occur at least at each financial year end.
53A and 53B	We disagree with the proposal to insert a specific disclosure requirement that the recognition of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up, in the period in which it is received, to be included in profit or loss/result for that period and be disclosed separately. If the compensation from third parties was worthy of separately reporting it would already be required to be disclosed by IAS 8 "Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies", paragraph 16.
60	We agree with the proposal to remove the exemption from disclosing comparative information for the reconciliation of the carrying amounts at the beginning and end of the period for each class of property, plant and equipment.
61(b)	We support the proposal to remove the requirement that the financial statements disclose the accounting policy for the estimated costs of restoring the site of items of property, plant and equipment (as this disclosure is required in IAS 37 "Provisions, Contingent Liabilities and Contingent Assets).
64(d), 64(e) and 64(f)	We agree with the proposal to require additional disclosures for items of property, plant and equipment stated at revalued amounts: • the methods and significant assumptions applied in estimating the assets' fair values; and • the extent to which the assets' fair values were determined directly by reference to observable prices in an active market or recent transactions on arm's-length terms or were estimated using other valuation techniques. However, we do not agree with the cost disclosure requirements articulated in existing paragraph 64(e) [the proposed amended paragraph 64(f)]. We contend that the measurement attribute fair value provides information that is more relevant than the measurement attribute historical cost. Accordingly, we recommend the deletion of this disclosure requirement.

4. EDITORIAL COMMENTS

Paragraph	Comment
6	We recommend that the definition of "fair value" used in paragraph 6 should be the same as the definition of "fair value" used in the Glossary of Terms.

AASB comments on proposed improvements to IAS 17 “Leases”

1. GENERAL COMMENTS

We generally support the proposed revisions to IAS 17. We also have comments on:

* the specific questions asked by the IASB;
* differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook* that we believe are better addressed in the Australian Standards;
* issues raised by Australian constituents during the consultation process; and
* other issues identified by the AASB and AASB staff.

2. SPECIFIC QUESTIONS

1 Do you agree that when classifying a lease of land and buildings, the lease should be split into two elements—a lease of land and a lease of buildings? The land element is generally classified as an operating lease under paragraph 11 of IAS 17, Leases, and the buildings element is classified as an operating or finance lease by applying the conditions in paragraphs 3-10 of IAS 17.

We support this proposal for the reasons outlined in paragraph A3 of the Basis for Conclusions to the proposed revised IAS 17.

2 Do you agree that when a lessor incurs initial direct costs in negotiating a lease, those costs should be capitalised and allocated over the lease term? Do you agree that only incremental costs that are directly attributable to the lease transaction should be capitalised in this way and that they should include those internal costs that are incremental and directly attributable?

We support removing the choice in accounting for initial direct costs currently available in IAS 17. We agree that initial direct costs should be capitalised and allocated over the lease term, and that this should include any incremental internal costs. Please refer to our comments on paragraphs 3, 34 and 44.

3. OTHER COMMENTS

The following comments include differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook*, and issues raised by constituents during the consultation process.

Paragraph	Comment
3	We support the inclusion of a definition for initial direct costs, but believe that the definiton should not exclude costs incurred by manufacturer or dealer lessors. We consider that initial direct costs should be capitalised and allocated over the lease term regardless of the type of finance lease.
3	Residual value should be a defined term. For example, AASB 1008.20.1 defines residual value as the estimated fair value of the leased asset at the end of the lease term, based on price levels and market conditions existing at the inception of the lease. IAS 17 should also include guidance on determining the amounts to be included in minimum lease payments and in lease commitments. See for example, AASB 1008, paragraphs 20.1.2 and 20.1.3. The interest rate implicit in the lease should be defined as "the discount rate that, ~~at the inception of the lease~~ at the beginning of the lease term, causes the aggregate present value of the minimum lease payments and any unguaranteed residual value to be equal to the fair value of the leased asset". The current requirements may lead to the use of a distorted discount rate, if the inception of the lease (that is, the date of the lease agreement, or if earlier, the date of a commitment by the parties to the principal provisions of the lease) differs from the beginning of the lease term (that is, the commencement date of the period during which the risks and benefits incident to ownership of the leased asset are transferred from the lessor to the lessee).
8	While we support the overriding principles, IAS 17, paragraphs 5 to 10 should be supplemented by specific quantitative criteria, such as those in AASB 1008, paragraph 5.3.4, to provide some implementation guidance in classifying leases as operating or finance leases. We appreciate that it would also be desirable to emphasise that the quantative criteria do not replace the core principle used to distinguish between operating and finance leases.
11	Further guidance should be included that where a premium forms part of a lump-sum payable for a long-term lease of land and buildings, the premium payable in respect of each is calculated in proportion to their fair value, and included in minimum lease payments. Where such a premium relates to an operating lease, it should be treated as a prepayment and amortised over the lease term on a basis which best reflects the pattern in which the economic benefits are consumed by the lessee.

Paragraph	Comment
11B	In circumstances where it is not possible to reliably allocate lease payments between the land and building elements, we believe that entities should make a reasonable allocation based on the best estimate of fair value, rather than arbitrarily deem both elements to be a finance lease (unless it is clear that both elements of the lease are operating in nature). If a choice must be made in this case, we support such leases being deemed to be finance leases.
11C	The paragraph should be extended to cover leases of land and buildings in which the value of the buildings at the inception of the lease is immaterial. For example, the leasing of grazing land with equipment or grain sheds of an immaterial value, should be treated as a single operating lease. Further guidance should be included that in the case of more than one building forming a leased asset consisting of buildings and land of immaterial value, the economic life of the entire asset is taken to be the value weighted average of the economic lives of the buildings (see for example, AASB 1008, paragraph 5.3.13).
12, 28	IAS 17 should specify the point of time at which the lessee and lessor must recognise the assets and liabilities arising from a finance lease. This should be the point at which the risks and benefits incident to ownership of the leased asset are transferred from the lessor to the lessee.
34	We consider that initial direct costs should be capitalised and allocated over the lease term regardless of the type of lease.
39	Lessors should be required to disclose for each class of asset leased out under operating leases: • the gross amount of leased assets as at the reporting date; • accumulated depreciation as at the reporting date; • accumulated write-downs to recoverable amount as at the reporting date; • depreciation recognised as an expense in the reporting period; • write-downs recognised as an expense in the reporting period; and • reversals of write-downs recognised as revenues in the reporting period.
44	The AASB considers that initial direct costs incurred in connection with an operating lease should be immediatley recognised as expenses. The notion of operating leases is founded on such contracts being period-by-period propositions and, accordingly, there may no future economic benefits associated with operating leases.

Paragraph	Comment
52	While neither IAS 17, paragraph 52 or commentary addresses this issue, the Appendix to IAS 17 illustrates that any excess between the fair value and carrying value of a sale and leaseback asset should be deferred and amortised. We believe that the black letter or commentary should address this issue. Furthermore, we believe that the excess should be recognised immediately as revenue, reflecting that the gain has been realised at the moment of sale, and to be consistent with revenue recognition principles for ordinary sales. While IAS 17, paragraph 52 requires an excess of the sale price above fair value to be deferred and amortised over the period for which the asset is expected to be used, it does not address the pattern in which the excess should be amortised. As consistent with other requirements in IAS 17, the excess should be amortised on a straight line basis unless another systematic basis is representative of the time pattern of the user's benefit.
Issue not addressed	IAS 17 should address the accounting for executory costs. For instance, AASB 1008, paragraph 20.1 defines executory costs as "the costs specifically related only to the operation and maintenance of the lease asset (including insurance, repairs and property taxes)". Under AASB 1008: • a lessee must recognise any part of lease payments representing a reimbursement of executory costs incurred by the lessor as an expense in the reporting period in which those rentals are incurred (paragraph 9.1); and • a lessor must recognise any part of lease payments representing a recovery of executory costs as revenues in the reporting period in which the related costs are incurred (paragraph 16.1). We believe this treatment reflects that the act of payment for executory costs is compensation for expenses incurred by the lessor.

