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COMMENT LETTER

To

First Annual Improvements Project
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Date

11 January, 2008

By email - Commentletters@iasb.org

Dear Sir,

Exposure Draft of Proposed Improvements to International Financial Reporting Standards

We are pleased to have the opportunity to comment on the above Exposure Draft issued by the International Auditing Standards Board (IASB), on behalf of BDO International[1]

This response is divided into two parts. The first part provides responses to the specific questions raised. Where we have not responded to any individual question contained in the ED it should be inferred that we agree with the Board's proposals and have no further comment to make. The second part provides suggested improvements to the drafting of paragraphs, sometimes arising as a result of comments made in part 1 of the response.

A significant concern we have is in respect of the scope of the exposure draft. The introduction states that the objective of the annual improvements project is:

> '...to provide a streamlined process for dealing efficiently with a collection of miscellaneous, non-urgent but necessary minor amendments to IFRSs.'

That being the case, we believe that a number of the proposed amendments should not be included in the annual improvements project, instead being exposed for comment in their own right, as the effect of the proposed changes could be significant. In particular, the proposed change in the definition of an embedded derivative will bring significant changes for some entities and, as noted below, the proposed change in definition is inconsistent with proposals for IAS 17. We are concerned that the Board has included this type of amendment in the collective exposure draft.

15

[1] BDO International is a world wide network of public accounting firms, called BDO Member Firms, serving international clients. Each BDO Member Firm is an independent legal entity in its own country.

The network is coordinated by BDO Global Coordination B.V., incorporated in the Netherlands, with an office in Brussels, Belgium, where the Global Coordination Office is located.

PART I

Proposed amendments to IFRS 5

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?

We agree with the proposal, although we believe it would be helpful to the reader if the standard also addressed the appropriate approach to be followed where a non-controlling interest is retained. This guidance might note that where the criteria for classification as Held For Sale are met for the retained non-controlling interest are met IFRS 5 should be applied, with the guidance set out in IAS 27.31 being applied in all other cases.

Proposed amendments to IFRS 7

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?

Although we agree with the need to resolve the potential conflict we are not convinced that the inconsistency has been entirely dealt with. Although paragraph IG13 is amended by deleting the reference to total interest income, the heading relating to that paragraph continues to refer to both interest income and interest expense. We believe that either the reference to "Total interest income" in the heading should also be removed, or paragraph IG13 should be expanded to deal separately with interest income.

In addition, to further remove any doubt, the board might consider further clarifying that the line item "finance costs" required by IAS 1:82(b) is not an amount presented net of any items of finance income. This may in turn require some explanation of why the board considers finance costs, but not finance income, to be of sufficient importance to be presented on the face of the statement of comprehensive income.

Alternatively, in an approach which we believe would be preferable, the minimum disclosures required by IAS 1.82 could be expanded to include both finance income and finance expense.

Proposed amendments to IAS 1

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 not?

We believe that this requirement is unnecessary, if not unworkable, and agree with the Alternative Views of Messrs Leisenring and McGregor set out in paragraphs AV1 to AV3. We strongly recommend that this proposed amendment is deleted. IAS 1 paragraph 18 explicitly states that inappropriate accounting policies are not rectified by explanatory notes, so it is not clear why the Board should now require such an explanatory note. Furthermore if an entity cannot make an explicit unreserved statement of compliance then presumably it is simply not within the "jurisdiction" of IFRS and therefore can simply choose not to comply with this disclosure requirement.

Where an entity, which is subject to audit, does not properly comply with IFRS but claims such compliance in its audited financial statements, the audit report would be expected to be qualified

115

and identify the non-compliance. It seems of little value to then have an additional qualification purely because the entity has not provided details of the non-compliance in accordance with proposed paragraph 16A.

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 of current?

We agree with the proposal, although believe it would assist the reader if the requirement made it clear that the instrument to be issued on settlement of the liability needs to be one which is classified as an equity instrument on issue.

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?

