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Professor Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
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Our ref MT/288
Contact Mary Tokar

11 January 2008

Dear Sir David

Exposure Draft of *Proposed Improvements to International Financial Reporting Standards*

We appreciate the opportunity to comment on the International Accounting Standards Board's (IASB, the Board) Exposure Draft of *Proposed Improvements to International Financial Reporting Standards* (the ED). This letter expresses the views of the international network of KPMG member firms.

We agree with the IASB's approach to deal with minor but necessary improvements by aggregating them into a single exposure document. However, we encourage the IASB to consider in the next one to two years whether the number of amendments that results from this approach is at expectation when considering the cost involved.

This covering letter contains our overall comments on the ED. In addition:

- Appendix 1 contains our detailed responses to the proposals with which we have fundamental concerns. In some cases our concern may be not with the specifics of the proposal but rather with trying to make the change as an annual improvements item. This may be because the change, though limited in the number of words, is not minor conceptually or for other reasons. For each we have sought to explain our concern.

- Appendix 2 contains our detailed responses to the proposals that generally we support, but for which we have further comments or suggestions.

- Appendix 3 lists the proposals that we support without comments or suggestions.

Use of the term "clarify"

We note that a number of proposals contained in the ED state the intention to "clarify" existing items in IFRSs. We believe that using the word "clarify" in these circumstances might be taken by some to imply that an entity would be correcting an error when it adopts the proposed changes. We believe that it is more likely that the Board meant to state that it is clarifying the intention of the IASB when the original standard was drafted, and a revision to the final IFRS by the Board to better reflect such intention is recommended.

Early application

We understand that, in certain circumstances, it may be necessary for the Board to link the adoption period of one standard to the adoption period of another standard, for example, by linking the adoption of the amendments to IFRS 3 *Business Combinations* with the adoption of the amendments to IAS 27 *Consolidated and Separate Financial Statements* that are both a result of the second phase of the Business Combinations project.

The Board proposed in the ED that early application of the proposals also requires the adoption of IAS 1 *Presentation of Financial Statements* (as revised in 2007). We believe that the ED does not provide a sufficient explanation as to why the adoption of these separate projects is linked. We recommend that the Board either explains the link between the two projects or removes the requirement that early adoption of the proposals would be permitted only when the revised IAS 1 is adopted in the same period.

Proposal 4: IAS 1 – Statement of compliance with IFRSs

We have submitted under separate cover dated 11 January 2008 a comment letter about the IAS 1 proposal regarding the statement of compliance with IFRSs. A copy of this IAS 1 comment letter has been included as Appendix 4 to this letter.

General principles

Our comments on the proposals consider the Board's objectives of the annual improvements project, in that the amendments should be non-urgent, minor but necessary. We recommend that if there is a significant level of dissent within the Board regarding a certain proposal, then the Board should consider if that proposal meets the criteria to be included within the annual improvements project, even if technically there is sufficient support for the proposed amendment.

Please contact Mary Tokar or Regina Croucher at +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited

Appendix 1

Appendix 1 contains our detailed responses to the proposals with which we have fundamental concerns. In some cases our concern may be not with the specifics of the proposal but rather with trying to make the change as an annual improvements item. This may be because the change, though limited in the number of words, is not minor conceptually or for other reasons. For each we have sought to explain our concern.

Proposal 11: IAS 17 *Leases* – Classification of leases of land and buildings

Proposal 11 is to amend IAS 17 by deleting IAS 17.14 and rewording IAS 17.15 to state that the classification of land and building elements should be based on the general classification guidance in IAS 17, which would essentially remove the land classification guidance.

We do not support the proposal to amend IAS 17 by deleting IAS 17.14 and rewording IAS 17.15. We understand that practice in this area was influenced by the International Financial Reporting Interpretations Committee (IFRIC) agenda decision on IAS 17 (March 2006, *IFRIC Update*), in light of which long leases of land, including for example fully prepaid 999-year leases of land, generally are classified as operating leases. We believe that the proposed amendment would result in a major change to the current application of IAS 17. Consequently, we believe that this is not a "minor" amendment and therefore should be outside the scope of the annual improvements project.

Since the Board already has begun revisiting the accounting model for leases under IAS 17, we do not recommend taking this proposal forward as a separate amendment outside of the annual improvements project, as we expect that the costs of doing so would outweigh the benefits.

If the Board decides to proceed with the proposed amendment, then we recommend the following:

- The Board should make a clear statement that this is a change in the requirements of IAS 17, and that any resulting changes in lease classification should be accounted for as a change in accounting policy in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

- The Board should clarify the principles to be used when determining the classification of a leasehold interest in land in situations in which the title is not transferred at the end of the lease. While generally we would not wish the Board to issue additional guidance in this manner, in this case we believe the position otherwise would remain unclear, given the IFRIC agenda decision referred to above.

- The Board should explain which transactions it expects to be affected by the proposed amendment, e.g., the example of a 999-year lease of land was discussed in the Observer Notes for the Board's deliberations but is not referred to in the basis for conclusion. In this discussion it should be clear whether or not the Board would distinguish between 999-year leases and other long-term leases of a shorter duration (e.g., 100-year leases) and, if so, on what basis the distinction would be made.