4. EDITORIAL COMMENTS (Paragraph references are to current IAS 17)

Paragraph	Comment
27(d)	To avoid confusion as to whether some difference exists between the terms, lessees should be required to disclose "material" rather than "significant" leasing arrangements.

IAS 21
"THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES"

1. GENERAL COMMENTS

We generally support the proposed revisions to IAS 1. We also have comments on:

* the specific questions asked by the IASB;
* differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook* that we believe are better addressed in the Australian Standards;
* issues raised by Australian constituents during the consultation process; and
* other issues identified by the AASB and AASB staff.

2. SPECIFIC QUESTIONS

1 Do you agree with the proposed definition of functional currency as "the currency of the primary economic environment in which the entity operates, and the guidance proposed in paragraphs 7-12 on how to determine what is an entity's functional currency?

We support the proposed definition of functional currency. However, we have some concerns with the guidance proposed in paragraphs 7-12 for the determination of an entity's functional currency.

(a) We recommend that IAS 21 clarify the relationship between the currency in which sales prices are denominated (IAS 21.7(a)) and the currency in which operating costs are denominated (IAS 21.7(b)). Many entities manufacture or produce goods and services in an economy with a domestic currency and sell those goods or services in international markets where prices are denominated in (say) US dollars. In some cases, it may be unclear which currency is the functional currency.

(b) We recommend that IAS 21 explain that the factors in paragraph 8 are only used where the factors in paragraph 7 do not clearly determine the functional currency.

(c) An entity may be a reporting entity in its own right and also be a foreign operation of another entity. We are concerned that paragraph 7 would apply to the entity as a reporting entity and that paragraph 9 would apply to the entity as a foreign operation of another entity. In our view, paragraphs 7 and 9 could give different answers as to the functional currency. Accordingly, there may be some confusion for some entities attempting to determine their functional currency.

As an illustration of our concern, we consider a typical situation that faces many subsidiaries of Australian companies. Assume that a foreign operation is established in a foreign jurisdiction to take advantage of factors such as low wage rates in that foreign jurisdiction or access to overseas markets. The relationship between the foreign operation and the reporting entity may be such that the foreign operation has little autonomy in determining its operating and financing policies. To identify the functional currency, the foreign operation would consider:

(i) the currency in which the sales prices and operating costs are denominated (paragraph 7), and conclude that the functional currency is the currency of the foreign jurisdiction (and this would be the functional currency of the entity if it were a reporting entity in its own right);

(ii) the lack of autonomy from the reporting entity (paragraphs 9(a) and (c)), and conclude that the functional currency is the functional currency of the reporting entity; and

(ii) the fact that the foreign operation incurs expenses, generates income and finances working capital in the currency of the foreign jurisdiction (paragraphs 9(a) and (d)), and conclude that the functional currency is the currency of the foreign jurisdiction.

We recommend that paragraph 9 be deleted and that foreign operations apply the same rules in determining functional currency as other entities. We consider that the operating relationship between the reporting entity and a foreign operation does not necessarily bear upon the currency of the foreign operation's primary economic environment. Further, we consider that the content of paragraph 9 will more likely confuse than assist in the determination of the functional currency of a foreign operation.

If paragraph 9 is retained, we recommend that the paragraph be re-drafted. Presently the factors are written with different perspectives. For example, a "yes" answer to (a) would indicate that the entity's functional currency is the reporting entity's functional currency, whereas a "yes" answer to (d) would indicate that the entity's functional currency is not necessarily the reporting entity's functional currency.

2 Do you agree that a reporting entity (whether a group or a stand-alone entity) should be permitted to present its financial statements in any currency (or currencies) that it chooses?

We support a choice of presentation currency (or currencies). However, we are concerned that there are no restrictions on an entity presenting its financial report in one currency in period one and another currency in period two. We appreciate that an entity in tune with the users of its financial report would be highly unlikely to put its users through this inconvenience. However, there may be circumstances in which an entity takes advantage of this lack of constraints. We consider that there should be principle that entities must choose their presentation currencies based on the needs of their primary users. We also consider that entities should be required to explain the reasons for any change in presentation currency (or currencies).

The AASB also considers that IAS 21 should acknowledge that some jurisdictions have requirements that financial reports be presented in the domestic currency. This is presently the case on Australia.

3 *Do you agree that all entities should translate their financial statements into the presentation currency (or currencies) using the same method as is required for translating a foreign operation for inclusion in the reporting entity's financial statements (see paragraphs 37 and 40)?*

The purpose of translating financial statements into the presentation currency (or currencies) is different from the purpose of translating financial statement for inclusion in the reporting entity's financial statements. Therefore, we do not consider that the same method should necessarily be applied to both situations.

We understand that the proposed revised IAS 21 proposals mean that a reporting entity need not prepare consolidated financial statements in the consolidated group's functional currency. If this is the case, then translation for presentation purposes and translation for consolidation purposes has been combined into a single translation, and a single translation methodology is necessary.

Our preference would be for two separate translations:

(a) translation of foreign entities into the functional currency of the parent entity for consolidation purposes and reporting the functional currency (see our response to question 2); and

(b) translation of the consolidated results into the presentation currency (or currencies).

If our preferred approach were adopted, we would recommend that the proposed paragraph 37 translation methodology apply to the translation of foreign operations for the purpose of consolidation. We would recommend that translation for presentation purposes be by applying the spot exchange rate at reporting date to all items and all periods presented to preserve the relationships in the foreign currencies. We note that the IASB has agreed that "the translation method should not have the effect of substituting another currency for the functional currency" (paragraph A13) and consider that this translation method best achieves the IASB's objective.

The IASB's current proposals would mean that each presentation currency translation will give rise to different income and expense amounts and different foreign currency translation reserves, which seems to be highly inappropriate.

4 *Do you agree that the allowed alterative to capitalise certain exchange differences in paragraph 21 of IAS 21 should be removed?*

Yes. In our view, all exchange differences should be recognised as revenues and expenses as they arise. The allowed alternative was not included in Australian standards when AASB 1012 "Foreign Currency Translation" was harmonised with IAS 21.

5 *Do you agree that:*

(a) goodwill and

(b) fair value adjustments to assets and liabilities that arise on the acquisition of a foreign operation should be treated as assets and liabilities of the foreign operation and translated at the closing rate (see paragraph 45)?

We support the proposal. We understand that this approach is consistent with the proposals in the business combinations project.

3. OTHER COMMENTS

The following comments include differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook*, and issues raised by constituents during the consultation process.

