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Response of the Accounting Committee of the Institute of Chartered Accountants in Ireland

Improvements to International Financial Reporting Standards

Dear Sir/Madam,

The Accounting Committee (AC) of the Institute of Chartered Accountants in Ireland welcomes the opportunity to comment proposals contained in the above document. The appendix to this letter provides answers to the detailed questions asked in the document.

Should you wish to contact us about any of our comments please feel free to do so.

Yours faithfully,

Mark Kenny

Secretary, Accounting Committee

Appendix

Question 1: Do you agree with the Board's proposed restructuring of IFRS 1?

AC agrees with this 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?

AC agrees in principle with the proposed amendment but considers that it should also clarify the treatment of intra-group funding and trading balances. The proposed amendment refers to **all** the assets and liabilities of the subsidiary. This does not completely address the problems that can arise with intra-group balances. In some cases these balances will be settled between the group entities prior to the sale completion and presumably therefore only the remaining assets and liabilities will qualify as held for sale. The intra-group balances would be eliminated as usual in the consolidation. However, where the intra-group balances derive from normal trading and will form part of the net assets disposal of, the question arises as to whether the intra-group balances should be shown as part of the assets/liabilities "held for sale", i.e. there would effectively be a gross up of the consolidated balance sheet.

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?

AC agrees with the proposed amendment to IG13.

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?

Ideally all financial statements should comply with IFRSs, but already Europe has carved out aspects of IAS 39 and thus it is important to disclose information in the financial statements to the extent that the statements have not been prepared in accordance with full IFRSs. Whilst it is ideal that all financial statements be in accordance with IFRSs, this is unlikely to be achievable in all cases, so AC supports the amended disclosure.

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?

AC agrees that in general the potential settlement of a liability by the issue of equity should not affect its classification as current or non-current where the holders' conversion option is for a fixed number of equity shares.

However, in the special case of a liability that is settled by the issue of a variable number of shares (as described in paragraph 21 of IAS 32), AC considers that the classification as current or non-current should depend on the due date for settlement and if the holder had an option to require conversion at any time then this should be disclosed as current. Furthermore, obligations that can be settled other than in cash or other assets – for example, by the provision of services or in exchange for another obligation – do not appear to be covered by the proposed amended wording and would not be classified as current.

Consequently, AC does not agree with the draft amendment in its current form.

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 held for trading in accordance with IAS 39 are required to be presented as current? If not, why?

AC agrees that financial liabilities should be classified as current or non-current in accordance with paragraph 69 of IAS 1. However, deletion of the example in paragraph 71 merely raises the question "if a financial instrument is classified as held for trading under IAS 39, how does it not meet the definition of 'held primarily for the purposes of trading' in paragraph 69(b) of IAS 1?". This calls into question whether it is the term 'held for trading' in IAS 39 that is misleading, since it includes derivatives that may not actually be held for trading, although their underlying risks may be. AC suggests that the definition of 'financial asset or financial liability at fair value through profit or loss' in IAS 39 should be reordered so that derivatives are a separate part of this definition rather than a sub-category of 'held for trading'. This would have the added benefit of removing the conflict with IAS 1. It is suggested that the definition should be reworded as follows:

A <u>financial asset or financial liability at fair value through profit or loss</u> is a financial asset or financial liability that meets either of the following conditions.

(a) It is classified as held for trading. A financial asset or financial liability is classified as held for trading if it is:

- ***(i) acquired or incurred principally for the purpose of selling or repurchasing it in the near term; or***
- ***(ii) 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;***

Question 6 (contd.)

(b) ***A derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument);***

(c) ***Upon initial recognition it is designated by the entity as at fair value through profit or loss. An entity may use this designation only when permitted by paragraph 11A, or when doing so results in more relevant information, because either:***

(i) ***it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or***

(ii) ***a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in IAS 24 Related Party Disclosures (as revised in 2003)), for example the entity's board of directors and chief executive officer.***

See also Response to Improvement No. 31a.

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?

