ERNST & YOUNG

Ernst & Young Global Limited
Becket House
1 Lambeth Palace Road
London SE1 7EU

Phone: +44 [0]20 7980 0000
Fax: +44 [0]20 7980 0275

www.ey.com

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

11 January 2008

Direct Line: 020 7951 0241
e-mail: lynda.tomkins@uk.ey.com

Dear Sir/Madam

Re: Invitation to comment – Exposure Draft of Proposed Improvements to International Financial Reporting Standards

Ernst & Young is pleased to submit its comments on the above Exposure Draft (ED).

We discuss below some of the broader issues raised in the ED and our thoughts on the Annual Improvements project. Our responses to specific questions in the Invitation to Comment are set out in the Appendix to this letter.

We are supportive of the overall objective of the project to deal with non-urgent minor amendments to International Financial Reporting Standards (IFRSs). We believe this is an efficient way of removing inconsistencies and clarifying the International Accounting Standards Board's (the 'Board's') original intentions.

However, we are concerned that some of the amendments proposed go beyond the scope of the project, going further than merely clarifying wording or removing inconsistencies. For example, the Amendment to IAS 1 Presentation of Financial Statements – *Statement of Compliance with IFRS.*

We are also concerned with the proposed provisions for early application of the amendments. The Exposure Draft proposes that if an entity wishes to early adopt any of the amendments it must adopt all 41 amendments concurrently. The Board has not indicated its reasoning for requiring this. Generally, each amendment is a separate issue and thus we believe entities should be able to early adopt individual amendments. Issuing the amendments within one document for convenience does not provide sufficient reason for requiring them all to be adopted together. Therefore, we do not believe that this requirement is appropriate. If the Board continues to believe this is required, the reason should be clearly articulated.

The ED also proposes that if an entity applies the amendments early it must also apply Revised IAS 1 *Presentation of Financial Statements* (IAS 1R). We do not believe there is a valid basis for this requirement. We acknowledge that two of the 41 proposed amendments refer to the new paragraph numbers in IAS 1R, and thus confusion could arise if IAS 1R is not also applied early. However, this applies only to the amendments to IFRS 7 *Financial Instruments: Disclosures* and IAS 1 *Presentation of Financial Statements* (IAS 1). We believe therefore that this requirement is unduly onerous. We propose that, if IAS 1R is irrelevant to an amendment, there should be no requirement for an entity to also early apply IAS 1R. If the Board continues to believe IAS 1R should be early applied, again the reason should be clearly articulated.

We note that the ED does not propose any specific transitional provisions. Therefore, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* will apply to all of the amendments. Our assumption is that these would all be considered changes in accounting policy. However, we do not believe that all of the amendments in the ED are changes in accounting policies. Many of the amendments refer to the clarification of wording or confirmation of the Board's original intentions. For example, the amendment to IAS 38 *Intangible Assets* is clarifying the meaning of 'as incurred'. Furthermore, in this situation, it would seem redundant to have an effective date, because essentially there has not been a change in the standard if wording is only being clarified. We believe the Board needs to indicate which amendments will be considered a change in accounting policy and how the remaining amendments should be applied.

Should you wish to discuss this letter with us, please contact Lynda Tomkins at 020 7951 0241.

Yours faithfully

Ernst & Young

APPENDIX

Exposure Draft – Improvements to International Financial Reporting Standards

Responses to specific questions

Question 1 – Do you agree with the Board's proposed restructuring of IFRS 1? If not, why?

We agree with the Board's proposal.

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?

In principle we agree with the proposals to clarify that if an entity plans to sell the controlling interest in a subsidiary, 100% of the assets and liabilities of that subsidiary are classified as held for sale, even if the entity does not plan on selling 100% of its investment.

However, we have concerns with the measurement requirements of IFRS 5 being applied to those assets, particularly when the remaining interest will become an associate or joint venture. For example, depreciation on 100% of the property, plant and equipment will cease when IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* is applied. However, once the portion of the subsidiary is sold, the investment will be accounted for using equity accounting or proportionate consolidation – each of which require the asset to be depreciated – and questions arise as to how the 'catch up adjustment' for the depreciation should be recognised.