Paragraph	Comment
6	We recommend that the term 'reporting entity' be defined. The use in IAS 21 (the parent entity in a consolidated group) is different from the more common use as defined in the IASB Glossary. Alternatively, the New Zealand term 'entity reporting' could be defined and used in place of 'reporting entity' (see FRS-21 "Accounting for the Effects of Changes in Foreign Currency Exchange Rates").
6, 13	Paragraph 6 defines a net investment in a foreign operation as "the amount of the reporting entity's interest in the net assets of that operation". Paragraph 13 extends this definition and states that this includes long-term receivables and payables. We recommend that the definition of net investment in a foreign operation be extended to ensure consistency between paragraphs 6 and 13. Accordingly, we recommend that the net investment in a foreign operation be defined as "the amount of the reporting entity's interest in the net assets of that <u>foreign</u> operation, <u>after adjustment for the effect of any items that are, in substance, part of the entity's net investment</u>".
11, 33 – 35	We recommend that paragraph 11 note that a change in functional currency is treated as a change in accounting policy. It would follow that the provisions of IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" apply to any change in functional currency. IAS 8 requires changes in an accounting policy to be applied retrospectively, and we consider that the same requirements should apply to a change in functional currency, rather than the prospective treatment proposed in paragraphs 33 – 35. It is likely that the circumstances giving rise to a change in functional currency will develop over a period of time, and, accordingly, retrospective application is more appropriate than prospective application.
14	We recommend clarification of the status of deferred tax assets and liabilities as either monetary items or non-monetary items.
21(b), (c)	Paragraph 19 requires foreign currency transactions to be translated at the spot exchange rate at the date of the transaction. It follows that non-monetary items will be translated at the transaction date into the functional currency. It is unclear why paragraphs 21(b) and (c) envisage a need to retranslate non-monetary items. In our view, these paragraphs are unnecessary and paragraphs 28 and 29 adequately address the treatment of exchange differences on revaluations of non-monetary items.

Paragraph	Comment
21(c), 23	We recommend that if paragraph 21(c) is retained, it refers to remeasured items rather than items measured at "fair value". This will remove the inconsistency with the reference in paragraph 23 to inventory measured at net realisable value.
24	We recommend that this paragraph include an example to explain when several exchange rates might be available in relation to a transaction or the translation of account balances.
30, 31	Paragraph 30 requires that exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation be recognised in a separate component of equity on consolidation. Paragraph 31 explains that this requirement applies when the monetary item is denominated in the functional currency of either the reporting entity or the foreign operation, but does not cover the situation where the monetary item is denominated in a third currency. We recommend that the explanation in paragraph 31 be amended to be consistent with the requirement of paragraph 30.
32	We recommend that this paragraph be deleted. Standards generally consider the final results of following recognition and measurement requirements and do not generally address the recording methodology applied.
37(a)	This paragraph requires "equity items other than those resulting from income and expenses recognised in the period" to be translated at the closing exchange rate at the date of each balance sheet presented. It is unclear whether this requires that retained profits and reserves derived from previously reported profits be: (a) translated at the relevant closing exchange rate on the grounds that they result from income and expenses recognised in other periods (in which case, the treatment of the portion resulting from income and expense items of the current period is unclear); or (b) translated as a total of a series of incomes and expenses from a number of periods. We note that the application of paragraph 37(a) to a foreign operation may result in the amount of contributed equity in a foreign operation differing from the amount of contributed equity in the financial statements of a parent entity. We presume that any necessary consolidation adjustments will be considered as part of the Consolidations project.
37(b)	We recommend that revised IAS 21 specify whether items such as income tax expense that are calculated at the end of a period based on activities throughout the period should be translated at an average exchange rate for the period or the closing exchange rate at the end of the period.

Paragraph	Comment
37(c), 39	The argument for recognising exchange differences resulting from financial statement translations directly in equity were in place before standard-setters had developed conceptual frameworks. In our view, translation exchange differences meet the definitions of income and expense and should be recognised directly in the income statement. We recommend that this issue be addressed in the IASB's Performance Reporting project if it is not addressed in the Improvements project.
46	We understand that the IASB has determined to prohibit recycling. If recycling is retained in "improved" IAS 21, we recommend that constituents be informed that it is likely to be removed as part of the Performance Reporting project.
50	We recommend that exchange differences recognised as income or expenses arising from cash flow hedges be separately disclosed to enable the separate identification of hedged sales at the spot exchange rate and the effect of cash flow hedges.
52	We recommend that disclosure of the reason for a change in functional currency be required.
54, 55	IAS 1 "Presentation of Financial Statements", paragraphs 10-12, envisages the need to disclose additional information in order to achieve a fair presentation. We recommend that IAS 21 clarify when additional information included in the financial statements is required by IAS 1, and when additional information is subject to the disclosure requirements contained in paragraph 55.
Issue not addressed	We recommend that revised IAS 21 clarify that equity denominated in a currency other than the entity's functional currency should not be retranslated after the initial transaction recording the issue. We recommend that revised IAS 21 contain transitional guidance clarifying that, under IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors", any adjustments necessary on application of the revised standard are to be made retrospectively.

4. EDITORIAL COMMENTS

Paragraph	Comment
46, 47	We recommend that these paragraphs refer consistently to "disposal or partial disposal".

IAS 24 "RELATED PARTY DISCLOSURES"

1. GENERAL COMMENTS

We generally do not support the proposed revisions to IAS 24. We consider that further improvements to IAS 24 are warranted. We also have comments on:

* the specific questions asked by the IASB;
* differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook* that we believe are better addressed in the Australian Standards;
* issues raised by Australian constituents during the consultation process; and
* other issues identified by the AASB and AASB staff.

2. SPECIFIC QUESTIONS

1 Do you agree that the Standard should not require disclosure of management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations (see paragraph 2)?

> *'Management' and 'compensation' would need to be defined, and measurement requirements for management compensation would need to be developed, if disclosure of these items were to be required. If commentators disagree with the Board's proposal, the Board would welcome suggestions on how to define 'management' and 'compensation'.*

We do not support the proposed exclusion of disclosures about management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations.

We believe that information regarding management compensation should be required to be disclosed as such information is useful to users in assessing the performance of management and the entity. We would only support the removal of such disclosures from IAS 24 if it were proposed in conjunction with the creation of a new standard focussed on disclosures about this class of related party. We note that the changes proposed (as part of the Improvements project) for IAS 19 "Employee Benefits" include removal of the cross-references therein to IAS 24 in relation to the remuneration of key management personnel.

It is suggested that the IASB needs clear definitions of "management" and "compensation" even if it proceeds with the proposed exclusion. Otherwise, there will be confusion as to what is excluded and what is included from all the transactions between a director (or other key management personnel) and the entity. It is noted that transactions with key management personnel other than compensation paid in the ordinary course of an entity's operations are not excluded in the proposed revision.

In response to the request that those who disagree with the exclusion should suggest how 'management' and 'compensation' might be defined, it is noted that the AASB has defined equivalent terms in ED 106 "Director and Executive Disclosures by Disclosing Entities". The IASB could draw on these definitions or combine them with similar concepts already in other IASB standards. In particular, compensation could be defined to include all items treated as employee benefits in IAS 19 and items addressed in the forthcoming IFRS on Share-based Payment. For these items, there would be no need to develop new measurement requirements as these are already contained in both IAS 19 and the proposed IFRS.

2 Do you agree that the Standard should not require disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or a wholly-owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs (see paragraph 3)?

