



Tasmania

DEPARTMENT of
TREASURY and FINANCE

Contact: Tara Woods
Phone: 03 6233 3846
Our Ref: D/001261 CJ/TW

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

Dear Mr Boymal

David,

**EXPOSURE DRAFT 159 - PROPOSED IMPROVEMENTS TO AUSTRALIAN
ACCOUNTING STANDARDS**

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to the Australian Accounting Standards Board's Exposure Draft 159 *Proposed Improvements to Australian Accounting Standards*.

HoTARAC's comments on the proposed changes are presented in the attachment.

If you have any queries regarding the above, please contact Peter Gibson from the Australian Government Department of Finance and Administration on 02 6215 3551 or peter.gibson@finance.gov.au.

Yours sincerely

Jon Challen

D W Challen
**CHAIRMAN
HEADS OF TREASURIES ACCOUNTING AND
REPORTING ADVISORY COMMITTEE**

// December 2007

Encl



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Ms Dora Cheung
Practice Fellow
International Accounting Standards Board
30 Cannon Street
London EC4m 6XH
UNITED KINGDOM

Dear Ms Cheung

**EXPOSURE DRAFT – PROPOSED IMPROVEMENTS TO INTERNATIONAL
FINANCIAL REPORTING STANDARDS**

Australia's Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to the International Accounting Standards Board's Exposure Draft 159 *Proposed Improvements to International Accounting Standards*.

HoTARAC's comments on the proposed changes are presented in the attachment.

If you have any queries regarding the above, please contact Peter Gibson from the Australian Government Department of Finance and Administration on 61 2 6215 3551 or peter.gibson@finance.gov.au.

Yours sincerely

D W Challen
CHAIR
**HEADS OF TREASURIES ACCOUNTING AND
REPORTING ADVISORY COMMITTEE**

10 December 2007

Encl

HOTARAC COMMENTS ON THE EXPOSURE DRAFT OF PROPOSED IMPROVEMENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

HoTARAC has elected not to respond to a number of proposed changes, however there are some matters that require further consideration.

General Comments

HoTARAC is concerned that the spirit behind the Annual Improvements Project may not have been strictly adhered to by the IASB in developing the matters for inclusion in this Exposure Draft (ED). Some of the issues appear to be developments in accounting Standards rather than simply clarifying existing Standards. While in some respects this is acceptable, it is inconsistent with the IASB's intent to maintain a stable platform of Standards until 2009.

HoTARAC is also concerned about the clarity of wording in the ED. In some cases, it is difficult to identify the issue and the impact of the proposed solution. Vague and imprecise wording results in considerable problems for preparers and auditors under a principles-based system.

Specific Matters for Comment

Question 1

No comments.

Question 2 – Do you agree with the proposal to add paragraph 8A to IFRS 5 to clarify that assets and liabilities of a subsidiary should be classified as held for sale if the parent has a sale plan involving loss of control of the subsidiary? If not, why?

HoTARAC believes this is consistent with the philosophical approach to assets held for sale. However, further thought needs to be given to the practical consequences of such an approach. For example, HoTARAC believes that the IASB has not adequately explored the impact of the proposal on accounting for the remaining equity interest in the former subsidiary after control is lost.

It is also noted that the proposal relates only to the interest in assets and liabilities recorded in group accounts, and does not consider accounting by the subsidiary.

It is recommended that the IASB carefully considers whether consequential amendments are required to IASs 27, 28 and 31.

Question 3 – The Board proposes to amend paragraph IG13 of the guidance on implementing IFRS 7 Financial Instruments: Disclosures to resolve the potential conflict with IAS 1. Do you agree with the proposal? If not, why?

HoTARAC supports this proposal on the assumption that there has been extensive research on the potential impact of the proposal on the financial statements of financial institutions such as banks and investment funds.

Question 4 – Do you agree with the proposal to require an entity that cannot make an unreserved statement of compliance with IFRSs to describe how its financial statements would have been different if prepared in full compliance with IFRSs? If not, why?