AC agrees that the IAS be amended to make the point that implementation guidance does not form part of the Standard clear and agrees with the statement that implementation guidance is published to assist entities in applying IFRSs, but is not mandatory. The adopted wording should not, however, excessively downgrade the status of the implementation guidance.

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?

AC agrees with the 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?

AC agrees with the proposal to amend the definition of 'recoverable amount' in IAS 16 and align the definition with other standards.

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

AC agrees with this proposed amendment to IAS 16. However, AC questions the use of the wording '… and are held for sale', as this could lead to some scope for confusion with assets falling under IFRS 5. AC recommends that the wording in this paragraph should be consistent with the definition of inventories in IAS 2, i.e. "… and are held for sale in the ordinary course of business".

AC considers that this amendment should include a requirement to classify this category of assets as a separate class under PPE. AC considers that it is important for users of financial statements to understand the extent of investment in assets currently available for rental that will subsequently fall to be included in inventory.

AC agrees with the consequential amendment to IAS 7.

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?

AC is concerned that the deletion of these paragraphs would remove two points that have proved important in distinguishing operating and finance elements of property leases, viz.

(i) land normally has an indefinite economic useful life; and

(ii) the residual value of land is often significant.

For this reason, the land and building elements of a lease of land and buildings should be considered separately.

In the event that the Board continues to conclude that a clarification is required, AC suggests that the Board consider the following:

> 'Leases of land and buildings are classified as operating or finance leases in the same way as leases of other assets. In this classification analysis, the land and building elements of a combined lease of land and buildings are considered separately. In determining whether the land element is operating or finance, it is relevant to consider that a key characteristic of land is that it normally has an indefinite economic life.'

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

AC agrees that, for consistency with finance leases, contingent rent should be recognised on an incurred basis.

This does however raise another question regarding the guidance in IAS 39, AG 33(f). This currently notes that an embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is 'contingent rent based on related sales'. The logic of why this is deemed to always be 'clearly and closely' related is unclear.

This is exacerbated by the proposed amendment in Improvement Question No.30. This improvement proposes to amend the definition of a derivative to include a contract where the value changes in relation to an underlying non-financial variable that is specific to a party to the contract. This would in practice appear to mean that where the return on an asset or the cost of a liability was linked to sales volume / revenue, EBITDA, etc that there would be an embedded derivative and it would need to be considered whether it was clearly and closely related. If a company purchases an asset and sources funding for that asset, and if the return on the funding is linked to the revenue of the company, could a company consider the return to be clearly and closely related to the debt host by analogy with AG 33(f) of IAS 39? If not, it appears to give significant scope for structuring. If the debt provider purchased the asset and leased it to the company with lease payments contingent on revenue of the company, should there be a different answer?

The Board needs to ensure that it has considered carefully the consistency of this proposed amendment, the amendment in Question 30 and the existing guidance in AG 33(f) of IAS 39.

Question 13: Do you agree with the proposed amendment to 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?

AC agrees with the proposal to amend IAS 18 to cross refer to IAS 39 for the definition of the relevant costs, thereby aligning the two standards on this matter.

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 a negative past service cost? If not, why?

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?

AC agrees with the proposed amendment. However, AC strongly recommends that the Board should also address the directly related issues of:

- the meaning of 'related' in IAS 19 paragraph 109(c); in particular, the proposed amendment may be interpreted as reducing the degree of 'related' unrecognized actuarial gains and losses that should be recognised with a curtailment gain.
- the distinction between a change in actuarial assumptions and a past service cost (positive or negative) when plan amendments are made.
- clarification of the type of events that can give rise to a curtailment <u>gain</u>, having regard to the fact that curtailment gains relate <u>only</u> to changes to future service and the defined benefit obligation at the balance sheet date relates only to past service costs.

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?

AC agrees with the proposal; however, AC considers that the disclosure requirements should be extended to require disclosure of which approach has been adopted.

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 definition of short-term employee benefits and other long-term employee benefits? If not, why?

AC members considered it unclear as to whether the improvement was intended to address only the current/non current distinction <u>or</u> also to clarify that 'fall due' should be interpreted in the context of entitlement arising rather than the point at which settlement of the entitlement occurs. While the BC appears clear, the actual wording of the amendment may be misinterpreted.