We do not agree with the proposed exclusion from disclosure in the financial report of an entity of its transactions and balances with its wholly-owned subsidiaries (or omission in the financial report of a wholly-owned subsidiary in relation to its parent or siblings), irrespective of whether published with the consolidated financial statements. Without such disclosures, the relationships within a group of companies become opaque.

It is important that information on related party transactions and outstanding balances is made available at the level of the entity that is most useful to the user. For example, creditors of a wholly-owned subsidiary may change their view of the credit-worthiness of their customer if the disclosures were made. A wholly-owned subsidiary remains a legal entity separate from its shareholder(s) and it is still possible for the shareholder or parent to walk away from a failing subsidiary.

Further, we are concerned that some transactions between a parent or wholly-owned subsidiary and related parties outside the group may be immaterial to the group and, based on the exemption in paragraph 3, would not be disclosed in either the entity or consolidated financial statements.

3. OTHER COMMENTS

The following comments include differences between IASB and Australian Standards, that are identified in *The Australian Convergence Handbook*, and issues raised by constituents during the consultation process. Descriptions of the proposed improvements, where included to give context to comments, are italicised.

Paragraph	Comment
9 *Definition: Related Party*	*Changes 'generic' definition to 'black letter' with specific identification of seven 'classes' of related party, re-arranging and extending the five 'classes' previously given in commentary (old paragraph 3).* ***Adds*** *(c) joint ventures in which the entity is venturer* *(g) post-employment benefit plans for the benefit of employees of the entity or of any related entity*

Paragraph	Comment
	Re (g) post-employment benefit plans Given the legal requirements in Australia for a superannuation plan to be distanced from the employer, it is uncertain whether it is appropriate to treat such a plan as a related party. Explicit inclusion as a class may avoid the problem that arises in relation to 'control' of trusts. Since a trustee or manager has no power to govern the trust so as to benefit from its activities, the manager cannot be said to control the trust in accordance with the proposed change of definition for 'control'. ***Extends*** ** control (a)(iii) parties with joint control over the entity* ** key management personnel (d) to include KMP of the parent entity and adds '(whether executive or otherwise)' after 'director'* **Re Key Management Personnel (KMP)** Widening the KMP category to include directors and executives of the parent of the reporting entity appears to extend this group unnecessarily and inefficiently. The extension is unnecessary because such individuals, if directly responsible for the governance of the entity, are already included as KMP or, if it is intended to include those individuals as related parties (and not KMP when they are not in substance KMP of the entity), are already included in the 'control' class in (a). The extension is inefficient as there may be only a loose connection between any one director of the parent and the management and direction of the reporting entity. It increases the difficulty in defining this class (so as to identify which individuals are included) and raises questions as to whether the key management role is to be defined in respect of the reporting entity or in respect of the external entity, the parent. Including as KMP those who are not directly responsible for the governance of the reporting entity (but are responsible in relation to the parent entity) means it is more difficult to identify those who are being remunerated for governing the reporting entity and, arguably, results in an unwarranted increase in the number of related parties (because it includes the close family members of the KMP of the parent entity). It was for these reasons that we previously recommended that the 'close family members' be removed from the description of the class of KMP and accordingly we strongly support the proposal that these now comprise a class (e) separate from class (d) KMP. *(see also re para 15 below: (f) refers to KMP 'of the entity or its parent')*
9 *Definition : control*	*Aligns definition of control to accord with that in IAS 27 and IAS 28* We agree. The proposed amendment will remove a difference between IAS 24, other IASB standards and AASB 1017.

Paragraph	Comment
14	*Disclosures - expanded to require explicitly:* *(a) the amount of transactions;* *(b) the amount of outstanding balances (plus some further details);* *(c) provision for doubtful debts related to (b); and* *(d) expense recognised for bad and doubtful debts.* We support the inclusion of more specific requirements as to what is to be disclosed but consider that it is desirable to include further directions to preclude netting of transactions and balances (in particular, balances owing and owed). Paragraph 18 grants 'permission' to disclose similar items in aggregate unless '*separate disclosure is necessary for an understanding of the effects*' but this does not appear to deny aggregation of items of a dissimilar nature. Further, it does not seem sufficiently strong to elicit separate disclosure of individual items when material. It is uncertain whether the list of examples in paragraph 16 of '*transactions that are disclosed*' is intended to identify what must be separately disclosed in respect of each related party or each 'class' of related party (using the seven classes nominated in paragraph 15).
15	*Separation of disclosures* *Categories in which amounts required by para. 14 should be disclosed:* *(a) parent;* *(b) entities with joint control or significant influence over the entity;* *(c) subsidiaries;* *(d) associates;* *(e) joint ventures in which the entity is a venturer;* *(f) KMP of the entity or its parent; and* *(g) other related parties.* Paragraph 2 excludes management compensation from IAS 24 but presumably the amounts of all other transactions and balances with directors (and other KMP) are included in (f). In order to exclude compensation for these individuals, it is necessary to define compensation, to achieve greater certainty in identifying which transactions (and amounts) are to be included. The specific reference in (f) to the KMP of the parent entity raises questions as to whether this includes individuals in that group who are not involved in the management of the entity (subsidiary). It is uncertain whether it is intended that the above dissection of related party transactions into seven 'amounts' based on the identity of the related party is the framework within which the aggregation of items similar in nature permitted under paragraph 18 would operate (disclosing separate amounts by nature for each class of related party) or whether it is intended that the aggregation by nature is applied first and each resulting aggregate amount is further divided to disclose amounts relevant to each of the seven identified classes of related party.

Paragraph	Comment
17	*Restriction on arm's length claims*

The proposed addition to commentary in this Standard is unnecessary because it simply means the descriptions should faithfully represent the circumstances. It might be contentious to apply such a restriction to one item without some equivalent comments on other items.

We strongly advise the removal of this paragraph because retention would create an unfortunate precedent.

4. EDITORIAL COMMENTS

Paragraph	Comment
15	*Separation of disclosures*

It is recommended that either these seven classes of related party are identified in the definition or the seven main classes identified in the definition (paragraph 9) are also used here as the basis for disclosing separate amounts. It is inefficient and confusing to have two lists of seven classes of related party (especially when they are numbered similarly).

16 *Examples of transactions*

The description of what these examples are illustrating has changed. The previous description (old paragraph 19) implied these were transactions (or situations) that may give rise to related party disclosures. The proposed description says they are examples of transactions to be disclosed if the other party is related. It is not clear whether this requires individual transactions to be disclosed or is intended to identify the classes of transactions requiring separate disclosure or is merely illustrating the sorts of transactions giving rise to amounts to be included in the amounts required to be disclosed for each class of related party (as required by paragraph 15).

IAS 27 "CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS"

1. GENERAL COMMENTS

We generally support the proposed revisions to IAS 27. We also have comments on:

* the specific questions asked by the IASB;
* differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook* that we believe are better addressed in the Australian Standards;
* issues raised by Australian constituents during the consultation process; and
* other issues identified by the AASB and AASB staff.

In particular, we believe that the revised IAS 27 could be improved with the inclusion of additional guidance. We believe that the commentary and appendices in AASB 1024 "Consolidated Accounts" provides useful guidance for preparers and helps ensure a consistent application of the accounting policies. Therefore, we believe that additional guidance in relation to the following should be included in the revised Standard:

- applying the notion of control;
- accounting for reciprocal ownership interests within the economic entity;
- accounting for the sale of an ownership interest in a subsidiary;
- accounting for the acquisition of an additional ownership interest in a subsidiary; and
- accounting for a new issue of capital by a subsidiary.

