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International Accounting Standards Board
30 Cannon Street
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Submitted electronically through the IASB Internet site (www.iasb.org)

Exposure Draft of Proposed Improvements to Financial Reporting Standards

Grant Thornton International is pleased to comment on the International Accounting Standards Board's (the Board) first annual Exposure Draft of Proposed Improvements to Financial Reporting Standards. Our main comments on matters of principle and general approach are summarised in the following paragraphs. Further detailed responses to the questions in the Invitation to Comment are set out in the Appendix to this letter.

Scope of the project

We support the Board's objective of providing a streamlined approach to dealing with miscellaneous necessary but minor amendments to standards. It would be helpful if any necessary minor amendments to IFRIC Interpretations are dealt with as part of the same process. We perceive benefits in such an approach both for the Board and for its constituents.

We also support the scope of the project being "non-urgent, but necessary, minor amendments" rather than addressing only clarifications and technical corrections. However, as explained further below, we question whether some of the amendments proposed fall within this scope. We acknowledge that assessing whether a specific amendment is minor is somewhat subjective. However, in making this assessment we believe that potential costs to preparers and possible wider implications must be considered. Moreover, dissenting opinions of one or more Board members may indicate the issue in question is of sufficient significance to merit separate exposure.

Accordingly, it would be helpful if the Board could explain, perhaps in the Basis for Conclusions, the reason why issues are considered minor in cases where the proposed amendment goes beyond a simple clarification or technical correction (in particular when the proposed change appears likely to result in widespread changes to existing practice).

Although one advantage of the process is to avoid having to deal with minor amendments on a piecemeal basis, we support the Board's practice of publication in *IASB Update* over the course of the year. We recommend that in future an opportunity to comment is given at that stage. The main purpose of an earlier opportunity to comment could be to ascertain constituents' views as to the appropriateness of the issue for inclusion of a topic in the annual improvement process. This will give the Board a more timely indication as to whether the issue should be subject to a more detailed review.

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Implementation and effective date

We agree that the effective date should be periods beginning 1 January 2009.

We do not agree that early application of any specific amendment should be conditional on early adoption of:

a) all the proposed amendments from the first annual improvements project; and

b) IAS 1 *Presentation of Financial Statements* (as revised in 2007).

When amendments are made to individual standards outside the annual improvements process, the effective date is selected individually. Even if several standards are amended during the same period, an entity can choose to adopt some amendments early but not others. We see no persuasive reason to take a more restrictive approach to amendments made pursuant to the annual improvements process. The proposed amendments vary in complexity and some will be more difficult for entities to adopt than others. As the amendments are considered necessary, early adoption should be encouraged. Preventing entities from early adopting some changes until they can address all other changes seems to go against the objective of encouraging high-quality, consistent application of standards.

Proposed amendments

We agree with most of the proposed amendments. In order to reduce the length of our response, we have not responded to the individual questions relating to proposals with which we agree and in relation to which we have no other comments or suggestions.

In some cases we support the Board's objective but have some concerns or suggestions as to the detailed wording of the proposal. Our comments on those cases are set out in the Appendix to this letter.

We have more significant concerns on a small number of the proposals. These concerns are summarised below and explained in more detail in the Appendix.

Significant concerns

Issue 4: Statement of Compliance with IFRSs

We believe this proposal is based on flawed logic and that it is unlikely to be effective in practice. Although we have some concerns over potentially confusing or misleading references to IFRS in financial statements prepared using jurisdictional "IFRS-based" accounting frameworks, we believe this is a complex and multi-faceted issue that should not be dealt with in the annual improvements process. See our response to Question 4 in the Appendix.

Issue 10: Sale of assets held for rental

We do not support this amendment. We see it as rule-based and without sufficient consideration of the underlying principle. It is also likely to significantly change the practice of many entities and is not in our view minor. We suggest the issue is dealt with as part of the wider revenue recognition project. See our response to Question 10 in the Appendix.