HoTARAC has concerns regarding the potential application of this requirement to not-for-profit entities. These entities generally do not make an unreserved statement of compliance with IFRSs due to the application of Aus paragraphs. Once potential GAAP-GFS harmonisation issues have also been considered, the cost of compliance for these entities would outweigh the benefits. Therefore, HoTARAC proposes that the AASB should insert an Aus paragraph to provide relief for not-for-profit entities.

Question 5 – Do you agree with the proposal to clarify that the potential settlement of a liability by the issue of equity is not relevant to its classification as current? If not, why?

HoTARAC supports the proposal that issuing equity is not relevant to a liability's classification.

HoTARAC further notes that the proposal is consistent with the existing provisions of IAS 1. However, HoTARAC does not agree with the approach in IAS 1 that liabilities should be defined as current solely on the basis of legal form. Such an approach does not provide a correct indication of the expected future cash flows, except in situations where going concern is not considered.

Questions 6 - 8

No comments.

Question 9 – Should the definition of recoverable amount in IAS 16 be amended to remove the perceived inconsistency with 'recoverable amount' used in other IFRSs? If not, why?

HoTARAC does not support the proposal because the definition of disposal values will be inconsistent across the platform of Standards.

Question 10

No comments.

Question 11 – Do you agree with the proposal to amend paragraphs 14 and 15 of IAS 17 to eliminate a perceived inconsistency between the specific classification guidance for leases of land and buildings and the general lease classification guidance in IAS 17? If not, why?

HoTARAC finds the proposal unclear in its current form. The ED does not clearly articulate the existing problem and the impact of the proposed solution.

The general and specific guidance on classifying land leases has been authoritatively reconciled in the Board's Basis for Conclusions on IAS 17. This explicitly rejects classifying land leases as finance leases in view of the (normally) indefinite economic life of land and the lessor's retention of significant risks and rewards of ownership at the end of the lease term (paragraph BC8). In addition, when considering the appropriate classification of a land lease with a term of five hundred years, IFRIC noted that the lease would be classified as an operating lease unless title or significant risks and rewards of ownership passed to the lessee, irrespective of the term of the lease (*IFRIC Update*, March 2006).

Some constituents may view the proposed change as having no impact as they do not perceive any inconsistency between the general guidance in paragraphs 8-12 and the specific guidance in paragraphs 14-15 of the Standard. However, other constituents are likely to view the proposed change as permitting a reclassification of some existing operating leases to finance leases. The proposed change may therefore create more inconsistency than it removes and lead to diversity of practice.

If it is intended to require or permit long-term land leases to be classified as finance leases, it would be preferable for the Standard to be clear on this point and to explain the rationale for such classification. It is noted, however, that if this is the case, the proposal may represent a substantive change to the Standard rather than a minor amendment. Such a change is inconsistent with the IASB's intention to maintain a stable platform of Standards.

In addition, HoTARAC recommends that the proposal to retain the residue of paragraph 14 as paragraph 19A, be relocated to a more appropriate part of IAS 17 as the paragraph deals with operating lease payments rather than classification of leases.

Question 12 – Do you agree with the proposal that contingent rent relating to an operating lease should be recognised as incurred? If not, why?

HoTARAC agrees that recognising contingent rent as incurred is a practical solution when compared to other possible alternatives.

Questions 13 – 14(a)

No comments.

Question 14(b) – Do you agree that the Board should delete the following sentence from paragraph 111 of IAS 19: ‘An event is material enough to qualify as a curtailment if the recognition of a curtailment gain or loss would have a material effect on the financial statements’? If not, why?

HoTARAC agrees with the proposed change, as a statement of materiality is redundant in IAS 19.

Question 15

No comments.

Question 16 – Do you agree with the proposal to replace in IAS 19 the term ‘fall due’ with the notion of employee entitlement in the definitions of short-term employee benefits and other long-term employee benefits? If not, why?