The Revised IAS 27 *Consolidated and Separate Financial Statements* (IAS 27R) requires the remaining portion of the investment to be recognised at fair value on the date control is lost, thereby resolving this issue. However, the effective date of IAS 27R has been extended to annual periods beginning on or after 1 July 2009, resulting in some anomalies in accounting. To ensure that an entity will account for the remaining portion of its investment in an appropriate manner, we believe the effective date of the amendment to IFRS 5 in this ED should be aligned with the effective date of IAS 27R. Furthermore, if entities early apply this amendment to IFRS 5, they should also be required to early apply IAS 27R (and therefore IFRS 3R). If the Board does not require the alignment of the two amendments entities will face problems with the measurement.

We would also like to raise a concern about the measurement of liabilities in the subsidiary. IFRS 5 indicates that 'an entity shall measure a non-current asset (or disposal group) classified as held for sale, at the lower of its carrying amount and fair value less costs to sell'. We believe that it is unclear whether the assets and liabilities of a subsidiary should be measured collectively or individually. If it is individually then the measurement basis as noted above does not make logical sense for a liability (ie the lower of carrying amount and fair value). Thus, we believe the wording should clarify this. While this issue is not a function of the change made, the changes will bring greater emphasis to this practical problem.

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

We agree with the Board's proposal.

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?

In principle, we support the Board's efforts regarding the proposed amendment because it encourages entities to comply with full IFRS. We do not believe, however, that such an amendment is a clarification to IAS 1, nor is it removing an inconsistency, and therefore is outside the scope of the project's objective. This is a highly emotive issue that has a number of ramifications which need fuller assessment and debate than they have had, or will get, as part of the improvements project.

Should the Board pursue the amendment we believe further thought needs to be given about how IFRS 1 *First-time Adoption of International Financial Reporting Standards* applies when making these disclosures. We also have some concerns about the drafting as the words 'not able to' may be subject to different interpretations, particularly when this is read with BC 3 which uses the words 'does not make'.

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?

We agree that the Board's proposal will result in conversion of an obligation to equity not being relevant to the classification of a liability as current. However, paragraph 69(d) is difficult to read, as it contains 'double negatives' ,and only considers two of the five types of settlements that are mentioned in paragraph 62 of the *Framework for the Preparation and Presentation of Financial Statements* (the Framework).

For example, if a liability can be settled by the provision of services within the next 12 months, the revisions to paragraph 69 (d) would effectively result in the liability being classified as non-current – which we don't believe is the intention.

We recommend that the amendment address each of the five types of settlements so that it is clear which types may be considered current and which may not.

Question 6 – Do you agree with the proposal to amend the examples in paragraphs 68 and 71 of IAS 1 to remove the potential implication that financial assets and financial liabilities that are classified as held for trading in accordance with IAS 39 are required to be presented as current? If not, why?

We agree with the Board's proposal.

Question 7 – Do you agree with the proposal to amend paragraphs 7, 9 and 11 of IAS 8 to clarify the status of implementation guidance? If not, why?

We agree with the Board's proposal.

Question 8 – Do you agree with the proposal to amend paragraph 13 of IAS 10 to clarify why a dividend declared after the reporting period does not result in the recognition of a liability at the end of the reporting period? If not, why?

We agree with the Board's proposal.

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?

We agree with the Board's proposal.

Question 10 – Do you agree with the proposals to amend paragraph 68 of IAS 16 and paragraph 14 of IAS 7? If not, why?

We do not support the proposed amendment to IAS 16 *Property, Plant and Equipment* as we believe it introduces inconsistencies with IAS 40 *Investment Property* and IFRS 5. IAS 16.68A proposes that 'an entity that, in the course of its ordinary activities, routinely sells items of property, plant and equipment that it has held for rental to others, transfer such assets to inventories'. However, this is in direct conflict with IAS 40.58, which prohibits an entity from transferring investment property to inventory simply when it has decided to sell the asset. An entity may only transfer investment property to inventory when it plans to develop it (see IAS 40.57(b)). We also note that IFRS 5 requires an entity to measure a non-current asset, classified as held for sale, at the lower of its carrying amount and fair value less cost to sell, recognising an impairment loss for any write-down. However, paragraph 68A requires reclassification to inventory at its carrying value, albeit, it may be written down to its net realisable value.