We recommend that the IASB consider the commentary and appendices in AASB 1024 prior to finalising its revisions to IAS 27.

2. SPECIFIC QUESTIONS

1 Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?

Whilst we consider that the proposed criteria provide practicable guidance to preparers, we believe that the information needs of users other than the owners of the parent entity should also be considered. The Australian Conceptual Framework, as well as the IASB Framework, identifies a number of different users of general purpose financial reports/financial statements, including employees, lenders, creditors and suppliers. It seems inappropriate for the revised paragraph 8 to only consider the information needs of the parent's owners (paragraph 8(a)). Therefore, rather than prescribing a set of criteria, we believe it is more appropriate to to prescribe the application of a general principle, such as the reporting entity concept (and to apply the definition of a reporting entity developed by the IASB as part of its Business Combinations Phase I project). In accordance with this general principle, each parent entity of an economic entity that is a "reporting entity" should be required to prepare consolidated financial statements.

2 *Do you agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity (see paragraph 26)?*

Yes. This proposal is supported.

3 *Do you agree that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, in the investor's separate financial statements (paragraph 29)?*

Yes. This proposal is supported, particularly the removal of the equity method as a measurement alternative.

Do you agree that if investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments should be accounted for in the same way in the investor's separate financial statements (paragraph 30)?

It is not clear from this paragraph as to the circumstances in which investments in subsidiaries would be accounted for in accordance with IAS 39. One interpretation of the current wording of paragraph 30 is that it provides the preparer with an option to account for investments in subsidiaries in accordance with IAS 39 in the consolidated financial statements (rather than consolidating the parent and its subsidiaries). It is our understanding that the only circumstance in which a subsidiary can be excluded from consolidation is by virtue of paragraph 13 (that is, temporary control). We believe that this should be articulated in paragraph 30. We suggest that paragraph 30 should be amended as follows:

Investments in subsidiaries <u>(by virtue of paragraph 13 of this Standard)</u>, jointly controlled entities and associates that are accounted for in accordance with IAS 39 in the consolidated financial statements shall be accounted for in the same way in the investor's separate financial statements and in the financial statements of a parent that need not present consolidated financial statements.

3. OTHER COMMENTS

The following comments include differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook*, and issues raised by constituents during the consultation process.

Paragraph	Comment
6	Yes. This proposal is supported.
11 & 13	We do not support the proposal to exclude subsidiaries from consolidation when control is temporary and held exclusively for disposal within 12 months of the acquisition ("temporary control"). Consistent with IAS 27, the equivalent Australian Standard adopts control as the criterion for determining a parent entity/subsidiary relationship for the purpose of identifying an economic entity for which consolidated financial statements may be prepared. Temporary control does not of itself affect the economic entity for which consolidated financial statements are to be prepared. During the time that control is held and until such time as control ceases, the subsidiary is part of the economic entity and needs to be reflected in the consolidated financial statements. We would recommend that the temporary control exemption be removed from the Standard.
12A	Yes. This proposal is supported.
13A	Consistent with our responses to Question 1 and paragraphs 11 & 13 above, we believe that any standard dealing with consolidated financial statements should be founded on the control concept and the reporting entity concept. As a consequence, paragraphs such as 13A would not be necessary.
12B	Yes. This proposal is supported. However, we would recommend that paragraph 12B should also incorporate additional guidance currently within SIC-33. We believe that the following text from SIC-33 would be useful: "Potential voting rights are not presently exercisable or presently convertible when, for example, they cannot be exercised or converted until a future date or upon the occurrence of a future event." (paragraph 3) "All facts and circumstances that affect potential voting rights considered in accordance with paragraph 3 of this Interpretation should be examined, except the intention of management and the financial capability to exercise or convert. Other facts that should be considered include the terms of exercise of the potential voting rights and possible linked transactions." (paragraph 4) Including Appendix A "Application of Potential Voting Rights" would also provide useful guidance. We believe that potential voting rights should reflect possible voting rights and not probable voting rights. Accordingly, we agree with the requirement in paragraph 4 of SIC-33 to ignore the intention of management and the financial

Paragraph	Comment
	capability to exercise or convert (which supports the notion of possible voting rights). In contrast, the last two sentences of paragraph 7 of SIC-33 (in particular the use of the word remote) appear to support the notion of probable voting rights. We recommend that only paragraphs 3 and 4 of SIC-33 should be incorporated into the Standard (since these paragraphs support the notion of possible voting rights) Similarly, the word remote should also be removed from the guidance in Appendix A.
15A	Yes. This proposal is supported. However, we would recommend that paragraph 15A should also incorporate additional guidance currently within SIC-33 with regard to entities that in-substance, have a present ownership interest. We believe that the following text from SIC-33 would be useful: "An enterprise may, in substance, have a present ownership interest when for example, it sells and simultaneously agrees to repurchase, but does not lose control of, access to economic benefits associated with an ownership interest. In this circumstance, the proportion allocated should be determined taking into account the eventual exercise of potential voting rights and other derivatives that, in substance, presently give access to the economic benefits associated with an ownership interest." (paragraph 5) Including Appendix B "Allocation of Ownership Interests" would also provide useful guidance.
19	We do not support the proposal to require the difference between a parent's and subsidiary's reporting date to be no greater than 3 months. We believe that if an entity controls another entity, it can change the reporting date of the other entity.
21	Yes. This proposal is supported.
24	Yes. This proposal is supported.
26	Yes. This proposal is supported.
32	Consistent with our responses to Question 1 and paragraphs 11, 13 & 13A above, we believe that all subsidiaries should be consolidated. As a consequence, the disclosure requirements within paragraph 32 would not be necessary, with the possible exception of paragraphs 32(c), (d) and (f).
33	Yes. This proposal is supported.

4. EDITORIAL COMMENTS

Paragraph	Comment
	None.

IAS 28 "ACCOUNTING FOR INVESTMENTS IN ASSOCIATES"

1. GENERAL COMMENTS

We generally do not support the equity method as a measurement basis. Although the equity method provides users with profit and loss information of the associate, it is uncertain as to what the carrying amount of an equity-accounted investment represents (for instance, the carrying amount is not necessarily indicative of current value). We believe that financial statements prepared using either the fair value method required by IAS 39 or the cost method is more appropriate (particularly in terms of providing users with relevant information). Using the fair value method required by IAS 39 would provide an indication of current value. Alternatively, any investment in an associate that does not have a quoted market price in an active market and whose fair value cannot be reliably measured would be recorded at cost. Even under the cost method, users would be provided with relevant information in terms of the dividend income received.

We believe that the equity method of accounting should be abandoned. We would recommend that investors should be required to account for their investment in an associate using either the fair value method required by IAS 39 or the cost method. In fact, if such an approach were adopted, an individual standard on accounting for investments in associates would not be necessary given that all such investments would ultimately be accounted for under IAS 39. Furthermore, if the equity method of accounting were abandoned, it may force investor entities to consider more carefully their relationship with investees and whether or not the relationship is based on control.