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

AC agrees with the removal of this inconsistency.

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?

AC agrees with the proposal to amend IAS 20 and IAS 41 to align its terminology to that used in other standards.

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?

AC agrees with this proposal to thereby ensure that all loans, regardless of the parties involved (government or otherwise), are treated on a consistent basis.

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?

AC disagrees with this proposal. AC believes that the proposal would represent a significant and unintentional change in current practice. Current practice involves the capitalisation of post-hedging borrowing costs, whereas the effective interest rate per IAS 39 excludes the impact of hedging.

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?

AC agrees with the proposal to clarify. However AC considers that further clarification is required by adding a further sentence to state that investments carried at fair value in accordance with IAS 39 are not subject to the measurement provisions of IFRS 5 when they are held for sale, as the proposal does not clarify how IFRS 5 applies to these investments.

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 or loss? If not, why?

AC agrees with this proposal; however, AC suggests that the Board should take this opportunity to line up the disclosures required by IAS 31 with those required by IAS 28.

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?

AC has concerns with this approach. The goodwill arising on the acquisition of an associate is determined at that initial date and therefore is a known amount at that time, albeit that it is recognised as part of the overall investment in the associate. However, AC believes that this is only a matter of presentation. In light of the goodwill being a clearly defined sum, AC is of the view that any impairment recorded should be considered to relate to goodwill in the first instance. Therefore any reversals of a provision for an impairment loss on the overall investment in the associate should be restricted to an amount equal to the excess over the earlier goodwill impairment amount, which would therefore be consistent with the treatment of impairment of goodwill arising on subsidiaries.

In addition, the accounting for joint ventures is worth noting. IAS 31 currently allows these investments to be carried using the equity method (as set out in IAS 28) or on a proportionate consolidation basis. In the case of the latter policy the investor would carry its proportionate share of goodwill arising in relation to the joint venture separately on its balance sheet. Therefore if an impairment issue arises on the joint venture investment, any provision would, under IAS 36, be first allocated to the goodwill amount, with subsequent reversal <u>not</u> being allowed. If the current proposals to amend IAS 28 go through, an inconsistency will arise in joint venture accounting depending on the accounting policy selected, i.e. more impairment provision reversals being allowed in the case of equity accounted investments when compared with those permitted when investments are proportionately consolidated.

In this regard, AC considers that the conclusions of IFRIC 10 and the dissenting opinion of Mr Yamada should weigh more heavily on the Board's conclusion.

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?

AC agrees with this 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?

AC agrees with this proposal. However, the Board should consider whether proposals in ED 9 Joint Arrangements will have an impact on this proposed improvement.

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?

AC agrees with the proposal. AC believes that there is little, if any, benefit from requiring entities not subject to IAS 33 to disclose both basic and diluted earnings per share as part of IAS 34.

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 vale less cost to sell? If not, why?

AC agrees with the proposed amendment to paragraph 134(e) of IAS 36. AC believes that this will improve transparency in this area. However, AC understands that it is general valuation practice to base such fair value calculations on post tax discount rates. Disclosure of a post tax discount rate in accordance with paragraph 134(d) (v) for a fair value calculation of a CGU and a pre-tax discount rate for a value in use calculation (as required by the standard) of another CGU in the same industry could be very confusing unless it is clearly stated that one is pre tax and the other post tax. The Board should consider whether this needs to be specifically required.

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 services? 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 services? If not, why?

AC does not agree with the proposal as it is likely to be interpreted as permitting inappropriate deferral of expenses. It is difficult to understand how an asset can be recognised for the prepayment when the "goods" to be received do not themselves meet the definition of an asset.

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?

AC does not agree with the proposal to remove the sentence in its entirety. AC is concerned that to do so could be interpreted as permitting the "back-loading" of depreciation / amortisation. However, if the Board continues to conclude that the existing language is too prohibitive, AC considers that a more temperate amendment would be to delete the phrase "if ever" from the sentence. This would resolve the issue of the sentence being interpreted as "never", whilst maintaining the straight-line basis as the norm for calculating minimum depreciation/amortisation.