We agree that the potential implication is undesirable and should be addressed, but do not believe that the proposed deletion of wording is necessarily the best solution as IAS 39 requires that financial assets and financial liabilities are classified as held-for trading when:

- acquired or incurred principally for the purpose of selling or repurchasing it ***in the near term*** [emphasis added];
- part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of ***short-term*** profit-taking [emphasis added]; or
- derivatives

In other words, other than derivatives it is expected that held for trading financial assets and liabilities will normally be classified as current. Consequently, we believe it would be better to clarify the wording in parentheses as following rather than deleting the wording altogether.

"... Current assets also include assets held primarily for the purpose of trading *(including items financial assets and liabilities classified as held for trading under paragraph IAS 39 other than the non-current portion of derivative assets and liabilities)* and the current portion of non-current financial assets."

Proposed amendments to IAS 16

Question 10 – Do you agree with the proposal to amend paragraph 16 of IAS 16 and paragraph 14 of IAS 7?

While we do not disagree with the proposed amendment in the context of the discussion in the basis for conclusions, we are concerned that some entities might seek to apply the guidance inappropriately by analogy. In particular, an entity which holds investment property which is leased to third parties under an operating lease might suggest adopting the approach set out in proposed paragraph 68A. We suggest that a restriction, similar to that in IFRIC 10, should be included indicating that this guidance may only be applied to assets falling within the scope of IAS 16.

We are also concerned that there may be confusion about how the guidance should be applied in practice. Some companies rent properties to third parties where the properties are precluded from being within the scope of IAS 40 as the lessor uses a proportion of the property itself (see IAS 40.10). Consequently, it would appear that the property would fall within the scope of IAS 16.

It is not clear how the disposal of such a property would be accounted for under the proposals, as the property would only partially be held for rental to third parties.

Proposed amendments to IAS 17

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?

Although we agree with the amendments to paragraphs 14 and 15 we do not agree with the use of the phrase in new paragraph 19A "in accordance with the pattern of the benefits provided" because it is not clear what "benefits provided" actually means. We are concerned that there could be potential for abuse with various benefits being suggested as accruing from the premium depending on the period over which an entity would prefer to charge the premium. For example, an entity might look at the expected profit or revenue to be generated by a property over its remaining lease term as the "benefit provided". We assume that the Board intends the focus to be on the benefits provided by the lease terms itself, e.g. the premium is being paid only because passing rent is below market rents. We assume that the Board views 'benefits' as being those derived from the lessee having access to the leased asset(s), rather than whether the lessee generates profits from the use of the asset(s). It would be helpful for this to be clarified.

As examples, a lessee in the retail sector might lease a shop for a period of five years. In order for the shop to be suitable for the lessee's business, there is a 'fit out' period after the start of the lease term (say, three months), during which time the lessee will make appropriate changes to the interior of the property. Some might argue that the benefits to be derived from the shop will only start to accrue from the end of the fit out period as this is the point at which revenue can be generated. However, the lessee has had access to the premises from the commencement of the lease, and so the operating lease rental should be spread over the period from that point and not three months later.

Similarly, in the shipping industry a cruise company might acquire a new vessel under an operating lease. However, the vessel is in the wrong location and it takes some time for it to travel from (say) Singapore to Europe. Some might argue that the benefits to be derived from the vessel will only start to accrue from the point at which it arrives in Europe. However, the lessee has access to the vessel from the commencement of the lease (when the vessel can be taken from Singapore) and so the operating lease rental should be spread over the period from that point, and not later on its arrival in Europe.

In some jurisdictions, additional considerations apply which the Board may wish to take into account. For example, from the perspective of a UK entity, the Landlord and Tenant Act contains provisions that require a landlord to offer a tenant a new lease at the end of the existing lease term unless certain conditions apply. This does not constitute an option to extend because there are circumstances when the Landlord is not required to offer a new lease. However, circumstances could be envisaged where entities, particularly those in the retail sector, may wish to spread a premium paid over a longer period on the basis that the premium paid for a short lease was in order to gain a foothold in a particular location and there is every expectation that the landlord will grant a new lease. Arguably, any premium paid only represents the difference between passing rent and market rent over the remaining (and perhaps short) lease term, but it is not clear whether the amendment as drafted permits the premium to be spread over a longer period.

