Institute of
CHARTERED ACCOUNTANTS
of New Zealand

12 September 2002

International Accounting Standards Board
30 Cannon Street
LONDON
EC4M 6Xh
United Kingdom

Dear Sir or Madam

IMPROVEMENTS TO INTERNATIONAL ACCOUNTING STANDARDS

The Financial Reporting Standards Board (FRSB) of the Institute of Chartered Accountants of New Zealand is pleased to submit its comments on the Exposure Draft of Proposed Improvements to International Accounting Standards (issued May 2002).

Although the FRSB focussed on the specific questions raised in the ED, comments are also provided in respect of some of the proposals not specifically addressed by the questions.

If you have any queries, or require clarification of any matters in the submission, please contact Sanel Tomlinson (sanel_tomlinson@icanz.co.nz) at the Institute of Chartered Accountants of New Zealand.

Yours faithfully

Tony van Zijl

Tony van Zijl
CHAIR – FINANCIAL REPORTING STANDARDS BOARD

IAS 1, PRESENTATION OF FINANCIAL STATEMENTS

OVERALL COMMENT

The FRSB agrees with the general thrust of the proposed improvements, but has a number of concerns – particularly in relation to the presentation of "extraordinary items" and the requirements relating to the current/non-current distinction of liabilities.

QUESTIONS	FRSB VIEWS
Question 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 paragraphs 13 – 16)?	The FRSB agrees with the proposed approach mainly because it takes into account situations where the regulatory framework prohibits departures.
Question 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 paragraphs 78 and 79)?	The FRSB agrees with the proposal to prohibit the presentation of items of income and expense as "extraordinary items" in the income statement. However, the FRSB considers that the standard should require disclosure of such items that meet the definition of "extraordinary items" because it provides useful information to users of financial statements. The FRSB recommends that the definition should be based on the New Zealand definition which defines such items more narrowly than in the existing IAS 1 definition. **New Zealand Definition of Extraordinary Items:** "Extraordinary items" are those items of revenue or expense

	which derive from events or transactions that: (a) are not expected to occur frequently, and (b) are distinct from the ordinary operations of the entity, and (c) are outside the control or influence of managers or owners. *(FRS-7, 4.1)*
Question 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 paragraph 60)?	The FRSB does not support the proposal, for the following reasons: • Where an entity is in the process of negotiating/finalising the refinancing agreement at balance date and such agreement is finalised by the time the financial statements are authorised for issue, the situation is comparable with an adjusting event in terms of IAS 10/FRS-5: *Events After Balance Date*. In such circumstances, the entity should be allowed to classify the liability as non-current. However, unless the subsequent agreement to refinance or to reschedule payments on a long term basis merely confirms this substantial agreement had been reached at balance date, the timing of the subsequent agreement is irrelevant and the liability should be classified as a current liability. • Paragraph 61 seems to conflict with paragraph 60 because it allows for classification as non-current where the refinancing or rolling over is at the discretion of the entity. Although the refinancing outcome could be more certain in a situation covered by paragraph 60, the liability is required to be classified as current, whereas the refinancing outcome of a situation covered by paragraph 61 could only be an expectation and the liability is required to be classified as a non-current. The FRSB considers that the current/non-current classification should not depend on the expected actions of an entity, but should be based on the actual circumstances at the

	balance date.
Question 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 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, during which time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement 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 paragraphs 63 and 64)?	(a) Assuming that the lender's agreement is not evidence of a condition that already existed at balance date, the FRSB does not agree with the proposal for the same reasons as set out in Question 3 above. (b) The FRSB agrees that an entity should be allowed to classify a liability as non-current when the requirements as set out in (b)(i) are met. However the FRSB disagrees with the proposal to allow entities to classify a liability as non-current under the circumstances set out in (b)(ii). The FRSB considers that "probable rectification" is not a compelling reason for classification as a non-current liability and could easily be misused.
Question 5 Do you agree that an entity should disclose the judgements 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 paragraphs 108 and 109)?	The FRSB agrees with the proposed additional disclosure requirements, but considers that further guidance be included in respect of what are considered to be the accounting policies that have the most significant effect on amounts recognised. The FRSB also considers that entities should be required to

	disclose the reasons for the selection of accounting policies and the application of the selected policies.
Question 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 amounts of assets and liabilities within the next financial year (see paragraphs 110 – 115)?	The FRSB agrees with the proposed additional disclosure requirements.

OTHER COMMENTS:

- The FRSB considers that the words "undue cost and effort" could be misused by entities and recommends that additional guidance be included in the standard on the meaning of this term. In particular the difference between cost and effort.

IAS 2, INVENTORIES

OVERALL COMMENTS

The FRSB agrees with the proposed changes to IAS 2.