Finally, we are concerned with the related amendments proposed to IAS 7 *Cash Flow Statements*. We believe that it is impractical to require an entity to assess, on initial purchase of an asset, what its future intentions are (i.e. whether the asset will be sold in the future or not). Furthermore, the asset will be initially classified as property, plant and equipment, while the cash flows will be shown as operating, thereby introducing inconsistency between the primary statements.

Accordingly, we recommend that the amendment address only the **presentation** in the income statement without affecting the balance sheet.

Question 11 – Do you agree with the proposal to amend paragraphs 14 and 17 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?

We agree with the proposal to delete paragraph 14 and amend paragraph 15 of IAS 17 *Leases*. However, the consequences of classifying a lease of land as a finance lease are not fully addressed, in particular, what type of asset exists. Is it property, plant and equipment (i.e. land) or is it an intangible asset (i.e. the 'right to use land'). If the asset is property, plant and equipment, it should be depreciated (based on the life of the lease) and may be carried at revalued amount (if this is the entity's policy) or may be classified as investment property. However, if the asset is an intangible asset, there would be restrictions on its ability to be revalued (as there must be an active market as defined in paragraph 8 of IAS 38) and "the right to use" would not qualify as an investment property.

While we agree with the direction of the proposal, as it is an improvement in the accounting for leases of land, we note that this will introduce a difference to US GAAP.

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

We agree with the Board's proposal. We note however that BC 4 and BC 5 are contradictory in nature, and therefore do not provide an appropriate rationale for this amendment.

Question 13 – Do you agree with the proposed amendment to the guidance on IAS 18 to explain that the definition of the transaction costs to be applied to the accounting for financial asset origination fees are those defined in IAS 39? If not, why?

We agree with the Board's proposal. We also recommend that the amendment made to paragraph 14(a)(i) of the Appendix to IAS 18 *Revenue* is made to paragraph 14(a)(ii) of the Appendix to IAS 18.

Question 14(a) – Do you agree that IAS 19 should be amended to clarify that when a plan amendment reduces benefits for future service, the reduction relating to future service is a curtailment and any reduction relating to past service is negative past service costs? If not, why?

We agree with the Board's proposal.

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?

We agree with the Board's proposal.

Question 15 – Do you agree with the proposal to amend the definition of return on plan assets in paragraph 7 of IAS 19 to require the deduction of plan administration costs only to the extent that such costs have not been reflected in the measurement of the defined benefit obligation? If not, why?

We believe the proposed amendment relating to the accounting for plan administration costs provides helpful guidance for preparers. However, we believe that a principle should be provided to stipulate in which situations plan administration costs should be included either in the return on plan assets or in the measurement of the defined benefit obligation. If a plan is open and ongoing, we do not believe it will make a difference where the cost is included. Thus the entity can chose whether the costs are included in either the return on plan assets or in the measurement of the defined benefit obligation. If the plan is closed to the accrual of a benefit, we believe the plan administration costs should be included in the defined benefit obligation. This is because the entity is obtaining no further benefits from the employees yet it remains liable to administer the plan and pay the eventual benefits.

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

We agree with the Board's proposal.

Question 17 – Should the reference in IAS 19 to recognising contingent liabilities be removed? If not, why?

We agree with the Board's proposal.

Question 18 – Do you agree with the proposal to conform terminology used by IAS 20 to the equivalent defined or more widely used terms? If not, why?

We agree with the Board's proposal.

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?

While we agree in principle with the proposed amendment to IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, we do not support making the amendment now. IAS 39 *Financial Instruments: Recognition and Measurement* acknowledges an entity's ability to recognise and measure below-market interest rate loans and thus this change to IAS 20 should remove an inconsistency.

However, the Board has had a project on its agenda for a number of years to revise the whole area of accounting for government grants. This project has been deferred until further work is completed on the revenue recognition and liabilities projects. We are therefore concerned with the Board taking a piece-meal approach and amending this inconsistency while not considering the numerous other inconsistencies both within IAS 20 and between IAS 20 and other standards.