HoTARAC strongly disagrees with this proposal because it would result in all short-term employee benefits being measured at nominal value. This would include short-term benefits that are expected to be paid or otherwise discharged at a date greater than 12 months away. In particular, a legal liability does not arise for long service leave until after a qualifying period of service has been met. This proposal would mean that employees, who satisfy the qualifying period of service for long service leave, are entitled to that benefit within 12 months of qualifying. It could be argued that the portion of the total long service leave liability that is entitled to be taken within 12 months could satisfy the short term employee benefit definition and be measured at a nominal value. This is despite the fact that there may not be any expectation that this liability will be settled within 12 months.

HoTARAC considers that the proposal is inconsistent with the measurement rules elsewhere in IAS 19 that focus on the present value of expected cash flows. HoTARAC also considers that the proposal is inconsistent with measurement rules in other Standards eg IAS 17 and IFRS 4, which require discounting of expected cash flows. Finally, HoTARAC believes that the proposal is inconsistent with the principle that accounting Standards should enable users to assess future cash flows of an entity.

Therefore, HoTARAC recommends that the use of legal form over economic substance should be emphasised and leave expected to be paid out after 12 months should be discounted to enhance consistency in measurement and disclosure.

HoTARAC is also concerned about the proposed wording of paragraph 8(b) of IAS 19. It is understood that, under the proposal, the timing of entitlement is the basis for classification and the event by itself, ie absence from work, is irrelevant. Paragraph 8(b) might be interpreted as meaning that absences occurring within 12 months are a primary condition for classification. HoTARAC proposes to re-draft the paragraph to remove the term “for absences occurring” to avoid confusion.

Please note that HoTARAC also prefers the terminology “expected to be settled” as was originally proposed in the IASB Update March 2007, rather than “to which the employee becomes entitled”.

Questions 17 - 18

No comments.

Question 19 – Do you agree with the proposed amendments to IAS 20 to clarify that the benefit of a loan received from a government with a below-market rate of interest should be quantified by the imputation of interest in accordance with IAS 39? If not, why?

HoTARAC agrees that the proposed amendments promote consistency between IAS 20 and IAS 39.

However, the IASB should consider the practicality of this proposal based on Australia's experience with the application of IAS 39 to the public sector.

The nature of loans issued by governments are typically not equivalent to those issued in private markets. Principally, this is because the government usually wants to achieve a policy objective that cannot be done through existing market mechanisms. For example, the loans may be for extended terms, contain flexible or deferred repayment options and/or incorporate non-market features such as government-to-government financing.

Given that IAS 39 focuses on the market rate rather than the cost of capital, governments would have to adopt a technique based on a hypothetical market rate that would be determined by:

- artificially equating the instrument to an instrument in the private sector (which may not satisfy paragraph AG79 and/or AG82); or
- building up a market rate using the individual elements contained in paragraph AG82. Note this has produced questionable results as participants perception of the combined package of risks may not equate to the sum of individual risks.

In the past, both approaches have resulted in considerable subjectivity which creates audit verification difficulties.

Questions 20 - 22

No comments.

Question 23 – Do you agree with the proposal to amend paragraph 33 of IAS 28 to clarify the circumstances in which an impairment charge against an investment in an associate should be reversed? If not, why?

HoTARAC agrees with the philosophy behind the proposal to amend paragraph 33 of IAS 28. However as noted in the general comments, HoTARAC is concerned about the clarity of wording in the ED and recommends that the IASB considers simplifying the paragraph so that it is direct in its explanation.

Questions 24 - 29

No comments.

Question 30 – Do you agree with the proposal to amend IAS 39 by removing from the definition of a derivative the exclusion relating to contracts linked to non-financial variables that are specific to a party to the contract? If not, why?