QUESTIONS	FRSB VIEWS
Question 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?	The FRSB agrees with the proposal to eliminate the LIFO method for determining the cost of inventories.
Question 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?	The FRSB agrees that the requirements relating to the reversal of write-downs of inventories should be retained.

IAS 8, NET PROFIT OR LOSS FOR THE PERIOD, FUNDAMENTAL ERRORS AND CHANGES IN ACCOUNTING POLICIES

OVERALL COMMENTS

Overall the FRSB agrees with the proposed improvements to IAS 8. However, the FRSB does have concerns about the use of the "undue cost and effort" exemption and the practicalities of the proposal in paragraph 19 regarding disclosures about the impact of new standards that have not yet come into effect.

QUESTIONS	FRSB VIEWS
Question 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)?	The FRSB agrees with the proposal to require that changes in accounting policies and corrections of errors should be accounted for retrospectively. The FRSB does, however, recognise that this treatment could lead to misuse, as history has proved in New Zealand. Therefore the current requirement in New Zealand permit retrospective treatment of errors only for fundamental errors and for changes in accounting policy only if that is directed by the relevant accounting standard (*FRS-7, 1994*). The previous requirement in New Zealand was as follows: *"The after tax effects of prior period adjustments, as defined, should be accounted for by adjusting the opening balance of retained profits and where practicable restating the corresponding figures for the previous period. Where the prior period adjustment arises from a change in accounting policy it may not be practicable to ascertain the effect of the change on the opening balance of retained profits. Nevertheless, the effect of*

	the change, if quantifiable, on profit for the current period should be clearly disclosed in the notes to the financial statements. *Prior period adjustments are those adjustments applicable to prior periods arising only from changes in accounting policies and from the correction of fundamental errors. They do not include the normal recurring corrections and adjustments of accounting estimates made in prior periods." (SSAP-7, 1986)*
Question 2 Do you agree with eliminating the distinction between fundamental errors and other material errors (see paragraphs 32 and 33)?	The FRSB agrees with the proposal to eliminate the distinction between fundamental and other material errors.

OTHER COMMENTS:

- As noted above, and in the response for IAS 1, the FRSB considers that the words "undue cost and effort" could be misused by entities and recommends that additional guidance be included in the standard.

IAS 10, EVENTS AFTER THE BALANCE SHEET DATE

OVERALL COMMENTS

The FRSB supports the proposed amendments to IAS 10. However, the FRSB considers it important for the IASB to note that some practical implementation issues were experienced in New Zealand when the standard become operative, especially in respect of Co-operatives, where dividends are effectively mixed up with rebates, and Trusts, where distributions are determined after the balance date.

IAS 15, *INFORMATION REFLECTING THE EFFECTS OF CHANGING PRICES*

OVERALL COMMENTS

The FRSB supports the proposal to withdraw IAS 15.

IAS 16, PROPERTY, PLANT AND EQUIPMENT

OVERALL COMMENTS

Overall the FRSB agrees with the proposed amendments to IAS 16. However, as noted below, the FRSB disagrees with the treatment of an item of property, plant and equipment that is retired from active use and held for disposal.

QUESTIONS	FRSB VIEWS
Question 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)?	The FRSB agrees with the proposed amendment. The FRSB considers that this requirement would not impose any additional burden on entities that revalue assets and will provide useful information on management decisions to users of the financial statements, especially where entities are carrying assets at historical cost.
Question 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.)	The FRSB agrees with the proposed amendment for the same reasons as set out in question 1 above.
Question 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)?	The FRSB agrees that depreciation of an item of property, plant and equipment should not cease when it becomes temporarily idle. The FRSB disagrees with the proposed amendment in respect of the treatment of items of property, plant and equipment which

	were retired from active use and held for disposal. The FRSB considers that such assets should be reclassified as current assets, measured at the carrying amount of the item at the date of retirement and subjected to an impairment test at each balance date.

OTHER COMMENTS

- The FRSB considers that IAS 16.64(d) and (e) should be combined. The disclosures in subparagraph (e) is an extension of the requirement in subparagraph (d) to disclose the "the methods … applied in estimating … fair values".

IAS 17, LEASES

OVERALL COMMENTS

Overall the FRSB agrees with the changes proposed to IAS 17.

QUESTIONS	FRSB VIEWS
Question 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.	The FRSB supports the additional guidance, relating to the separation of leases of land from leases of buildings, to be included in the standard.
Question 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?	The FRSB supports, for consistency with IAS 39 *Financial Instruments: Recognition and Measurement*, the proposal for capitalising initial direct costs incurred in negotiating a lease.

IAS 21, THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

OVERALL COMMENTS

Overall the FRSB agrees with the proposed amendments to IAS 21. However, concerns were expressed that the market driving the price of an entity's goods and services is not necessarily the same as the economy in which the entity primarily generates and expends cash.