- The Board should delete IAS 17.BC8, as it conflicts with the proposed amendment.

Proposal 14: IAS 19 *Employee Benefits* – Curtailments and negative past service cost

Proposal 14 is to amend IAS 19 to provide guidance on the accounting for plan amendments when both past and future services are impacted. In addition, the proposal amends IAS 19.111 to eliminate references to materiality and, in two instances, to substitute "material" with "significant".

We do not support the proposal to amend IAS 19 in respect of plan amendments. The Board acknowledged in the proposed amendment that "ambiguous definitions of negative past service costs and curtailments have resulted in diverse accounting for plan amendments that reduce existing benefits" and it had previously accepted the ambiguity (IAS 19.BC62). We therefore believe that the proposal is not appropriate for the annual improvements project. Considering known diversity in practice that previously had been accepted, we believe that it is not appropriate to characterise the proposed amendment as a "minor amendment". This is supported by the fact that IFRIC did not take the issue onto its agenda (May 2007, *IFRIC Update*) and referred it to the Board for consideration in its employee benefits project. Also, in light of differences in practice, we believe that full retrospective application might be difficult, especially in cases in which the "corridor" method was applied by an entity.

Further, we disagree with the proposed clarification that when a plan amendment reduces benefits for future service, the reduction relating to the future service is a curtailment and any reduction relating to past service is negative past service cost. We believe that this approach is inconsistent with the attribution of benefits to years of service under IAS 19. In particular, we are concerned that the proposal is inconsistent with the Projected Unit Credit Method under IAS 19, as under the proposal future salary increases would be viewed as an element of future service benefits, rather than a remeasurement of past service benefits. We also note that this issue interacts with IFRIC deliberations on allocation of future salary increases (September 2007, *IFRIC Update)*. For these reasons, we believe that the Board should reconsider whether this proposed amendment should be made as part of the annual improvements project.

If, however, the Board does not agree with our recommendation and decides to proceed with the proposed amendment, then we believe that, at a minimum, guidance and examples would be required on how to bifurcate plan amendments into past and future components as there is no guidance to this effect currently available in IAS 19.

With respect to the Board's proposal to delete the reference to materiality in IAS 19.111, we support the deletion of the sentence from IAS 19.111 as proposed. However, we do not support amending IAS 19.111(a) and (b) to replace "material" (a defined term) with "significant" (an undefined term). We believe that this may cause diversity in practice.

Proposal 16: IAS 19 – Replacement of term "fall due"

Proposal 16 is to amend IAS 19 to replace the term "fall due" in the definitions of short-term employee benefits and other long-term employee benefits to reflect the notion of employee entitlement.

We are concerned that it is not clear what the Board intends by "entitlement". We believe that it can be read by some as benefits having been "earned" and also interpreted by others as "entitled to require settlement". This is further highlighted by the fact that the proposal does not remove existing conflicts between the definitions of short-term employee benefits and other long-term employee benefits and the corresponding examples. We believe that the current proposal does not satisfy the objective of removing conflicts between the definitions and the examples in order to achieve consistent classification of short-term and long-term employee benefits. In addition, we are concerned that the declared focus solely on "entitlement" potentially may have a significant impact in practice in some cases considering that examples in IAS 19 continue to use "settlement" as a criteria. We outline our concerns in more detail below and address our interrelated concerns regarding the term *"end of period"* in the definitions and regarding whether a plan is assessed in its *entirety* for classification purposes or if benefits can be segregated.

Given our comments below, we believe that the proposed amendment should not be within the scope of the annual improvements project. Instead we believe that it would be appropriate to address the issues identified as part of the employee benefits project. However, if the Board decides to proceed with the proposed amendment, at a minimum, we believe that inconsistencies within IAS 19, as noted below, should be eliminated.

Term "entitled" and conflicts between definitions and examples

The Board states in IAS 19.BC4 of the proposed amendment that "it is the timing of the employees entitlement to the benefit rather than the expected timing of settlement that is the critical factor in classifying the benefit", yet the proposed amendment to IAS 19.8(b) still retains two criteria, i.e., the notion of entitlement ("employees are entitled") and the notion of "occurrence" ("absences occurring within 12 months"). As such, we are concerned that the example provided in IAS 19.8(b) is still inconsistent with the definition in IAS 19.7 and that this may lead to different classifications of similar plans.

It is unclear what the Board means by "entitled". Some read it in the context of IAS 19.8(b) as meaning that benefits have been *earned* but that settlement *occurs* later, i.e., either because there is an additional vesting period or because settlement is deferred by agreement or at the discretion of the employer, employee or both. Others believe that it was the intention of the Board to focus on entitlement *to require settlement*. This is of practical significance since for example an annual bonus plan under which payment is deferred for more than one year would be classified as a short-term employee benefit under the "earned" reading of the IAS 19.7 definition (benefit is "earned" under the plan formula) but not when applying the example in IAS 19.8(b) since settlement does not "occur" for more than twelve months. If the Board intended to focus on a right to receive settlement and decides to proceed with the proposed amendment, we believe, as a result, that the definition of short-term employee benefits should be amended to read "...of which the employee is entitled to require settlement within twelve months..." and that the definition for other long-term employee benefits and the examples should be amended accordingly.