While HoTARAC agrees with the principle behind the proposal, it would be concerned if it resulted in confusion about whether individual contracts should be accounted for under IFRS 4 or IAS 39. This is particularly the case if the amendment led to reclassifications of existing contracts under IAS 39 to IFRS 4. This is because HoTARAC believes that IFRS 4 does not deal appropriately with individual contracts as opposed to groups of contracts that form part of an insurance business.

Question 31(a) – Do you agree with the proposal to amend IAS 39 to clarify the definitions of a financial instrument classified as held for trading? If not, why?

Question 31 (b) – Do you agree with the proposal to insert in IAS 39 paragraph 50A to clarify the change in circumstances that are not reclassifications into or out of the fair value through profit or loss category? If not, why?

The majority of HoTARAC does not agree that the proposal should be limited to hedges, but should also apply to other types of financial instruments.

HoTARAC also considers that a substance over form approach is more appropriate as it allows reclassification when the fundamental purpose of holding the asset changes. The IASB could either rely on adequate interpretation by preparers and auditors or issue additional interpretative material to supplement this approach.

Note that a minority of HoTARAC constituents agree with the proposal and are of the view that tight restrictions on reclassifications prevent selective accounting.

Questions 32 - 33

No comments.

Question 34 – Do you agree with the proposal to amend AG30(g) of IAS 39 to clarify that prepayment options, the exercise price of which compensates the lender for loss of interest by reducing the economic loss from reinvestment risk, as described in paragraph AG33(1), are closely related to the host debt contract? If not, why?

HoTARAC agrees with the proposed changes. HoTARAC believes there is scope for more prepayment options to be considered as being closely related to the host debt contract, given the integral nature of prepayment options to many financial instruments.

Question 35 – The exposure draft proposes to include property under construction or development for future use as an investment property within the scope of IAS 40. Do you agree with the proposal? If not, why?

The majority of HoTARAC's constituents do not believe that all investment property acquired for construction or development should be recorded at fair value. This view is based on the practicalities and costs of complying with this requirement, as well as the following theoretical arguments:

- a great deal of property acquired for investment would not be available for sale during the construction period. Consequently, fair value, which is mostly based on exit prices, is irrelevant although it is noted that impairment may be relevant;
- the major consideration of management during a project's construction phase, would be the variance in actual construction costs when compared to budgeted construction costs. Again, fair value is largely irrelevant; and
- the IASB has not adequately explored the distinction between an existing property held for partial redevelopment (with minimal change to the existing asset) and an acquired property that is intended to be developed (usually requiring considerable change to the asset).

In situations where an existing or acquired investment property is specifically held for sale during the construction period (within the meaning of IFRS 5) it could be argued that it should be held at fair value. This could be achieved without requiring all properties to be held at fair value.

It is noted that the IASB is looking to align the treatment of property under construction with property under re-development.

Questions 36 - 38

No comments.

Question 39 – Do you agree with the proposed amendment to IAS 41 to permit either a pre-tax or a post-tax discount rate to be used according to the valuation methodology used to determine fair value? If not, why?

HoTARAC disagrees with the proposal to permit the use of a post-tax discount rate to determine fair value because it is inconsistent with IAS 40. IAS 40 prohibits the inclusion of tax burdens or tax benefits to the owner being included in fair value. Hence, IAS 41 should also reflect the full fair value of the asset with deferred tax assets or liabilities shown separately. For consistency, all Standards that refer to fair value should be assessed before this measurement attribute is changed.

Question 40 – Do you agree with the proposal to remove the exclusion of ‘additional biological transformation’ from paragraph 21 of IAS 41? If not, why?

HoTARAC agrees that additional biological transformation could be considered in determining the value of biological assets. HoTARAC believes this may be useful when determining fair values where there is no market for the assets in their current condition eg due to immaturity.

However, HoTARAC would be concerned if this amendment resulted in current period recognition of biological transformation that was to take place in the future, as this would not result in appropriate allocation over accounting periods. Further, HoTARAC is not convinced that the proposed amendment will prevent considerable diversity in practice continuing, albeit within a narrower range.

Question 41

No comments.