15

Question 12 – Do you agree with the proposal that contingent rent relating to an operating lease should be recognised as incurred?

While we agree with the proposed amendment, we believe that a consequential amendment would be required to the amendment proposed to IAS 39 which changes the definition of a derivative. At present, many embedded features in leases which give rise to contingent rental payments are scoped out of the definition of a derivative because the underlying is a non financial variable which is specific to the lessee (such as an operating lease payment which varies according to the turnover generated by retail premises occupied by a lessee). The change in the definition of a derivative, to include those contracts with underlyings that are specific to a party to the contract, would result in this type of lease having an embedded derivative (in accordance with IAS 39) which, presumably, would be separable as it would not be viewed as being closely related to the host contract. However, the recognition of such an embedded derivative and the accounting that would result from this recognition would conflict with the new requirement proposed for IAS 17 to recognise contingent rentals in the period in which they are incurred.

As noted in our response to the proposed amendment to the definition of a derivative, we believe that the issue might be resolved by regarding such a term in a leasing contract as being closely related to the host contract unless the variation in rental is leveraged. This would then require the proposed amendment to IAS 17 to be revisited, with a cross reference to IAS 39 in the event that the feature was leveraged and was therefore required to be accounted for as a separable embedded derivative.

Proposed amendments to IAS 19

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

While we agree with the intention of the proposed amendment, we believe that the drafting should be more restrictive. By basing the distinction on the point at which the employee becomes 'entitled' to the benefit, a long term benefit could be classified as short term.

As an example, say an employee becomes entitled to a payment in advance. The payment is non refundable, unless the employee leaves within three years, in which case it is refundable on a sliding scale, time apportioned, basis. Based purely on an entitlement approach, it could be argued that this constitutes a short term employee benefit, despite the payment clearly relating to the following three years of service.

Consequently, we suggest that the drafting is modified to the employee becoming 'unconditionally entitled' to the benefits.

Proposed amendments to IAS 20

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 not?

We agree with the revised drafting of IAS 20 save for paragraph 12 which uses somewhat awkward and convoluted language with the only objective seemingly to be removing the reference to matching. We suggest that the original wording is retained; wording that the Board considers to be old fashioned can be removed when the replacement standard for government grants is drafted.

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Proposed amendments to IAS 28

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 in accordance with IAS 39, with changes in fair value recognised in profit and loss?

We agree with the clarification, although believe that highlighting the need to comply with disclosures required by paragraph 37(f) should be highlighted more clearly.

Rather than specifying the need for all entities to comply with paragraph 37(f) at the end of paragraph 1 we believe that sentence 2 would be better drafted as "However, other than the disclosures required by paragraph 37(f), this standard does not apply to investments in associates held by…"

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 associate should be reversed?

We disagree with the proposal. In our view the proposal conflicts with both IAS 36 as indicated in the dissenting opinion, and also paragraphs 20 and 23 of IAS 28 which requires the principles of IFRS 3 to be applied to the acquisition of an interest in an associate such that the goodwill acquired is known. Indeed, the way the improvement is currently drafted the question left unanswered is "if the impairment is not allocated to the goodwill and other assets included in the investment in the associate, where is it allocated?"

Proposed amendments to IAS 31

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 the profit and loss account

We agree with the proposal, although we refer you to our answer to Question 22 concerning the drafting of paragraph 1.

Proposed amendments to IAS 36

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?

Preparers of accounts are comfortable with the notion that recoverable amount is the higher of value in use and fair value less costs to sell. However, most preparers would only associate the use of discounted cash flow techniques with a calculation of value in use. As the proposed amendment now refers to the determination of fair value less costs to sell using discounted cash flows techniques, it is possible that preparers of financial statements might find the guidance unclear in its requirements. We assume that the requirement to discount fair value less costs to sell would only arise where there was necessarily a period of time before the cash generating unit could be disposed of.