Question 20 – Do you agree with the proposal to amend paragraph 6 of IAS 23 to refer to the guidance in IAS 39 *Financial Instruments: Recognition and Measurement* relating to effective interest rate when describing the components of borrowing costs? If not, why?

We agree with the Board's proposal.

Question 21 – Do you agree with the proposal to require investments in subsidiaries that are accounted for in accordance with IAS 39 in the parent's separate financial statements to continue to be accounted for on that basis when classified as held for sale (or included in a disposal group that is classified as held for sale)? If not, why?

We agree with the Board's proposal.

Question 22 – Do you agree with the proposal to clarify the disclosures required of an investor in an associate that accounts for its interest in the associate at fair value recognised in profit or loss? If not, why?

We agree with the Board that there is inconsistency within IFRS regarding which disclosures are required for associates that are accounted for at fair value through profit or loss. However, the Board has not provided any rationale in the Basis for Conclusions regarding the specific disclosure requirements proposed. We agree that disclosure of the information required by paragraph 37(f) of IAS 28 *Investments in Associates* is reasonable as such investments have unique risks associated with them that do not exist for other investments that may be held at fair value through profit or loss. We believe the Board should indicate why this disclosure is included and why the other disclosures are not required. We would also recommend the Board to consider whether consistent disclosures are required between associates and joint ventures accounted for at fair value through profit or loss.

Question 23 – Do you agree with the proposal to amend paragraphs 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?

We agree with the Board's proposal. We note however, that the reasoning provided in BC 4 is not clear. In particular, the statement 'The Board decided that any additional impairment … should not be allocated against any goodwill included in the investment balance' is not helpful. A statement explaining why the Board decided this would be helpful.

Question 24 – Do you agree with the proposal to update the description of historical cost financial statements in paragraph 6 of IAS 29 and to conform terminology in IAS 29 to the equivalent defined or more widely used terms? If not, why?

We agree with the Board's proposal.

Question 25 – Do you agree with the proposal to clarify the disclosures required of a venturer in a jointly controlled entity that accounts for its interest in the jointly controlled entity at fair value in accordance with IAS 39, with changes in fair value recognised in profit or loss? If not, why?

We agree with the Board that there is inconsistency within IFRS regarding which disclosures are required for joint ventures that are accounted for at fair value through profit or loss. However, the Board has not provided any rationale in the Basis for Conclusions regarding the specific disclosure requirements proposed. We believe the disclosure requirements of paragraph 55 (a) of IAS 31 *Interests in Joint Ventures* are reasonable as this relates to the venturer's commitments. However, we do not believe it is appropriate to require the disclosures in paragraph 55(b) because such commitments are not part of the venturer's business.

We also have concerns with the Board requiring an entity to include the disclosures required by paragraph 56 of IAS 31 for joint ventures held at fair value through profit or loss (FVTPL). Paragraph 56 requires an entity to disclose a listing **and description** of interests in significant joint ventures. We note that a similar requirement is not included in IAS 28, nor has the Board specifically required this disclosure for associates held at FVTPL in the Exposure Draft. However, we also note that IAS 27 *Consolidated and Separate Financial Statements* requires entities to disclose a list of significant investments in subsidiaries, jointly controlled entities and associates. There is no discussion in the ED as to whether this requirement will apply to both associates and joint ventures held at FVTPL. We recommend that the Board makes all of these disclosure requirements consistent and avoid duplication. If the Board continues with the proposal to require the disclosure of a list and description of joint ventures, the Board should provide the rationale in the Basis for Conclusions for this requirement.

Question 26 – Do you agree with the proposal to amend paragraph 11 of IAS 34 to require the presentation of basic and diluted earnings per share only when the entity is within the scope of IAS 33? If not, why?

We agree with the Board's proposal.

Question 27 – Do you agree with the proposal to amend paragraph 134(e) of IAS 36 to require the same disclosures to be given for fair value less costs to sell as are required for value in use when discounted cash flows are used to calculate fair value less costs to sell? If not, why?

We agree with the Board's proposal.

Question 28(a) – Do you agree that IAS 38 should emphasise that an entity should recognise expenditure on an intangible item as an expense when it has access to the goods or has received the service? If not, why?