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?

AC agrees with the intention of this proposal.

This improvement proposes to amend the definition of a derivative to include a contract where the value changes in relation to an underlying non-financial variable that is specific to a party to the contract. This would in practice appear to mean that where the return on an asset or the cost of a liability was linked to sales volume / revenue, EBITDA, etc that there would be an embedded derivative and it would need to be considered whether it was clearly and closely related. This does however raise another question regarding the guidance in IAS 39, AG 33(f). This currently notes that an embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is 'contingent rent based on related sales'. The logic of why this is deemed to always be 'clearly and closely' related is unclear. The proposed change to 'contingent rents' in Question 12 is also relevant as this would say that contingent rentals should be accounted for as incurred.

If a company purchases an asset and sources funding for that asset, and if the return on the funding is linked to the revenue of the company, could a company consider the return to be clearly and closely related to the debt host by analogy with AG 33(f) of IAS 39? If not, it appears to give significant scope for structuring. If the debt provider purchased the asset and leased it to the company with lease payments contingent on revenue of the company, should there be a different answer?

The Board needs to ensure that it has considered carefully the consistency of this proposed amendment, the amendment in Question 12 and the existing guidance in AG 33(f) of IAS 39. In addition, while AC considers that the proposed amendment may achieve its purpose, it recommends that the Board should give due regard to any responses that instance examples where its effects would require a change to legitimate current practices.

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?

AC considers that it would be preferable not to have to designate financial instruments as 'held for trading' when they are not actually held for trading in the real sense. To achieve this, the definition could be reordered so that classification as FVTPL would apply to (a) financial instruments held for trading, (b) to non-hedging derivatives, (c) financial instruments designated as FVTPL on initial recognition. See below and also the answer to Question 6.

A <u>financial asset or financial liability at fair value through profit or loss</u> is a financial asset or financial liability that meets either of the following conditions.

(a) ***It is classified as held for trading. A financial asset or financial liability is classified as held for trading if it is:***

- ***(i)*** ***acquired or incurred principally for the purpose of selling or repurchasing it in the near term; or***

- ***(ii)*** ***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;***

(b) ***A derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument);***

(c) ***Upon initial recognition it is designated by the entity as at fair value through profit or loss. An entity may use this designation only when permitted by paragraph 11A, or when doing so results in more relevant information, because either:***

- ***(i)*** ***it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or***

- ***(ii)*** ***a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in IAS 24 Related Party Disclosures (as revised in 2003)), for example the entity's board of directors and chief executive officer.***

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?

AC agrees with this 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?

AC agrees with this proposal.

Question 33: Do you agree with the proposal to amend paragraph AG 8 of IAS 39 to clarify that the revised effective interest rate calculated in accordance with paragraph 92 should be used, when applicable, to remeasure the financial instrument in accordance with paragraph AG 8? If not, why?

AC agrees with the proposal as the revised effective interest rate is a more meaningful and appropriate rate to apply to the new estimated cash flow stream.

Question 34: Do you agree with the proposal to amend paragraph AG 30(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 AG 33(a), are closely related to the host debt contract? If not, why?

AC agrees with the proposed amendment to AG 30(g) to allow for compensation to the lender for loss of interest. However, there is an additional issue that could arise where no penalty fees are charged; for example in the case of a variable rate borrowing. On initial recognition, where a borrowing is to be subsequently carried at amortised cost, incremental direct costs will be netted against the borrowing's initial carrying amount. If the issuer has the option to settle at any date after the initial drawdown, the option exercise price immediately after the issuance date will be the loan's principal amount, which may not be 'approximately equal' to the loan's amortised cost amount. Where initial costs are substantial this would appear to still give rise to an embedded derivative issue for the issuer.

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

AC agrees with this proposal.

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

AC agrees with this proposal.

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

AC agrees with this 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?

AC agrees with this 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?

AC agrees with this 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?

AC agrees with this proposal.

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

AC agrees with this proposal.