It would be helpful for the Basis of Conclusions to include a brief explanation of how the Board anticipates discounted cash flow techniques will be used when recoverable amount is based on fair value less costs to sell.

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Proposed amendments to IAS 38

Question 28(a) - Do you agree that IAS 38 should emphasis that an entity should recognise expenditure on an intangible item as an expense when it has access to the goods or has received the services?

We disagree with the proposal, as the application of the proposals as drafted could result in different accounting for transactions that are essentially identical (see our response to question 28 (b) below in respect of accounting for brochures and catalogues).

We suggest that the point might be addressed by including further guidance that in such cases, the costs should be included in inventory (with the carrying amount being subject to a provision for impairment due, for example, to obsolescence or overstocking), and then expensed when the brochures are used (ie sent to the retailers or travel agents), rather than at the point at which they are received from the printer.

For other types of transaction falling within the scope of the amendment, it would assist many users if there was some Implementation Guidance. For example, suppose an entity intending to advertise on the television engages an advertising agency to produce an advert that will subsequently be broadcast 6 times. If at the year end, the advert has been produced, but has yet to be shown on the television then we would interpret the proposed improvement to mean that all of the costs associated with the production would have to be expensed (because those services have been received) but the costs of broadcast would not be expensed. If, however, the advert has been broadcast three times, then all of the production costs and half of the broadcast costs would be expensed.

If this is not the correct interpretation, then we believe the drafting should be amended to clarify the Board's intentions.

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 services?

We disagree with the proposal, as it could result in different accounting for two circumstances which are, in substance, nearly identical.

For example, suppose a travel company employs a printer to produce brochures to assist its travel agents in promoting the following season's holidays (say, the following summer). The travel company has a December financial year end and the printing is carried out towards the end of the calendar year. Under the proposals, the cost of those brochures would be expensed immediately on receipt by the travel company from the printer.

We do not consider this to be an appropriate approach.

Firstly, there would seem no reason why the brochures should not be recorded as an asset before they are distributed to travel agents; the definition of an asset in paragraph 49 (a) of the Framework appears to be met, as the printed brochures are controlled by the travel company, and benefits are expected to be derived from them. They are effectively advertisements which have not yet been shown. Any asset would, of course, be expensed immediately on distribution of the brochures to the travel agents, as the travel company would no longer have control over the brochures.

Secondly, under the proposals, the timing of delivery from the printer would have a substantial effect on the timing of the recording of an expense by the travel company. If the brochures were

157

delivered on 31 December 2007, they would be expensed in that financial year; if they were delivered on 1 January 2008, they would be expensed in the following financial year, despite there being no substantive difference in the two transactions (other than the timing of delivery being different by less than 24 hours).

We suggest that the Board reconsiders the proposed approach.

Proposed amendments to IAS 39

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 we do not object in principle to the amendment, we would note that the change, although perhaps considered to be a minor change from the Board's perspective, is likely to give rise to substantial changes in practice.

We also note that the change in the definition of a derivative is inconsistent with the Board's proposed amendment to IAS 17, that contingent rentals payable under operating leases should be recognised as incurred. In particular, payments made under many operating lease contracts for retail premises are linked to the amount of turnover which, under the revised definition of a derivative contract, would appear to fall to be accounted for as separable embedded derivatives as the economic characteristics and risks of the embedded derivative would not be regarded as being closely related to the host lease contract.

As noted in our response to the proposed amendment to IAS 17, we believe that the issue might be resolved by regarding such a term in a leasing contract as being closely related to the host contract unless the variation in rental is leveraged. This would then require the proposed amendment to IAS 17 to be revisited, with a cross reference to IAS 39 in the event that the feature was leveraged and was therefore required to be accounted for as a separable embedded derivative

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?