Question 28(b) – Do you agree that paragraph 70 of IAS 38 should be amended to allow an entity to recognise a prepayment only until it has access to the related goods or has received the related service? If not, why?

We agree with the proposed amendments to IAS 38. However, clarification is needed about what 'access' means in this circumstance because in many cases an entity may not ever obtain 'physical access' to the goods. For example, when an entity buys catalogues but does not physically receive the catalogues because the supplier delivers them on behalf of the entity. The entity will never gain physical access to the goods yet it has received the benefit from them. Further, an entity may instruct a supplier not to deliver the goods to them because they would like to have them stored at the supplier, which would mean that the entity does not *have* physical access to them. We therefore suggest that the wording is amended to refer to either the 'right to access the goods' or when the entity has 'control' of the goods.

Further, paragraph 68 assumes that if expenditure is not an intangible asset it must be expensed. However, expenditure may meet the definition of a different type of asset and thus should not be expensed. The amendment should therefore state that expenditure is expensed only if it does not meet the definition of an asset under IAS 38 or any other standard.

Question 29 – Do you agree with the proposal to remove the last sentence of paragraph 98 of IAS 38 regarding the amortisation method used for intangible assets? If not, why?

We agree with the Board's intention to clarify that an entity is able to use the unit of production method even if it results in a lower amount of accumulated amortisation than that calculated under the straight-line method. However, we do not believe that the proposal to remove the statement will achieve the Board's objective.

We believe that the Board needs to establish a clear principle to identify the pattern of consumption of economic benefits. For example, where a license to operate a road is valid for 20 years, and it is expected that the revenue generated from the use of the road will be higher in later years, what is the pattern of consumption of economic benefits? Is consumption related to the revenue derived from the use of the license, or is it related to the time period for which the entity has access to use the road?

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?

We agree with the Board's proposal.

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?

We agree with the Board's proposal.

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

We agree with the Board's proposal.

Question 32 – Do you agree with the proposal to amend paragraph 73 of IAS 39 to remove the references to segments and segment reporting? If not, why?

We agree with the Board's proposal.

Question 33 – Do you agree with the proposal to amend paragraph AG8 of IAS 39 to clarify that the revised effective interest rate calculated in accordance with paragraph 92 should be used, when applicable, to remeasured the financial instrument in accordance with paragraph AG8? If not, why?

We agree with the Board's proposal.

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

We agree with the Board's proposal.

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?

We agree with the Board's proposal. However, it would be useful to provide guidance about how an entity might determine the fair value of property under construction. One option is to analogise to IAS 41 *Agriculture*, which includes consideration of how the fair value is determined for assets that are growing. We believe that similar principles could be applied to property under construction and thus the Board should acknowledge this in its amendment.

Question 36 – Do you agree with the proposal to conform terminology used in paragraph 31 of IAS 40 to the terminology used in IAS 8? If not, why?

We agree with the Board's proposal.

Question 37 – Should paragraph 50(d) of IAS 40 be amended to clarify the accounting for investment property held under lease? If not, why?

We agree with the Board's proposal.

Question 38 – Do you agree with the proposal to replace the terms 'point-of-sale costs' and 'estimated point-of-sale costs' in IAS 41 with 'costs to sell'? If not, why?

We agree with the Board's proposal.

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?

We agree with the Board's proposal.

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?

We broadly agree with the proposal to remove the restriction on taking additional biological transformations into account. However we note that the Basis for Conclusions is contradictory. Initially BC6 states that IAS 41.21 excludes cash flows from additional biological transformations, when discounted cash flows are used to determine the discounted cash flow, and then goes on to state it is removing a 'perceived prohibition'.

We also recommend that the statements in BC 6 specifically acknowledging that the entity should reflect these cash flows in their calculations is included in the body of the standard. We also believe this will help overcome any ambiguity that is likely to arise over what the 'relevant market' is.

We are aware of some regulators that believe that if there is an active scrap market for such agricultural assets this market price should be used in determining the fair value of the asset at the balance sheet date. Therefore, we believe that the Basis for Conclusions should highlight that scrap markets cannot be used as they are not the relevant market.

Question 41 – Do you agree with the proposed amendments to the examples in paragraph 4 of IAS 41? If not, why?

We agree with the Board's proposal.