As noted above, the proposed definitions only use the notion of employee entitlement as classification criteria. In contrast, examples provided for short-term and long-term employee benefits still use the notion of occurrence or settlement, thus indicating that other criteria have to be met. In addition to IAS 19.8(b) as outlined above, the following paragraphs continue to focus on "actual or expected settlement" rather than only on "entitlement":

- IAS 19.22 refers to "due wholly within 12 months";
- IAS 19.8(c) and 126(d) use the term "payable"; and
- IAS 19.126(e) uses the phrase "deferred compensation paid twelve months or more after the end of the period in which it is earned".

We believe that there should be a clear principle governing the classification of short-term and long-term employee benefits that is consistently applied throughout IAS 19, both in the definitions and examples.

Since the examples cited use the "settlement" notion and this may have been applied in classifying plans, we believe that the practical impact of the focus on "entitlement" (meaning able to require settlement) may potentially have a significant impact in some cases; therefore, we believe that the Board should assess that impact.

Term "end of period" and assessment of a plan in its entirety

In addition, we draw the Board's attention to the following interrelated issues when applying the definitions and examples, through an example provided below.

Consider a three-year annual bonus scheme under which employees receive a bonus based on the financial performance of an entity in the financial year. However, bonuses are paid only after two more years if employees stay in employment with the entity. The plan is designed to provide an incentive for employees to remain committed to the entity.

Under the current as well as the amended definitions, questions arise with respect to the interpretation of the phrase "the *end of the period* in which the employees render the related service" (IAS 19.7) [emphasis added]. One could argue that the service period is not the one-year period but the entire three-year period since the employee is required to stay in employment in order to receive the benefit. If this was the interpretation, then the whole benefit would be classified as a short-term benefit and the cost accrued over a three-year period. Alternatively, if "end of the period" is interpreted to mean the financial year, then the benefit for service in the first two years would be classified as a long-term employee benefit and the third year as a short-term employee benefit. However, we believe that a plan should be assessed in its *entirety* and therefore a split approach would not be appropriate; otherwise, this would lead to inconsistent measurement within a single scheme (accrual method for the short-term portion and Projected Unit Credit method for the long-term portion). We believe that a single scheme should not be split into short-term and long-term portions but classification should be assessed for the scheme as a whole. Considering the above, we believe that it is necessary to clarify that the "end of the period" refers to *reporting* period and that such a scheme should be assessed in its entirety at the introduction of the plan to achieve consistent classification.

Proposal 28: IAS 38 *Intangible Assets* – Advertising and promotional activities

Proposal 28 is to amend IAS 38 to clarify the meaning of "as incurred" by providing guidance that an entity may recognise a prepayment for goods or services as an asset until that entity has access to the goods or has received the services.

We do not support the proposal to amend IAS 38.69 to clarify that "as incurred" means "when the entity receives the goods or services". We believe that this proposed amendment may have wider implications and might result in a significant change in practice, as explained below.

We believe that expensing goods or services intended to be used for advertising and promotional activities when the entity has access to the goods or has received the services may not be the only answer. We believe that all facts and circumstances should be analysed before reaching this conclusion. For example, if an entity produces a catalogue every year for its new range of products then, we believe, the costs of preparing and producing the catalogue could be recognised as prepaid expenses and recognised in profit or loss as the catalogues are distributed to customers. This would be consistent with current practice for many entities.

We believe that IAS 38.69 should be explained further through a simple amendment to IAS 38.70 as follows:

> *Paragraph 68 does not preclude recognising a prepayment as an asset when payment for the delivery of goods or services has been made in advance of the delivery of goods or the rendering of services to that entity. Similarly, it does not preclude recognising an asset for costs incurred in respect of, for example, training, and advertising or promotional activities until the date on which those activities occur, for example through the delivery of training, the distribution of publications or the exhibition of advertising.*

Proposal 30: IAS 39 *Financial Instruments: Recognition and Measurement* – Definition of a derivative

Proposal 30 is to amend IAS 39 to remove from the definition of a derivative the exclusion for contracts linked to non-financial variables that are specific to a party to the contract. Essentially the amendment would result in contracts linked to non-financial variables that are specific to a party to the contract, that are within the scope of IAS 39, being classified as derivatives.

We do not support 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. We note that such an exclusion has been used in practice, e.g., for contracts linked to EBITDA, revenues etc., based on the existing guidance in IAS 39, For example, consider a joint venture agreement that contains a condition whereby if the assets of one of the venturers outperform as compared to the original business plan, then the venturer may exercise the right to purchase up to 10 percent of the capital held by the other venturer. In this scenario we believe that accounting for such agreements as derivative instruments would result in significant measurement difficulties and fails to capture the economic substance of the agreements. Further, the proposal would create a difference with U.S. Generally Accepted Accounting Principles where one does not exist currently. Consequently, we believe that this is not a "minor" amendment and therefore would be outside of the scope of the annual improvements project.

Appendix 2

Appendix 2 contains our detailed responses to the proposals that generally we support, but for which we have further comments or suggestions.