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Issue 28: Advertising and promotional activities

We do not believe that the proposed amendment provides greater clarity than the current requirements of IAS 38 *Intangible Assets*. We also agree with the Board member's dissenting view that the treatment of tangible goods should not be dealt with in the standard dealing with intangible assets. This is a problematic and complex issue that requires a more detailed analysis of the underlying principles in order to determine the appropriate accounting treatment. See our response to Question 28 in the Appendix.

Issue 30: Definition of a derivative

Although we agree that the proposed amendment will address a significant interpretational uncertainty, we believe that it may have a significant wider impact. The proposed broader scope of the definition of a derivative (including embedded derivatives) seems likely to capture many other contracts currently regarded as outside the scope of IAS 39 *Financial Instruments: Recognition and Measurement*. We believe this matter requires more detailed consideration. See our response to Question 30 in the Appendix.

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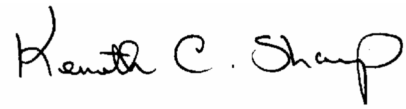
If you have any questions on our response, or wish us to amplify our comments, please contact our Director of International Financial Reporting, Andrew Watchman (andrew.watchman@gtuk.com or telephone + 44 207 391 9510).

Yours sincerely,



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Appendix 1: Responses to Invitation to Comment questions

As noted in the accompanying letter, we have not responded to the Invitation to Comment questions relating to proposed amendments with which we agree. Our comments on proposals on which we have concerns or suggestions are as follows.

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Question 2: Plan to sell the controlling interest in a subsidiary

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?

The arguments for this amendment in the Basis for Conclusions are persuasive. We agree that a sale plan involving loss of control should trigger held for sale classification. However, we have some doubt as to the proposed wording of new paragraph 8A, which refers to **all** assets and liabilities of the subsidiary being classified as held for sale [emphasis added]. This would appear to capture current items that will be realised, transferred or settled prior to the completion of the sale plan for the subsidiary. As a practical matter, we tend to agree that this is appropriate (because it may be impractical to divide assets such as inventory into those to be sold along with the subsidiary and those to be sold before that). However, the proposed approach appears inconsistent with the description of a disposal group in IFRS 5.4, which refers to disposal of a group of assets and associated liabilities in a **single transaction** [emphasis added]. Moreover , a sale agreement may exclude some of the subsidiary's assets and liabilities. We therefore suggest the following wording may be more appropriate:

> 8A An entity that is committed to a sale plan involving loss of control of a subsidiary shall classify all the assets and liabilities of that subsidiary that are to be included in the sale agreement as held for sale, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale.

IAS 1 Presentation of Financial Statements

Question 4: Statement of Compliance with IFRSs

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?

We understand the Board's reasoning behind this proposed amendment as described in BC3 but do not agree that the proposal will achieve its aim. We agree with the alternative views expressed by both Mr Leisenring and Mr McGregor. In particular, we are concerned that the amendment might be perceived as an endorsement by the Board of non-compliance with IFRS. Moreover, jurisdictions that have established mechanisms to adopt or endorse IFRS into a jurisdictional framework may simply decide to omit this requirement.

We do share the Board's concerns over potentially confusing or misleading references to IFRS when financial statements are prepared using a jurisdictional, IFRS-based accounting framework that differs from full IFRS. However, the applicable accounting framework is mandated by a government or regulator. The extent to which that framework uses IFRS and the manner in which it is described in local law and regulation are ultimately matters for the appropriate jurisdictional authority.

If the Board wishes to restrict use of the IFRS "brand" in such circumstances, that is not in our view a matter for the standards themselves.

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We are aware that the International Auditing and Assurance Standards Board (IAASB) have published proposals intended to complement this proposed amendment (ie the exposure draft of proposed amendments to International Standards on Auditing 700 *The Auditor's Report on Financial Statements* (ISA 700 (Redrafted)). The proposed IAS 700 (Redrafted) would form a useful basis for a review and wider debate.

Regarding the technical aspects of the proposal, we question the usefulness of the requirement to describe but not disclose the impact of the departure from "full" IFRS. We do not agree with the comment in BC3 that users will be able to adequately assess the significance of the differences and assess comparability with other entities using different forms of "IFRS-based" financial statements. Consequently, if the Board decide to go ahead with the proposed amendment, we recommend that a requirement to quantify the significant departures from "full" IFRS be added.