We agree with the proposal to clarify that the change in accounting treatment of hedging instruments on commencement or cessation of hedge accounting are not reclassifications. However, we note that for fair value hedges, whether or not hedge accounting applies the classification is fair value through profit or loss. Consequently rather than referring to hedge accounting generally, we believe it would be more precise to refer in paragraph 50A to:

(a) a derivative that was previously a designated and effective hedging instrument in a cash flow or net investment hedge no longer qualifies as such;

(b) a derivative becomes a designated and effective hedging instrument in a cash flow or net investment hedge.

Proposed amendments to IAS 41

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?

We do not agree with the amendment as drafted because it is not clear whether the proposed amendments permit an entity to choose whether or not potential tax cash flows should be taken into account in valuing the asset or whether the decision should be based on the circumstances of the buyer itself (i.e. in some circumstances tax cash flows should be taken into account, but in others it would not be appropriate).

The issue perhaps has more relevance in the context of valuing intangible assets on a business combination as there are some differing views in the approach taken: some entities take into account tax amortisation benefit in their valuations (irrespective of whether there is a future tax benefit) whereas other entities, if there is no future tax amortisation benefit in the particular circumstances of the acquisition, do not.

However, given the hierarchy in IAS 8 for selection of accounting policies, it may be that entities will make use of paragraph 11 of that standard to argue that as IAS 41 allows the use of a pre-or post tax discount rate to value agricultural assets so that a pre- or post-tax discount rate can be used to value intangibles arising on a business combination. We suggest that the Board considers the effect of the proposed amendment to IAS 41 before concluding on whether the change should be made.

PART II – OTHER DRAFTING MATTERS

Proposed amendments to IAS 7

Paragraph 14 - We believe sentence 3 of this paragraph is better drafted as "However, cash payments to manufacture or acquire assets held for rental to others ***which are*** subsequently held for sale…"

Proposed amendments to IAS 17

Assuming that the Board amends its proposals in IAS 39 for the apparent inconsistency between the proposed amendment to IAS 17 for contingent rentals on operating leases, and the definition of an embedded derivative in IAS 39,, we suggest that:

- the last sentences of Paragraph 33 should be drafted as "Contingent rent shall be recognised as an expense in the periods in which it is incurred unless the contingent feature is an embedded derivative that is require to be accounted for separately in accordance with IAS 39"; and
- the last sentences of Paragraphs 39 and 50 should be drafted as "Contingent rent shall be recognised as an income in the periods in which it is incurred unless the contingent feature is an embedded derivative that is require to be accounted for separately in accordance with IAS 39".

We are unclear why paragraph 40 has been amended such that contingent rent is not applied against the gross investment in the lease. Where the entire lease payment is contingent, then it is not clear how the asset will ever be derecognised.

Proposed amendments to IAS 28

As noted above, we do not agree with the proposed amendments. However, if the Board does proceed with the proposal to allow reversals of impairments in investments in associates we would recommend the following drafting improvements:

- Paragraph 33 – "… Any impairment loss recognised in those circumstances is not allocated specifically to the underlying goodwill and other assets of the associate, rather is allocated generally to its carrying value. Accordingly…"
- Paragraph BC4 – "… Therefore such an impairment charge could and should be reversed in a subsequent period to the extent that the recoverable amount of the associate increases."
- Paragraph BC5 – "… It also decided to specify that any impairment loss is not deemed to be allocated against any goodwill…"

Proposed amendments to IAS 39

The first sentence of paragraph BC5 should presumably begin "The definition of a financial asset ***or*** financial liability…[emphasis added]"

Given the clarification being incorporated into IAS 39, the Board might also add an additional category of financial assets and liabilities, being a derivative or derivatives designated in an effective hedging relationship that meets the criteria set out in paragraph 88.

We would be happy to discuss our views with you. If you would like to discuss these comments, please contact Helen Thomson of BDO Global Coordination B.V. on +32 2 778 01 30.

Yours faithfully,

BDO Global Coordination B.V.