Proposal 1: IFRS 1 *First-time Adoption of International Financial Reporting Standards* – Restructuring of IFRS 1

We support the proposed restructuring of IFRS 1, including the minor wording changes. However, we believe that the Board should consider the following additional minor changes:

- We believe that IFRS 1.B3 is confusing when it says "...an entity may apply the derecognition requirements in IAS 39 retrospectively from..." We believe that the sentence would read better if "retrospectively" is changed to "prospectively".

- IFRS 1.D2 and D3 include references to 1 January 2005, which can be deleted if the effective date of the revised standard is 1 January 2009.

Proposal 2: IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* – Plan to sell the controlling interest in a subsidiary

Generally we support the proposal to amend IFRS 5 to address the classification of assets and liabilities of a subsidiary when a parent company has a sale plan involving loss of control of that subsidiary. However, we believe that the guidance in IFRS 5.8A, BC2 and BC3, as currently drafted, implies that "loss of control" as determined under IAS 27 occurs on the date that an entity commits to a sale plan. As there can be a significant time lag between the date when a parent company commits to a sale plan of a subsidiary and when the parent company actually loses control, in accordance with IAS 27, of that subsidiary, we recommend that the Board considers expanding the basis for conclusion to explain how "loss of control" correlates with the commitment date for a sale plan. In addition, we believe that IFRS 5.8A should be amended to refer to the criteria in IFRS 5.7 and 8 as such criteria (e.g., available for immediate sale) also has to be met in order to achieve the held for sale classification.

Proposal 3: IFRS 7 *Financial Instruments: Disclosures* – Presentation of finance costs

Generally we support the proposal to amend the potential conflict between IAS 1 and IFRS 7.IG13 by removing the reference to "total interest income" and "non-financial assets" as forming part of finance costs. However, we recommend that the Board considers, as an alternative to removing the reference to "total interest income" and "non-financial assets", the inclusion of a reference to IAS 1.81(a) within IFRS 7.IG13, and mentions that total interest income is a component of revenue which should be disclosed separately from total interest expense. This additional wording would act as Implementation Guidance to the requirements in IFRS 7.20(b) in its entirety, rather than just address the expense side.

Proposal 5: IAS 1 – Current / non-current classification of convertible instruments

Generally we support the proposal to amend IAS 1 so that the potential conversion of a liability into equity does not affect the classification of such liability as current or non-current; instead, the timing of any cash settlement would be the key determinant for classification. However, we believe that the current drafting does not adequately capture what we believe is the Board's intention with regard to this proposed amendment.

The amendment proposed is to insert "by the transfer of cash or other assets" into IAS 1.69(d). We note that paragraph 62 of the *Framework* mentions various ways in which a liability might be settled other than by the conversion of the liability to equity or the transfer of cash or other assets – by services being provided, exchange for another liability or extinguishment by other means. Settlement by performance, for example, may affect the entity's solvency by the utilisation of cash resources and it therefore seems inconsistent for such other means of settlement also not to lead to current classification. We believe that a liability should be classified as current whenever the entity cannot unconditionally avoid settlement within the next twelve months, other than in situations in which the settlement will be by the issue of a fixed number of equity shares. In addition, we believe that this exemption should be only for situations in which there is a fixed number of equity shares and not in situations in which there is settlement into a variable number of equity shares for a fixed monetary amount, as settlement into a variable number of equity shares for a fixed monetary amount is tantamount to settlement in cash.

We believe that the proposed amendment should be revised to exclude settlement by the issue of a fixed number of equity shares and recommend the following revised wording for IAS 1.69(d) as proposed in the ED:

> *...it does not have the unconditional right to defer settlement of the liability for at least twelve months after the reporting period<u>, except when the settlement is by the issue of a fixed number of equity shares, which does not affect classification</u>.*

Proposal 7: IAS 8 – Status of implementation guidance

Generally we support the proposal to amend IAS 8 to clarify the status of Implementation Guidance. However, we are concerned that the proposed deletion from IAS 8.7 of the statement that entities "consider" Implementation Guidance, and the insertion into IAS 8.9 of a statement that Implementation Guidance "is not mandatory", could be read as a deliberate move by the Board to reduce the interpretive weight carried by Implementation Guidance, and not just a clarification.

In practice, the interpretive weight carried by Implementation Guidance varies between standards and is dependent on the context. In some cases, when the Implementation Guidance provides a full description of a specific situation, the approach set out in Implementation Guidance may represent the only sustainable interpretation of the standard. For example, in our experience, entities do not deviate from the Implementation Guidance in IAS 39 unless the facts and circumstances are clearly different to those described in that guidance. However, the proposed amendments could be misinterpreted as an attempt by the Board to change practice and so reduce comparability in such circumstances.

Instead, we suggest that the Board retains IAS 8.7 unamended and does not add the proposed final two sentences to IAS 8.9. We consider that this more limited amendment, which retains the existing statement that Implementation Guidance "does not form part of IFRSs, and therefore does not contain requirements for financial statements", still meets the Board's intention of the proposed amendment while avoiding potential changes in established practice.

Proposal 8: IAS 10 *Events after the Reporting Period* – Dividends declared after the end of the reporting period

Generally we support the proposal to amend IAS 10 to provide a basis as to why a dividend declared after the reporting period does not result in the recognition of a liability in order to resolve potentially conflicting guidance implying a constructive obligation.