QUESTIONS	FRSB VIEWS
Question 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?	The FRSB agrees with the definition of functional currency but has concerns regarding the criteria and guidance provided to determine the functional currency. One concern is that the market driving the price of an entity's goods and services is not necessarily the same as the economy in which the entity primarily generates and expends cash. For example, 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 a different currency. In some cases, it may be unclear which currency is the functional currency.
Question 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?	The FRSB agrees with the proposal that a reporting entity should be permitted to present its financial statements in any currency that it chooses, however, the concession should be subjected to national legislation and the entity should disclose the reason for choosing a particular currency.

Question 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 FRSB agrees with the proposal that entities should translate their financial statements into the presentation currency using the same method as is required for translating a foreign operation for inclusion in the entity's financial statements.
Question 4 Do you agree that the allowed alternative to capitalise certain exchange differences in paragraph 21 of IAS 21 should be removed?	The FRSB agrees with the proposal to remove the allowed alternative to capitalise certain exchange differences.
Question 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)?	The FRSB agrees with the proposal to treat the goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign operation as assets and liabilities of the foreign operation and to translate the balances at the closing rate.

IAS 24, RELATED PARTY DISCLOSURES

OVERALL COMMENTS

The FRSB agrees with the majority of the proposed amendments to IAS 24. The FRSB disagrees with the proposal to not require disclosure of related party transactions and outstanding balances in the separate financial statements of the parent entity.

QUESTION	FRSB VIEWS
Question 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)?	The FRSB agrees with the proposal 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.
'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'.	

Question 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)?	The FRSB disagrees with the proposal 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 the consolidated financial statements for the group to which that entity belongs. Disclosure of such transactions is essential because the external users of the financial statements need to be made aware of the level of support provided by related parties.

IAS 27, CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING FOR INVESTMENTS IN SUBSIDIARIES

OVERALL COMMENTS

Overall the FRSB supports the proposed amendments to IAS 27.

QUESTIONS	FRSB VIEWS
Question 1 Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?	The FRSB agrees with the proposal to exempt entities from preparing consolidated financial statements when all the criteria in paragraph 8 are met.
Question 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)?	The FRSB agrees with the proposal that minority interests should be presented in the consolidated balance sheet within equity, but separately from the parent shareholders' equity.
Question 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)? Do you agree that if investments in subsidiaries, jointly controlled entities and associates that are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments	The FRSB considers that it is not appropriate for IAS 27 to deal with the treatment of investments in an investor's separate financial statement and therefore, disagrees with the proposals.

should be accounted for in the same way in the investor's separate financial statements (paragraph 30)?	

OTHER COMMENTS

- If there is no binding agreement to sell a subsidiary within a year, then we think it would be imprudent not to require consolidation in this situation. Only if such a binding agreement does exist should the sale be accounted for as a current asset. The FRSB recommends that paragraph 13 should be revised to include a requirement that a binding agreement exist before being excluded from consolidation.

IAS 28, ACCOUNTING FOR INVESTMENTS IN ASSOCIATES

OVERALL COMMENTS

Overall the FRSB agrees with the proposed amendments to IAS 28.

QUESTIONS	FRSB VIEWS
Question 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)?	The FRSB agrees with the proposal that IAS 28 and IAS 31 should not apply to investments by such entities that are measured at fair value in accordance with IAS 39, when such measurement is well-established practice in those industries.
Question 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)?	The FRSB agrees that where an investment in an associate is reduced to nil because the associate incurs losses in excess of the investor's equity investment, the investor should have regard to other interests, such as long term receivables, in the associate. However, the FRSB considers that such interests should be subjected to an impairment test rather than just a mechanical write down of that interest.

OTHER COMMENTS

- The FRSB recommends a revision of paragraph 8 of IAS 28 in the same way as suggested under "other comments" for paragraph 13 of IAS 27.

IAS 33, EARNINGS PER SHARE

OVERALL COMMENTS

Overall the FRSB agrees with the proposed amendments to IAS 33.

QUESTIONS	FRSB VIEWS
Question 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?	The FRSB agrees with the proposal that contracts that may be settled either in ordinary shares or in cash should be included as potential ordinary shares in the calculation of diluted earnings per share.

Question 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 (i.e. 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 upon, 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).	The FRSB agrees, for consistency, with the proposed approach to the year-to-date calculation of diluted earnings per share.

IAS 40, INVESTMENT PROPERTY

OVERALL COMMENTS

Overall the FRSB agrees with the proposed amendments to IAS 40.

QUESTIONS	FRSB VIEWS
Question 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?	The FRSB agrees with the proposal to amend the definition of investment property to permit the inclusion of property interests held under operating leases where these conditions are met.
Question 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?	The FRSB agrees with the proposal 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.
Question 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 corresponding New Zealand financial reporting standard requires annual valuations of investment properties, but entities can apply either the fair value model or modified historical cost. However, the FRSB is comfortable with the decision of the IASB.