Question 5: Current/non-current classification of convertible instruments

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 potential settlement of a liability by the issue of equity is not relevant to its classification as current, on the grounds of the persuasive arguments in BC6 and BC7. However, we do not believe that the general objective expressed in BC7 (ie that classification of the liability should be on the basis of the requirements to transfer cash or other assets rather than on settlement) is fully achieved by the proposed amendment.

IAS 1.69(a) and (c) both refer to settlement without any qualification as to the meaning of settlement. Consequently, all liabilities due or expected to be settled by the issue of equity shares would still be classified as current. This creates inconsistency and confuses the principle behind the proposed amendment. We recommend that equity settlement should be eliminated from the entire definition of current liabilities. The amendment should not just be targeted at convertible instruments.

We also believe that the use of the phrase "by the transfer of cash or other assets" would result in the unintentional reclassification of some current liabilities as non-current, eg instruments that are settled through the provision of services.

We suggest replacing the phrase "cash and other assets" with "cash and other benefits" and using it in IAS 1.69(a), (b) and (d). An alternative approach might be to define non-current liabilities and use current as the residual.

IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

Question 7: Status of implementation guidance

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 consider that the existing wording is sufficiently clear but agree the proposed amendment makes it even clearer. The penultimate sentence of IAS 8.9 need only say "It is published to assist entities in applying IFRSs.", as the previous sentence renders the phrase "but are not mandatory" superfluous. Over-emphasising the non-mandatory nature could unnecessarily devalue the guidance.

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IAS 16 Property, Plant and Equipment

Question 10: Sale of assets held for rental

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

No. We see this proposal as a specific rule addressing a narrow scenario. The Board's reasoning behind the proposal does not address the underlying principle of what is revenue and how should it be recognised. It also creates an inconsistency with the treatment of investment properties. IAS 40.58 specifically prohibits the transfer of an investment property used to generate rental income to inventories when the decision to sell is made. However, IAS 40.57(a) requires such a transfer when development of the property with a view to sell commences. Such inconsistency confuses the underlying principle.

We therefore suggest that this issue be removed from the annual improvement process and be looked at as part of the wider revenue recognition project.

Alternatively, reference to such "dual-use" assets could be made in both IAS 16 and IAS 2 *Inventories* to permit an accounting policy choice based on the "primary" use or source of income. However, it should be made clear that the accounting treatment follows in accordance with the primary standard. Similarly, the consequential impact on the cash flow statement category should follow in a consistent manner.

IAS 17 Leases

Question 11: Classification of leases of land and buildings

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?

We agree in principle with this proposal but the explanation for it in the Basis for Conclusions (BC1 - BC3) is not sufficient. It would be helpful if the reasoning behind the change could be more fully explained to avoid the possibility of inconsistency of application due to misunderstanding of the purpose of the amendment. Such clarity could be achieved by explaining the perceived inconsistency in IAS 17 as it stands.

We assume that the deleted wording may be perceived to elevate the "useful life" indicator of a finance lease (IAS 17.10(c)) to the status of a rule that overrides any other indicators in IAS 17.10-11. A consequence of the proposed amendment is that the land element of some leases currently classified as an operating lease may become a finance lease (based on the fair value indicator in IAS 17.10(d)). This in on the basis that for long land leases, the time value of money would reduce the residual value to a negligible amount.

However, this seems to contradict the view of the IFRIC, as expressed in their agenda decision published in IFRIC Update March 2006. The IFRIC also noted that, as summarised in IAS 17.BC 8, the Board itself had previously considered but rejected that approach in relation to the classification of leases of land and buildings, because ‘it would conflict with the criteria for lease classification in the Standard, which are based on the extent to which the risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee’.