We agree with the Board's statement in IAS 10.BC2 that an established pattern of paying dividends does not create a constructive obligation for future dividends prior to these dividends being declared. Therefore, we generally are supportive of the Board's objective and proposed amendments. However, our discussion of the Board's proposed amendment identified a related issue that we wish to highlight relating to dividends that do not require shareholder approval, such as many interim dividends. In these cases we believe that announcement of the intention to pay a specific dividend could be viewed as an obligation even if management could, in theory, reverse its decision prior to the payment date. We agree that a decision that has not been communicated would not create an obligation.

Proposal 10: IAS 16 *Property, Plant and Equipment* – Sale of assets held for rental

Generally we support the proposal to amend IAS 16 and IAS 7 *Cash Flow Statements* to address presentation issues relating to the sale of assets previously held for rental. However, we believe that this proposed amendment may result in changes in practice for some entities. If the Board receives a significant level of comments regarding the appropriateness of the proposed amendment as an annual improvements item, then we believe that the Board should reconsider whether this proposed amendment should be made as part of the annual improvements project.

If the Board decides to proceed with the proposed amendment, then while we accept that the proposed amendment is practical rather than conceptual in nature, we have the following specific comments to revise the proposed amendments to incorporate the language and principles of related IFRSs:

- We support the proposed amendment focusing on whether disposal of an asset generates revenue under the principles of IAS 18 *Revenue*. That is, a disposal will generate revenue when the transaction occurs "in the course of the ordinary activities of an entity". As such, judgement will be required to assess whether a disposal occurs in the course of an entity's "ordinary activities". It remains possible that an entity may dispose of an asset previously held for rental and record a gain rather than revenue. We recommend that this point is stated explicitly in the basis for conclusion.

- We disagree with the use of the word "routinely" in IAS 16.68A, as this word is not used in IAS 18. It is possible that a lessor will "routinely" seek to recover the residual value of its assets at the end of a lease term, without this being part of its "ordinary activities". We recommend that IAS 16.68A be redrafted to use the language in IAS 16.BC4, as this more accurately reflects the principles of IAS 18.

- We disagree with the use of the phrase "held for sale" in IAS 7.14 and IAS 16.68A, as this phrase has a specific meaning in IFRS 5 which we believe is not what was intended by the Board in this case. Instead, we propose the use of "held for resale", as per IAS 18.3.

- At present there is no substantive basis for conclusion explaining the proposed amendment to IAS 7, beyond a description of the proposed amendment in IAS 16.BC6. We are unclear as to whether the proposed amendment to IAS 7 is intended as an anti-avoidance measure, and the extent of the linkage between the proposed amendments to IAS 7 and IAS 16. For example, is classification of the cash outflow on the acquisition of a rental asset as operating a condition for subsequent recognition of revenue on disposal of that rental asset? Or, if the cash outflow is classified as investing initially, then does recognition of revenue on disposal trigger a requirement to retrospectively revise the previously reported cash flow statement? As we believe that this is unclear, we recommend that the Board provides the rationale for the proposed amendment to IAS 7 in the basis for conclusion.

- We are unclear as to why the Board is proposing to amend the requirements on disposal of property, plant and equipment (PPE) held for rental without conforming the requirements for PPE and investment properties. By definition, many investment properties are held for rental, and in practice many investment property companies hold separate portfolios of properties for investment and trading purposes. However, we understand that it will remain possible to transfer an investment property to inventory only on "commencement of development with a view to sale" (IAS 40.57(b)). We recommend that the Board considers limiting the proposed amendment to plant and equipment only so that transfers of property to inventory under IAS 16 and transfers of investment property to inventory under IAS 40 *Investment Property* are treated in a similar manner.

Proposal 12: IAS 17 – Contingent rents

Generally we support the proposal to amend IAS 17 to explicitly state the accounting for contingent rents by lessees and lessors under operating leases, and by lessors under finance leases. However, we consider that accounting for contingent rents is, and will remain, a complex area in practice and have the following additional comments:

- The proposed amendment to the main body of the standard states that lessors should recognise contingent rent as "earned" and lessees should recognise contingent rent as "incurred"; IAS 17.BC5 does not differentiate between lessors and lessees in stating that contingent rent should be recognised as "incurred". We are unclear as to whether "incurred" and "earned" are intended to be complements, and whether the Board is seeking to achieve symmetry between lessees and lessors in relation to contingent rents. If this is not the case, then we recommend that the Board conforms the language in IAS 17.BC5 with the proposed amendments to the main body of the standard.

- In any case, the meaning of "incurred" is not always clear in practice. There are a variety of common forms of lease payment under which the resolution of a single contingency affects lease payments in a number of periods, e.g., tax variation clauses, rentals subject to cumulative indexation, upwards only rent reviews in property leases etc. In such cases, questions can arise as to whether all resultant changes in lease payments have been "incurred" in the period when the contingency is resolved. It may be appropriate to consider whether a clearer phrase than "incurred" can be found. For example, we assume that the Board intended something similar to "contingent rent shall be recognised as an expense in the period to which it relates, once that portion of the rent is no longer contingent".