We also have comments on:

* the specific questions asked by the IASB;
* differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook* that we believe are better addressed in the Australian Standards;
* issues raised by Australian constituents during the consultation process; and
* other issues identified by the AASB and AASB staff.

2. SPECIFIC QUESTIONS

1 *Do you agree that IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, should not apply to investments that otherwise would be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries (see paragraph 1)?*

Yes. This proposal is supported (however, in the longer term, we would have a strong preference that requirements or exemptions not rely on whether or not a treatment is a well-established practice within an industry). Also, consistent with our comments in section 1 above, we believe that this principle should be extended to all entities. That is, where an entity is able to measure its investments in associates at fair value in accordance with IAS 39, that fair value should be recognised rather than the surrogate value derived from the use of the equity method.

2 Do you agree that the amount to be reduced to nil when an associate incurs losses should include not only investments in the equity of the associate but also other interests such as long-term receivables (paragraph 22)?

We do not support this proposition. Applying the impairment test within IAS 39.109 to financial assets (including long-term receivables) seems a more appropriate subsequent measurement technique. The fact that an associate's losses have reduced the "Investment in Associate" to nil would represent "objective evidence" that the long-term receivable may be impaired. In accordance with IAS 39.111, an entity would be required to compare the carrying amount of the long-term receivable with its recoverable amount (which is calculated as the present value of the future cash flows discounted at the long-term receivable's original effective interest rate). This would appear to be a more efficient approach than that proposed by the amendment (for instance, subsequent to reducing the carrying value of the long-term receivable by virtue of the associate's losses, the entity would necessarily test the long-term receivable for impairment to ensure that its "adjusted" carrying amount is not in excess of its recoverable amount).

We would recommend that the previous wording be retained (in which case, paragraphs 22A and 22B would no longer be required).

3. OTHER COMMENTS

The following comments include differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook*, and issues raised by constituents during the consultation process.

Paragraph	Comment
3	Yes. This proposal is supported.
5A	Yes. This proposal is supported. However, we would recommend that paragraph 5A should also incorporate additional guidance currently within SIC-33. We believe that the following text from SIC-33 would be useful: "Potential voting rights are not presently exercisable or presently convertible when, for example, they cannot be exercised or converted until a future date or upon the occurrence of a future event." (paragraph 3) "All facts and circumstances that affect potential voting rights considered in accordance with paragraph 3 of this Interpretation should be examined, except the intention of management and the financial capability to exercise or convert. Other facts that should be considered include the terms of exercise of the potential voting rights and possible linked transactions." (paragraph 4) Including Appendix A "Application of Potential Voting Rights" would also

Paragraph	Comment
	provide useful guidance. We believe that potential voting rights should reflect possible voting rights and not probable voting rights. Accordingly, we agree with the requirement in paragraph 4 of SIC-33 to ignore the intention of management and the financial capability to exercise or convert (which supports the notion of possible voting rights). In contrast, the last two sentences of paragraph 7 of SIC-33 (in particular the use of the word remote) appear to support the notion of probable voting rights. We recommend that only paragraphs 3 and 4 of SIC-33 should be incorporated into the Standard (since these paragraphs support the notion of possible voting rights) Similarly, the word remote should also be removed from the guidance in Appendix A.
5B	Yes. This proposal is supported.
8	Refer to section 1 above for our comments with regard to the use of the equity method of accounting.
24A	Yes. This proposal is supported.
11 & 11A	Consistent with our comments in section 1 above, we believe that an investor should be required to account for an investment in an associate using either the fair value method required by IAS 39 or the cost method. As a consequence, paragraphs such as 11 & 11A would not be necessary.
16A	Refer to section 1 above for our comments with regard to the use of the equity method of accounting. If, however, the use of the equity method is retained, we support this proposal.
16B	Refer to section 1 above for our comments with regard to the use of the equity method of accounting. If, however, the use of the equity method is retained, we support this proposal.
18	Refer to section 1 above for our comments with regard to the use of the equity method of accounting. If, however, the use of the equity method is retained, we do not support the proposition that the difference between investee and investor reporting dates be no greater than 3 months. Despite the investor's significant influence over the financial and operating policies of the investee, the investor may not be able to change the reporting date of the investee. Consequently, the imposition of a 3-month limit may result in undue cost and effort on behalf of the investor who has investments in associates with reporting dates that differ by more than 3 months.
20	Refer to section 1 above for our comments with regard to the use of the equity method of accounting. If, however, the use of the equity method is retained, we support this proposal.

Paragraph	Comment
27 & 28	Refer to section 1 above for our comments with regard to the use of the equity method of accounting. If, however, the use of the equity method is retained, we support this proposal. If the use of the equity method is abandoned, some of the proposed disclosures would continue to be useful to users, including restrictions on transfers of funds and the investor's share of contingent liabilities of the associate.

4. EDITORIAL COMMENTS

Paragraph	Comment
	None.

AASB comments on proposed improvements to IAS 33 “Earnings Per Share”

1. GENERAL COMMENTS

We generally support the proposed revisions to IAS 33. We also have comments on:

* the specific questions asked by the IASB;
* differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook* that we believe are better addressed in the Australian Standards;
* issues raised by Australian constituents during the consultation process; and
* other issues identified by the AASB and AASB staff.

2. SPECIFIC QUESTIONS

1 *Do you agree that contracts that may be settled either in ordinary shares or in cash, at the issuer’s option, should be included as potential ordinary shares in the calculation of diluted earnings per share based on a rebuttable presumption that the contracts will be settled in shares?*

We support this proposal on the basis that it is reasonable to place the onus on the preparer to establish that a potential ordinary share is not dilutive. This is because the amount of diluted EPS is intended to “warn” users of the financial report of the potential for dilution.

2 *Do you agree with the following approach to the year-to-date calculation of diluted earnings per share (as illustrated in Appendix B, examples 7 and 12)?*

* *the number of potential ordinary shares is a year-to-date weighted average of the number of potential ordinary shares included in each interim diluted earnings per share calculation, rather than a year-to-date weighted average of the number of potential ordinary shares weighted for the period they were outstanding (ie without regard for the diluted earnings per share information reported during the interim periods).*
* *the number of potential ordinary shares is computed using the average market price during the interim periods reported on, rather than using the average market price during the year-to-date period.*
* *Contingently issuable shares are weighted for the interim periods in which they were included in the computation of diluted earnings per share, rather than being included in the computation of diluted earnings per share (if the conditions are satisfied) from the beginning of the year-to-date reporting period (or from the date of the contingent share agreement, if later).*

We strongly oppose the proposed approach.
Earnings per share should be calculated on the basis of each reporting period being discrete. That is, each quarterly report would be prepared on the basis of the events of each quarter and

the annual report would be prepared on the basis of the events of the whole year (not an "accumulation" of the quarters). This view is based on the notion in AASB 1029 "Interim Financial Reporting", which conforms with IAS 34 "Interim Financial Reporting", that each reporting period is discrete. Accordingly, we consider that the "discrete" treatment should be followed in the revised IAS 33 to be consistent with the principles underlying IAS 34. We consider that the proposed approach appears to give a different answer depending on how frequently the entity reports, which is inappropriate.

3. OTHER COMMENTS

The following comments include differences between IASB and Australian Standards that are identified in *The Australian Convergence Handbook*, and issues raised by constituents during the consultation process.