Consequently the IFRIC concluded that a lease of land, irrespective of the lease term, is classified as an operating lease unless title is expected to pass to the lessee or significant risks and rewards associated with the land at the end of the lease term pass to the lessee. Although leases of land that do not transfer title are widespread, the IFRIC has not observed, and does not expect, significant diversity in practice.

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The proposed amendment could, therefore, represent a significant change in existing practice. If this is not the Board's intention, then this proposal does not represent an "improvement" to the existing standard and so should be discarded, on the grounds that there is no evidence to suggest that current practice is diverse or inappropriate.

If the Board decide to go ahead with the proposal, subject to suitably clear reasoning, then to clarify that the need to consider the land element and the building element separately is retained, we suggest adding a second "of the" to the amended last sentence of IAS 17.15. The paragraph would then read:

> "The classification of the land and of the building elements as finance or operating is made in accordance with paragraphs 7-13."

IAS 19 Employee Benefits

Question 14(a): Curtailments and negative past service cost

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 cost? If not, why?

We agree that the current definitions and treatment of negative past service costs and curtailments in IAS 19 are ambiguous and need amendment to provide greater clarity. The proposed amendments go some way to achieving this but fail to recognise that in some situations, an amendment to the plan can improve benefits but still result in a reduction in the obligation. For example, the plan could be amended to allow for a larger lump sum to be claimed on retirement.

Consequently we do not agree with the proposed addition of the last sentence to IAS 19.97: "Negative past service cost arises when an entity reduces the benefits attributable to past service under an existing defined benefit plan." We suggest that this is changed along the lines of:

> "Negative past service cost arises when an entity changes the benefits available to employees such that it reduces its benefit obligation attributable to past service under an existing defined benefit plan."

A similar amendment is needed to the definition of past service costs in IAS 19.7.

Question 16: Replacement of term "fall due"

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?

We have no objection with the replacement of the term "fall due". However, the proposal also deletes the term "wholly" from the definitions of short-term and long-term employee benefits. At present, the inclusion of the term "wholly" results in an obligation that is due to be settled partly within 12 months and partly beyond 12 months being classified as an "other long term benefit" in its entirety (and measured accordingly). The proposal would create an ambiguity as to whether bifurcation (into short-term and long-term) is required for benefits to which entitlement vests only partly within 12 months.

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IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

Question 19: Government loans with a below-market rate of interest

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?

We agree in principle with the proposed amendment. However, the proposed wording requires the benefit to be quantified by "the imputation of interest on the loan" and cross-refers to IAS 39 *Financial Instruments: Recognition and Measurement*. IAS 39 does not use the term "imputation of interest". We recommend that IAS 20.10A is reworded to be more consistent with IAS 39, along the following lines:

> The benefit of a government loan at a below-market rate of interest is treated as a government grant. The loan shall be recognised and measured in accordance with IAS 39 Financial Instruments: Recognition and Measurement. The benefit of the below-market rate of interest shall be measured as the difference between the initial carrying value of the loan determined in accordance with IAS 39 and the proceeds received. The benefit is accounted for in accordance with this Standard. The entity shall consider the conditions and obligations that have been, or must be, met when identifying the costs for which the benefit of the loan is intended to compensate.

IAS 27 Consolidated and Separate Financial Statements

Question 21: Measurement of subsidiary held for sale in separate financial statements

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 in principle with the proposed amendment. However, some investments in subsidiaries accounted for in accordance with IAS 39 can be measured at cost, not fair value. For example, if the investment does not have a quoted price in an active market and its fair value cannot be reliably measured. To avoid doubt, we suggest the words "in accordance with (a) above" are deleted and that the proposed amended paragraph reads

> ". . . However, when those investments that were accounted for at cost are classified as held for sale . . . ."

IAS 38 Intangible Assets

Question 28(a): Advertising and promotional activities

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): Advertising and promotional activities

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?

We do not support this amendment. We agree with the view of Mr Leisenring that guidance relating to the supply of goods should not be introduced into the standard on intangible assets. The proposed amendment is not in our view sufficiently supported by the arguments set out in the Basis for Conclusions.