- The basis for conclusion refers only to the proposed amendment in relation to contingent rents under operating leases, whereas the proposed amendment relates also to the treatment of contingent rent by lessors under finance leases. We recommend that the basis for conclusion addresses all of the proposed amendment.

- IAS 17.BC4 of the proposed amendment states that IAS 17 specifies the required accounting for contingent rents under operating leases but that these requirements are not applied in practice. We believe that the suggestion that there is widespread and wilful non-compliance with the requirements of IAS 17 is incorrect and inappropriate. We recommend that the basis for conclusion be redrafted to acknowledge the difficulties that users have encountered in seeking to apply an ambiguously drafted standard.

Proposal 13: IAS 18 – Costs of originating a loan

Generally we support the proposal to amend the guidance accompanying IAS 18 that aims to align the description of transaction costs with the definition of transaction costs in IAS 39 and, we believe, with the requirement of IAS 18.A14(b)(iii).

However, we note that some might consider that the proposed amendment may lead to an inconsistency with IAS 11 *Construction Contracts*, another revenue recognition standard. IAS 11.21 defines contract costs as directly attributable and does not require them to be incremental. Therefore, under IAS 11.21 there is no requirement for pre-contract costs to be incremental. The argument about inconsistency is supported further by the fact that IFRIC (August 2002, *IFRIC Update)* stated that IAS 11.21 can be used for analogous circumstances.

Therefore, we recommend that the Board considers expanding the basis for conclusion to explain why the costs incurred in originating a financial asset for transactions within the scope of IAS 18 should not be analogised with pre-contract costs under IAS 11.

Proposal 15: IAS 19 – Plan administration costs

Generally we support the proposal to amend the definition of "return on plan assets" in IAS 19.17 to require the deduction of plan administration costs other than those reflected in the measurement of the defined benefit obligation, as it eliminates existing inconsistency within the standard. However, we note that the proposed amendment is incomplete as it does not propose to amend current IAS 19.BC75, which states that all plan administration costs are deducted in determining the return on plan assets. In addition, we believe that in IAS 19.BC2 of the ED, the phrase "only to the extent that" might be read as implying a preference for treatment of the costs as part of the defined benefit obligation. We do not believe that such preference is appropriate or intended.

In addition, we believe that additional clarification is required with regard to taxes payable by the plan. The definition of return on plan assets in IAS 19.7 treats taxes payable the same way as plan administration costs. However, IAS 19.107 refers to administration costs only. By inserting a new phrase in IAS 19.7 before taxes payable, the Board seems to indicate different treatment for taxes payable, i.e., taxes payable by a plan cannot be included in the measurement of the defined benefit obligation, even though plan administration costs could. The current definition does not envisage different treatment and the proposal does not explicitly indicate that the Board intended to introduce a change.

As such, we recommend that the Board considers expanding the proposed amendment to explain whether the treatment of "taxes payable by the plan" differs from plan administration costs, taking into account current practice.

Proposal 26: IAS 34 *Interim Financial Reporting* – Earnings per share disclosures in interim financial reports

Generally we support the proposal to amend IAS 34.11 to require the presentation of basic and diluted earnings per share only when an entity is within the scope of IAS 33 *Earnings per Share*. However, we recommend that the wording of IAS 33.11 mirrors the wording of IAS 34.16(g) in respect of segment information.

Additionally, we recommend that the Board considers expanding IAS 34.11 to require the disclosure of basic and diluted earnings per share in respect of continuing operations when necessary for an understanding of the interim period. This would align IAS 34 better with IAS 33.

Proposal 27: IAS 36 *Impairment of Assets* – Disclosure of estimates used to determine recoverable amount

Generally we support the proposal to amend the disclosure requirements in respect of cash-generating units (CGUs) for which the recoverable amount is based on fair value less costs to sell, when that fair value was determined using discounted cash flows.

However, we note that the proposal might be read as removing the requirement in the introduction to IAS 36.134(e) to disclose the methodology used to determine fair value less costs to sell. We recommend that the proposal be revised so that it is clear that this disclosure is maintained.

Additionally, by limiting the proposed amendment to IAS 36.134 we note that the proposal affects only those instances in which the CGU includes significant amounts of allocated goodwill or indefinite-lived intangible assets. We recommend also amending IAS 36.130(f) to require disclosure of the current and any previous discount rate when a material impairment is based on a recoverable amount determined using discounted cash flows to estimate fair value less costs to sell; this will align the disclosure with IAS 36.130(g) in respect of value in use.

Proposal 31: IAS 39 – Reclassification of financial instruments into or out of the classification of at fair value through profit or loss

Generally we support the proposal to amend IAS 39 to reflect that only derivatives that become or cease to be designated as effective hedging instruments can be transferred into or out of the fair value through profit or loss category after initial recognition.

However, we believe that there is one other change in circumstances that does not represent reclassifications into or out of the fair value through profit or loss category. When loans become part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit taking, those loans should be reclassified into the fair value through profit or loss category. Therefore, we recommend that the Board considers amending the proposed IAS 39.50A to reflect these circumstances.