Paragraph	**Comment**
37 Mandatory conversion	We suggest that the treatment of potential ordinary shares for which conversion is mandatory or is at the option of the company should be treated in a manner that recognises the likely impact of these characteristics. AASB 1027 (paragraph 12.2) requires that potential ordinary shares for which conversion to, calling of, or subscription for ordinary share capital is mandatory be included in the calculation of diluted EPS. Similarly, AASB 1027 (paragraph 12.3) requires that potential ordinary shares for which conversion to, calling of, or subscription for ordinary share capital is at the option of the entity be included in the calculation of diluted EPS where, based on conditions at the reporting date, it is probable that the entity will successfully exercise its option at any time in the future. IAS 33 does not specifically deal with these types of potential ordinary shares and they would be dealt with in accordance with the general requirement in paragraph 37 of the draft improved IAS 33 and treated as dilutive only when their conversion to ordinary shares would decrease net profit per share from continuing operations.
Issue not addressed Major capital restructuring	We suggest that the IASB consider including a requirement to disclose alternative EPS amounts where an entity has undergone a major capital restructuring. Based on feedback received from constituents since AASB 1027 "Earnings per Share" was first issued in 1992, the AASB included a requirement in AASB 1027 (paragraph 21.1) that an entity that has undergone a major capital restructuring during the reporting period must disclose an additional basic EPS and, where applicable, an additional diluted EPS, using an alternative denominator where this is more meaningful than the EPS calculated in accordance with the other requirements of AASB 1027. AASB 1027 (paragraph 21.1.1) comments that the alternative numbers of shares that may be more relevant include: * where the number of shares has increased significantly during reporting the period, the number of shares outstanding at the reporting date; and * where a company is newly incorporated before the business began operations, the weighted average number of shares for the period that the

Paragraph	Comment
	business was operating.
	Further, AASB 1027 (paragraph 21.2) requires that where an entity discloses an additional basic and diluted EPS in accordance with paragraph AASB 1027 (paragraph 21.1), the information be disclosed less prominently than the EPS calculated in accordance with the other requirements of AASB 1027.
32 Lapsed and cancelled shares	In common with the existing IAS 33, paragraph 32 of the proposed improved IAS 33 requires potential ordinary shares to be weighted for the period they are outstanding and notes that this includes potential ordinary shares that are cancelled or allowed to lapse during the period. These are included in the calculation of diluted earnings per share for the portion of the period during which they were outstanding. The AASB included the same requirement in AASB 1027 only in the interests of harmonising with IAS 33 (and Statement of Financial Accounting Standards SFAS 128 "Earnings per Share"). AASB 1027 (paragraph 18.1) requires disclosure of the weighted average number of converted, lapsed or cancelled potential ordinary shares included in the calculation of diluted EPS. The main impetus for requiring the disclosure was the view of the AASB that the inclusion of lapsed and cancelled potential ordinary shares in calculating diluted earnings per share is conceptually incorrect. The disclosure was intended to allow users of the financial report to rework the EPS calculation without the lapsed and cancelled shares. The AASB continues to hold the view that it is counter-intuitive to include potential ordinary shares that are known to have lapsed or have been cancelled during the year in the calculation of diluted earnings per share. We suggest that the IASB reconsider the issue and require such shares to be excluded from the calculation.

4. EDITORIAL COMMENTS

General	We consider that the format of IAS 33 could be improved by separating, to the extent feasible, the requirements dealing with basic earnings per share (EPS) from the requirements dealing with diluted EPS. The AASB did this with its EPS Standard so that readers that have a simple capital structure, without potential ordinary shares, can read the Standard without the distraction of the complexities of dilution. This format gives rise to some repetition, but we have received positive feedback from Australian constituents as regards this approach.

IAS 40 “INVESTMENT PROPERTY”

1. GENERAL COMMENTS

We generally support the proposed revisions to IAS 40. We also have comments on:

* the specific questions asked by the IASB;
* differences between IAS 40 and Australian ED 103 that we believe are better addressed in the Australian Exposure Draft;
* issues raised by Australian constituents during the consultation process; and
* other issues identified by the AASB and AASB staff.

2. SPECIFIC QUESTIONS

1 Do you agree that the definition of investment property should be changed to permit the inclusion of a property interest held under an operating lease provided that:

(a) the rest of the definition of investment property is met; and

(b) the lessee uses the fair value model set out in IAS 40, paragraphs 27-49?

We support the intention behind the proposed amendment to the definition of investment property. In certain parts of Australia there is land that is not freehold and may only be leased. The position of long-term lessees of such property differs little from that of an owner. Classifying such property as investment property, provided that the rest of the definition is met, would be consistent with the IASB Framework.

We disagree with the proposal in paragraph 1(b) that an operating lease can only be classified as investment property where the entity uses the IAS 40 fair value model. This proposal implies that the economic nature of an asset can change depending on how its value is measured for accounting purposes. However the function of measurement is to determine the monetary amounts at which the elements of the financial statements are recognised and carried. Measurement is a descriptive process – it is not capable of changing the economic nature of the asset being measured. We therefore question the conceptual justification for the proposed requirement.

Another reason for disagreeing with the proposed change is that it results in a definition where inclusion of particular types of property depends on the measurement model adopted. Definition should precede, not depend on, measurement.

The proposed change to the definition of investment property is also problematic because it makes the availability of the option to measure investment property at cost or fair value dependent on the type of property rights an entity has in the asset. A common manner in which the lessee of an operating lease could satisfy the rest of the definition of investment property would be to sublease the property, thus becoming a lessor of an operating lease. Owner-lessors of operating leases are permitted the choice between cost and fair value, but the proposed paragraph 1(b) would require sub-lessors of operating leases to measure investment property using the fair value model. This treatment would appear to be drawing a distinction based on the legal nature of an entity's property rights rather than their economic substance, contrary to paragraph 35 of the IASB Framework.

If the IASB decides to continue allowing a choice between cost and fair value measurement, we recommend that the definition of investment property be amended to include all leases held by a lessee, provided that the rest of the definition is met. However we believe the above problems would be best overcome by amending IAS 40 to prohibit use of the cost model (see question 3, below). All investment property would then be measured using the fair value model and paragraph 1(b) would become redundant. There should be no requirement for lessees to use the fair value model in order to classify operating leases as investment property.

2 *Do you agree that a lessee that classifies a property interest held under an operating lease as investment property should account for the lease as if it were a finance lease?*

We support the proposal on the basis that it will help to ensure that the substance of property investments in jurisdictions where investors are generally unable to acquire land on a freehold basis is reflected in the financial report.

3 *Do you agree that the Board should not eliminate the choice between the cost model and the fair value model in the Improvements project, but should keep the matter under review with a view to reconsidering the option to use the cost model in due course?*

The AASB does not support the continuation of choice between the cost model and the fair value model, particularly when that choice will be denied to some entities under the proposed changes to the definition. The choice between measurement models in IAS 40 comes at the expense of comparability. Investment property should be measured at fair value at all times because the fair value model generates more relevant information than the cost model. A significant number of submissions on the AASB's Exposure Draft ED 103 "Investment Property" (December 2001) disagreed with permitting choice between cost and fair value measurement, and there was strong support for a proposal to prohibit use of the cost model. (The AASB would be happy to provide the non-confidential ED 103 responses and the collation of those responses to the IASB.)