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The issue that the Board is trying to address is broad in that it touches on any type of actual or possible asset that is not specifically addressed in IFRS. Although the Basis for Conclusions discusses the goods or services to be used in advertising and promotional activities, the proposal is not limited to such activities. In our view this is too complex and far-reaching to deal with in the context of this annual improvements process. We recommend that the Board remove this issue from the process and deal with it as a separate project.

Moreover, we do not believe that the proposed amendment in IAS 38.69 to replace "as incurred" with "has access to those goods" or "when it receives those services" is any clearer than the existing terminology. For example, in the design of a magazine or television advertising campaign a number of services are procured over what can be a lengthy period. These services may include graphic design, artwork, photography, modelling/acting, film production, editing, etc. The end product may be the photographs or a film strip or other storage device on which the advertisement is contained. Should the expense be recognised as the services contributing to the end product are carried out or when the photographs/film strips are delivered to the purchaser? If the supplier does not deliver the physical products to the purchaser but instead holds them for distribution to the magazine publisher or television broadcaster, when is the expense recognised?

IAS 39 Financial Instruments: Recognition and Measurement

Question 30: Definition of a derivative

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?

Although we agree that the proposed amendment will address a significant interpretational uncertainty we believe that it has wider implications and so should not be progressed as part of this project. We believe that the proposed amendment may broaden the definition of derivatives substantially. This is especially the case in view of IAS 39's requirements on embedded derivatives. For example, a technology licensing agreement with payments due to the licensor based on production volumes would (in our view) be outside the scope of IAS 39 at present because "production volume" is a non financial variable specific to the licencee. The amendment could "capture" many other contracts currently outside the scope of IAS 39, such as royalty arrangements (currently within IAS 18) and some service concession arrangements (IFRIC 12).

Consequently, we believe that the Board should consider this amendment and its possible implications outside the scope of the annual improvements process. There needs to be a more in-depth review and discussion to identify a clear principle as to when derivatives should be recognised in accordance with IAS 39 and when they should be excluded from its scope.

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Question 34: Treating loan prepayment penalties as closely related embedded derivatives

Do you agree with the proposal to amend paragraph 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(a), are closely related to the host debt contract? If not, why?

We agree that paragraph AG30(g) should be amended. The existing form of words is unsatisfactory in that it seems to require separation of an embedded derivative in order to determine if separation is required. We also agree that a prepayment option, the exercise price of which ensures that the lender receives a lender's rate of return in the event of prepayment, should be regarded a closely-related. However, we find the proposed amendment unduly complex and unclear. Consequently, we suggest that the proposed amendment is modified as follows:

> "However, a prepayment option for which the exercise price compensates the lender for loss of interest is closely related to the host contract."

IAS 41 Agriculture

Question 39: Discount rate for fair value calculations

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?

Yes. Many valuation approaches use a post-tax discount rate applied to expected after-tax cash flows to determine fair value. This is consistent with the notion of a willing buyer and willing seller. However, we believe that the explanation in BC8 could be improved by incorporating wording similar to that in IAS 40.43. This more clearly explains why the specific tax circumstances of either entity are disregarded.

Question 40: Additional biological transformation

Do you agree with the proposal to remove the exclusion of 'additional biological transformation' from paragraph 21 of IAS 41? If not, why?

Yes. We agree with the amendment to IAS 40.21 and the related amendment to IAS 41.17 (inserting the words "in its present location and condition"). This is consistent with other IFRSs, which deal with conditions that exist at the reporting date. Where there is no market for the assets in their present condition, taking into account the cash flows involved in bringing the assets to market is consistent with the notion of net realisable value in IAS 2 *Inventories*.

We are concerned that some may see this amendment as a change in principle for the valuation of other assets using discounted cash flow techniques such as land with planning permission for future development. It is clear from IAS 40.51 that the fair value should be based on the potential to sell the land in its undeveloped state - it should not be based on the expected value after development (less costs to develop). It would be helpful if the Board could make it clearer in the Basis for Conclusions that the removal of the perceived prohibition on taking into account cash flows associated with future activities to enhance the value is restricted to assets for which there is no active market in their present condition.

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