Proposal 34: IAS 39 – Treating loan prepayment penalties as closely related embedded derivatives

Generally we support the proposal to remove the apparent inconsistency between IAS 39.AG30(g) and AG33(a) with respect to embedded prepayment options. However, IAS 39.AG33(a) includes a wider range of prepayment options than the narrow one included in the proposed amendment. Therefore, we recommend that the Board considers broadening the proposed amendment to cover situations in which prepayment options meet the requirements in IAS 39.AG33(a) so as to permit these other items to be considered closely related to the host contract.

Proposal 35: IAS 40 – Property under construction or development for future use as investment property

Generally we support the proposal to amend IAS 16 and IAS 40 to require that investment property under construction be accounted for under IAS 40. However, we believe that this proposed amendment may not meet the objectives of the annual improvements project as it would result in a significant change in the standards. In addition, we believe that the proposed amendment may result in significant changes in current practice, as an entity would not be able to use the revaluation model (fair value through equity treatment) for investment property under construction, which is allowed for PPE within the scope of IAS 16. If the Board receives a significant level of comments regarding the appropriateness of the proposed amendment as an annual improvements item, then we believe that the Board should reconsider whether this proposed amendment should be made as part of the annual improvements project.

If the Board decides to proceed with the proposed amendment, then we recommend the following:

- The Board should not delete IAS 40.22 in full, as the guidance in this paragraph continues to be relevant for the determination of the cost of investment property. Instead, we recommend that IAS 40.22 be redrafted to state that entities should apply the requirements of IAS 16.16 - 25 in order to determine the cost of investment property.

- The Board should reconsider IAS 40.51, which states that the fair value of an investment property does not reflect future capital expenditure and related benefits. We are concerned that this paragraph could be read to mean that the fair value of an investment property under construction should not reflect the costs and benefits of completing construction, even if a market participant would acquire the property with the intention of completing construction. It is our understanding that market participants normally take such costs and benefits into consideration when determining the fair value of investment properties under construction, and those costs and benefits generally are included in valuation models that use a discounted cash flow approach.

- The Board should delete IAS 40.65, which addresses the accounting treatment upon completion of the construction or development of a self-constructed investment property, which is to be measured at fair value, as it would no longer be relevant.

- The Board should delete IAS 40.BC16 - BC20, which discuss why investment properties under construction should not be measured at fair value, as these paragraphs would no longer be relevant.

Appendix 3

We support the following proposals without comments or suggestions:

- Proposal 6: IAS 1 – Current / non-current classification of derivatives
- Proposal 9: IAS 16 – Recoverable amount
- Proposal 17: IAS 19 – Guidance on contingent liabilities
- Proposal 18: IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* – Consistency of terminology with other IFRSs
- Proposal 19: IAS 20 – Government loans with a below-market rate of interest
- Proposal 20: IAS 23 *Borrowing Costs* – Components of borrowing costs
- Proposal 21: IAS 27 – Measurement of subsidiary held for sale in separate financial statements
- Proposal 22: IAS 28 *Investments in Associates* – Required disclosures when investments in associates are accounted for at fair value through profit or loss
- Proposal 23: IAS 28 – Impairment of investment in associate
- Proposal 24: IAS 29 *Financial Reporting in Hyperinflationary Economies* – Consistency of terminology with other IFRSs
- Proposal 25: IAS 31 *Interests in Joint Ventures* – Required disclosures when interests in jointly controlled entities are accounted for at fair value through profit or loss
- Proposal 29: IAS 38 – Unit of production method of amortisation
- Proposal 32: IAS 39 – Designating and documenting hedges at the segment level
- Proposal 33: IAS 39 – Applicable effective interest rate on cessation of fair value hedge accounting
- Proposal 36: IAS 40 – Consistency of terminology with IAS 8
- Proposal 37: IAS 40 – Investment property held under lease
- Proposal 38: IAS 41 *Agriculture* – Point-of-sale costs
- Proposal 39: IAS 41 – Discount rate for fair value calculations
- Proposal 40: IAS 41 – Additional biological transformation
- Proposal 41: IAS 41 – Examples of agricultural produce and products

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Appendix 4

Professor Sir David Tweedie
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Our ref MT/288

Contact Mary Tokar

11 January 2008

Dear David

Annual improvements to IFRSs: compliance with IFRSs

In addition to responding generally to the IASB's proposed amendments to IFRSs as part of its annual improvements process, we wanted to comment separately on the proposed amendment to IAS 1 *Presentation of Financial Statements* in respect of compliance with IFRSs. This letter expresses the views of the international network of KPMG member firms.

In the past we have been among the commentators who have noted to the trustees of the IASC Foundation that the IFRS brand should be protected. Therefore we are pleased that the Board is seeking to respond to these concerns.

However, we do not agree that the annual improvements project (AIP) is an appropriate forum in which to deal with this issue, and we have concerns about the approach proposed. This letter explains our concerns, including the need for the IASB to work with standard setters (or legislators) and regulators, and to focus on frameworks rather than individual entities, in resolving this issue.

Is the AIP the appropriate forum in which to deal with this issue?