We acknowledge that entities choosing to apply the cost model are required by IAS 40, paragraph 69(e), to also disclose fair value of investment property. However, disclosure is not a substitute for recognition.

We believe that the choice between cost and fair value measurement should be eliminated in the Improvements project, rather than sidelined for future consideration. This change is unlikely to impose unduly-excessive additional costs on preparers, as entities are already required by IAS 40 to disclose fair value information.

3. OTHER COMMENTS

The AASB would like to bring several additional issues to the attention of the IASB and recommend they be considered in conjunction with other amendments proposed in the

Improvements project. These issues were raised by many constituents responding to our ED 103.

Paragraph	Comment
7(d)	A substantial number of submissions on ED 103 argued that property under development or construction for future use as investment property should be regarded as investment property. The main objections to the IASB's position were that: (a) it is inconsistent to treat self-constructed investment property in one way before completion of construction and another way after completion (and would mean that cost is still used when the fair value model is chosen); (b) where it is possible to reliably determine the fair value of self-constructed property prior to completion, the choice to use fair value should be available (for example, when leasing pre-commitments exist); and (c) this treatment fails to recognise the value of pre-completion leasing contracts. For these reasons, the AASB recommends that the IASB consider permitting property under development or construction for future use as investment property to be regarded as investment property. We note that this may entail consequential amendments to IAS 16 "Property, Plant and Equipment".
10	In ED 103, the AASB followed IAS 40, paragraph 10, in describing owner-managed hotels as owner-occupied property, rather than investment property. This approach was strongly criticised in the submissions on ED 103 because: (a) it is arbitrary not to classify hotels as investment property when similar properties such as shopping centres and office blocks can be classified as investment property; (b) it should be possible to classify a hotel as investment property when the purpose of operating that hotel is to earn investment returns; (c) the distinction between owner-occupied properties and investment properties is difficult to identify precisely in the case of hotels and encourages manipulation of the form of a lease to achieve the desired result; and (d) owner-occupied hotels are of such a similar nature to investment property that they should be treated as investment property, in the interests of comparability. We acknowledge that the IASB has spent considerable time debating the classification of owner-managed hotels. However we recommend that the IASB reconsider this issue, given the strong opposition encountered in Australia, where this segment of the investment market is highly developed. The AASB recommends that the IASB consider adding commentary to acknowledge that hotels may satisfy the definition of investment property in some circumstances.

Paragraph	Comment
28	Australian constituents objected strongly to the proposal in ED 103 that fair value changes should be recognised in the net profit or loss for the period in which they occur. The IAS 40 requirements would cause many listed property trusts to breach their constitutional obligation to distribute 100% of accounting profits to unitholders. This could entail unfavourable tax consequences and significant initial compliance costs. Some Australian constituents disagreed so strongly with these requirements that they favoured retaining the option of cost-based measurement so as to allow entities to avoid the treatment of fair value changes contained in the fair value model. Most of these entities presently use a fair value basis, with changes in fair value flowing through revaluation reserves (consistent with IAS 16 "Property, Plant and Equipment"). The AASB recommends that the IASB include, as part of its Performance Reporting project, consideration of the location of IAS 40 changes in fair value in the proposed presentation structure.
47	The AASB strongly disagrees with the assumption that, where the presumption of being able to determine a reliable fair value is rebutted, investment property has a residual value of zero. This is inconsistent with other standards and may imply that land can have a zero value. We consider this to be a serious flaw that should be addressed immediately.

Further, the AASB advises that it intends to include the following commentary on stapled security arrangements when releasing a standard on investment property:

> "There are cases where hotel assets are held via stapled security arrangements. Typically, under these arrangements, a trust unit is attached to a company share with the trust being the property investor leasing the hotel to the company that undertakes the management. Such assets are classified as investment property in the financial report of the trust and regarded as owner-occupied property in the combined financial report of the owner and manager."

The AASB considers that such commentary may be useful and relevant to entities outside Australia. We therefore recommend that the IASB consider incorporating this, or similar, commentary on stapled security arrangements into IAS 40.

4. EDITORIAL COMMENTS

The AASB recommends that the term "owner-operated" should be used instead of the term "owner-occupied" throughout IAS 40. "Owner-occupied" property is defined in IAS 40, paragraph 5, as "property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes". However the term "owner-occupied" may be interpreted as requiring the owner to physically occupy the property. There may be situations where property is held for use in the production or supply of goods or services or for administrative purposes without any "occupation" by the owner. An example of this is where a hotel rents rooms to customers (guests) and has no right to "occupy" the rooms while rented.

The term “owner-operated” would apply to all situations covered by the term “owner-occupied” as well as situations similar in substance that might otherwise be excluded.

IASB Improvements – general editorial suggestions

1. Shall versus must

We have a preference for using "must" in requirements in accounting standards on the basis that the word leaves no doubt about the intention. In Australian English "shall" is not necessarily regarded as an imperative.[2]

2. Order of definitions

We suggest that definitions be placed in alphabetical order. The IASB's existing layout seems to try and rank the definitions in order of importance, yet different users are likely to have different views on that ranking. An alphabetical layout facilitates quick reference to terms by users of the standards.

3. Paragraph numbering

In order to fully harmonise with the IASB, the AASB's standards need to reflect as closely as possible the wording of the IASB's standards, which are primarily directed at for-profit entities. The AASB has responsibility for setting accounting standards for all types of reporting entities in Australia. On occasions, there are issues affecting not-for-profit entities that necessitate additional or different requirements and guidance. Even in relation to for-profit entities, there may be local issues that necessitate additional or different requirements and guidance. We assume the same would apply in other jurisdictions seeking to harmonise with the IASB.

We suggest that the IASB adopt a paragraph numbering format that facilitates the addition of material without creating a difference between the paragraph references in IASB standards and the references in national standards. The section-by-section format currently used in the AASB's standards would facilitate this outcome.

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[2] AASB staff received the following e-mail response from Kate Burridge, Associate Professor, Linguistics, La Trobe University, Victoria, on the relative merits of shall and must.

It's an interesting question and an area of English language which is extremely tricky – the so-called modal verbs. The main problem with "shall" is that it's disappearing from the language. As a future marker it has been virtually replaced by "will", especially in Oz English. It used to have a strong sense of obligation (due to its origin – it comes from an Old English verb meaning "to owe" as in "to owe money") and as you point out still appears in regulations – its use is akin to the Ten Commandments "Thou shalt ....". This use is formulaic - as you know legal drafting is full of linguistic fossils! In newer documents and Plain English re-writes it tends to be avoided – largely because people don't have a strong sense of its meaning any more, especially as this sense is really confined to regulations and isn't a part of the living language any more. Also it's often ambiguous between "futurity" and "undertaking" – so is best avoided for that reason.

"Should" is described as a necessity modal (like "ought to") – being concerned with obligations, duty etc. (Palmer's Modality and English Modals). Palmer confirms your observation that both are considerably weaker than "must" here. For instance "must" doesn't allow for the event referred to not to take place. He gives the following two examples. The first is unacceptable:

* He must come tomorrow, but he won't. He should/ought to come tomorrow, but he won't.

4. Standard titles

We recommend that, where appropriate, the titles of the IASB Standards subject to improvement be simplified in line with current practice for establishing the titles of standards. For example, we recommend that IAS 21 be retitled “Foreign Currency” and IAS 28 be retitled “Investments in Associates”.