The objective of the AIP is to "provide a streamlined process for dealing efficiently with a collection of miscellaneous, non-urgent but necessary minor amendments to IFRSs." While the IASB's proposals in respect of this matter appear simple, we believe that the issue itself is not a minor amendment.

In our view, this issue goes beyond a simple accounting disclosure to encompass the interaction between the IASB and standard setters and regulators, and between IFRSs and other financial reporting frameworks. A solution in respect of how best to protect the IFRS brand requires a wider debate that cannot be achieved when dealt with as one of a number of miscellaneous proposals. Accordingly we believe that the IASB should deal with this issue as a separate project and, if necessary, publish a dedicated exposure draft (ED) for comment to invite that debate.

Protecting the IFRS brand

Dialogue with standard setters and regulators

Paragraph 16A to IAS 1 proposes that if variants of IFRSs do arise, then financial statements prepared in accordance with that variant should include some disclosure to alert the user to differences from IFRSs. The amendment relies on an assumption that the variant of IFRSs will adopt this proposed paragraph 16 and therefore incorporate that disclosure requirement, which we believe is far from certain. Using "IFRSs as adopted by the EU" as an example, how would this disclosure requirement be transposed when all references in IFRSs are changed to "IFRSs as adopted by the EU"? In this example the proposed disclosure will be nullified unless the EU makes a conscious decision to rewrite the requirement to require disclosure of the differences between IFRSs as adopted by the EU and IFRSs as issued by the IASB. In any event a variant of IFRSs may "carve out" the proposed disclosures, which is a point made in the dissenting views published with the proposal. If some IFRS variants include the disclosure, but others do not, this may cause further confusion amongst users about the nature of IFRS-variant financial statements.

The IASB's proposals refer to the July 2007 ED of the International Auditing and Assurance Standards Board (IAASB), ISA 700 (Redrafted) *The Independent Auditor's Report on General Purpose Financial Statements*. The ISA 700 ED proposes that when a financial reporting framework is described by reference to IFRSs, but the framework does not require the disclosures proposed in paragraph 16A of IAS 1, then "the description is likely to be misleading if the effect on financial statements of the difference between the framework and International Financial Reporting Standards may be significant." We do not agree with the IAASB's proposal because it shifts responsibility for assessing the appropriateness of variants of IFRSs to reporting entities and their respective auditors; in effect this requires reporting entities and auditors to second-guess the judgement of the standard setter or regulator in their jurisdiction.

In a perfect world the IFRS brand would be protected best if its use was not allowed other than in connection with a set of financial statements that complied in all respects with IFRSs as issued by the IASB. We agree that this solution is not practicable, not least because the IASB does not have the authority to impose such a condition; however, we believe that the IASB should make every effort to engage in dialogue with standard setters and regulators to discourage them from allowing references to a variant of IFRSs.

We appreciate the efforts that the IASB has made in liaising with the IAASB on this issue, but the discussions should be widened to include financial reporting standard setters and regulators. These are the organisations with the power to support IFRSs as issued by the IASB and so prevent the development of IFRS-variants. For example, in October 2007 the Australian Accounting Standards Board decided that entities in Australia should no longer be allowed to use the term "AIFRS" (Australian equivalents to IFRSs) in their financial statements on the basis that the term may imply wrongly that Australian accounting standards are not IFRS-compliant. In accordance with AASB 101 *Presentation of Financial Statements*, entities in Australia include in their financial statements a statement of compliance with Australian Accounting Standards, and are encouraged to make a separate statement of compliance with IFRSs when they are able. In turn the auditor is required to report on any such statement of compliance with IFRSs.

At a minimum any discussions should include the International Organization of Securities Commissions because of its wide remit. While we understand that any such dialogue might not result in a speedy outcome, we believe that the quality of the final outcome is paramount to the success of the vision of global accounting standards.

Focus on frameworks

If the Board does not believe that the above approach of working with standard setters and regulators will achieve the desired outcome, then we encourage the Board to focus in its disclosures on differences between IFRSs and appropriate financial reporting frameworks used by entities, rather than the current focus on the entity itself ("when an entity refers to IFRSs…"). We are concerned that the proposals as drafted may encourage individual entities to adopt variants of IFRSs. In this regard we agree with the dissenting views that the proposed approach will undermine the credibility of IFRSs.

We prefer the IASB to focus on financial reporting frameworks that are used by entities to meet reporting requirements in their jurisdictions. This could be achieved, for example, using the language in paragraph A9 of the ISA 700 ED, by referring to the fact that an authorised or recognised standard-setting organisation, or relevant law or regulation, may describe the applicable financial reporting framework by reference to IFRSs, even though the framework is such that management cannot make an explicit and unreserved statement of compliance with IFRSs. In such circumstances one possibility is to require disclosures to identify the differences between that framework and IFRSs, and the entity could be required to highlight which of its specific accounting policies may have been different had IFRSs been applied.

We understand that this approach would not prevent individual entities from adopting a variant of IFRSs outside of a recognised financial reporting framework, but we feel that it would at least discourage such behaviour. It also would avoid giving the impression that the IASB views IFRS-variant reporting as an acceptable approach, or that such variations would not result in a qualified or adverse audit opinion.

Please contact Mary Tokar or Julie Santoro at +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Ltd

KPMG IFRG Limited