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Dear Sir David,

## **Exposure Draft of Proposed Improvements to IFRSs**

Deloitte Touche Tohmatsu is pleased to respond to the International Accounting Standards Board's (the IASB's) Exposure Draft of Proposed Improvements to IFRSs (referred to as the "exposure draft").

We welcome the IASB's continuing process to deal with certain amendments to IFRSs in an efficient and effective manner. We note that the IASB has responded to concerns raised by constituents about the quantity and content of the proposed amendments and that the exposure draft has been published earlier in the year. Furthermore, we acknowledge the decreased number of proposals which are also less contentious than the proposals in the October 2007 exposure draft.

We wish to highlight three issues here. We do not agree with the proposal in IAS 7 *Statement of Cash Flows* for basing the classification of expenditures as cash flows from investing activities on recognition of an asset in the statement of financial position and believe this has significant impact for certain entities and industries. We believe that the question of classification of cash flows in the statement of cash flows would be better addressed in the IASB's project on financial statement presentation.

In addition, we believe the proposed guidance in IAS 18 *Revenue* on determining whether an entity is acting as a principal or as an agent does not establish a principle underlying the list of indicators provided and hence, will not resolve many of the issues that arise in practice.

Finally, we believe the proposed change of guidance in IAS 39 *Financial Instruments: Recognition and Measurement* for determining whether a non-financial contract contains a separable embedded foreign currency derivative could be improved. We acknowledge that determining whether such embedded derivatives require separation has proved problematic in practice and therefore the requirement does need improvement. However, we do not believe the current proposed wording will establish the necessary clarity. We have provided an alternative wording that uses the indicators provided in the proposed Basis for Conclusions which we believe would make the amendment clear and operational.

*Comment Letter on Exposure Draft on Improvements to IFRSs*

Our detailed responses to the questions in the invitation to comment are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0)20 7007 0907.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ken Wild', written over a horizontal line.

**Ken Wild**  
Global IFRS Leader

**APPENDIX**

Amendment to IFRS 2 *Share-based Payment* – Scope of IFRS 2 and revised IFRS 3

*Question 1*

Yes, we agree.

*Question 2*

We agree with the proposed transition provisions and effective date.

Amendment to IFRS 5 *Non-current Assets held for Sale and Discontinued Operations* –  
Disclosures of non-current assets (or disposal groups) classified as held for sale or  
discontinued operations

*Question 1*

We agree with the intention of the amendment to make clear that, for non-current assets and disposal groups classified as held for sale or as discontinued operations to which both the measurement and the presentation/disclosure requirements of IFRS 5 apply, the disclosure requirements of other IFRSs do not apply – unless those other IFRSs specifically require disclosures for IFRS 5 items. However, we doubt whether the proposed amendment will achieve the desired result. In our view, it is not clear whether the disclosure requirements of other IFRSs do not apply with respect to measurement disclosures of assets and liabilities that are *not* within the *measurement* scope of IFRS 5. For example, IAS 40 *Investment Property* requires certain disclosures with regard to measurement of investment property measured at fair value (these assets are excluded from the measurement requirements of IFRS 5).

The Basis for Conclusions to this proposed amendment aggravates this uncertainty. While BC4 implies that disclosures relating to measurement where the item is exempted from the measurement requirements in IFRS 5 should be made, BC5 states that IFRS 5 sets out all the disclosure requirements unless another IFRS specifically requires disclosures for IFRS 5 items.

We believe that the amendment should be clarified to state that *if* measurement disclosures in accordance with other IFRSs are required for assets and liabilities that are scoped out of IFRS 5 for measurement purposes, but to which the classification and presentation requirements apply, those disclosures on measurement from the respective IFRSs have to be provided. We suggest amending the proposed IFRS 5.5A to state (new text underlined):

“5A This IFRS specifies the disclosures required in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Disclosures in other IFRSs do not apply to such assets (or disposal groups) unless those IFRSs specifically require disclosures in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. However, if the measurement requirements of this IFRS do not apply to those non-current assets (or disposal groups) classified as held for sale or discontinued operations, any disclosures required in respect of measurement in those IFRSs should be provided. Additional disclosures about such assets (or disposal groups) may be necessary to comply with the general requirements of IAS 1.”

#### *Question 2*

We agree with the proposed transition provisions and effective date.

#### IFRS 8 Operating Segments – Disclosure of information about segment assets

##### *Question 1*

We agree with the proposed clarification in principle. We note that the Board believes that the conclusion is consistent with the wording of the IFRS. However, we believe that there continues to be a perceived inconsistency between paragraph 23 and 25 of IFRS 8. We therefore recommend that the Board amends paragraph 23 to remove this perceived inconsistency as follows (new text underlined, deleted text struck through):

“23 An entity shall report a measure of profit or loss ~~and total assets~~ for each reportable segment. An entity shall report a measure of total assets and liabilities for each reportable segment if such an amount is regularly provided to the chief operating decision maker. [...]”

##### *Question 2*

We acknowledge that the proposals of the Board would neither require an effective date nor transition provisions as the Basis for Conclusions does not form part of an IFRS. However, these would be required if you adopt our proposed changes. We believe it is appropriate to require an effective date of 1 January 2010 with a requirement for retrospective application.

#### IAS 7 Statement of Cash Flows – Classification of expenditures on unrecognised assets

##### *Question 1*

We disagree with the amendment as proposed. As set out in our comment letter dated 15 February 2008 on the IFRIC’s tentative agenda decision regarding this issue, we are concerned that this would narrow the situations in which a cash flow can be classified as investing, possibly drastically for certain entities, when the expenditure economically represents an investing activity.

We believe that the statement of cash flows and the statement of financial position serve different purposes and hence, cohesion between the two is not a prerequisite for

classification of cash flows. Management view and the business model of an entity should drive the criteria for classifying cash flows accompanied by appropriate disclosures to make transparent the criteria applied by the entity for classification.

We believe this issue forms part of a larger debate on cohesiveness and would be addressed appropriately in the IASB's project on financial statement presentation.

#### *Question 2*

If the Board decides to continue with this amendment we agree with the proposed transition provisions and effective date.

### IAS 18 Revenue – Determining whether an entity is acting as a principal or as an agent

#### *Question 1*

We agree that additional guidance is required in determining whether an entity is acting as a principal or as an agent. However, we are concerned that the guidance provided will not resolve the issues arising on this topic because it does not establish clearly the fundamental principle to be used for making an assessment of the role played by the entity. Specifically, we believe that the statement, in the middle of paragraph 21 before the list of factors to consider, indicating that “*an entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or rendering of services*” appears to set the criterion to consider. We believe that exposure to significant risks and rewards may be *indicative* that the entity is acting as a principal but we do not believe that it is, by itself, determinative of the role as a principal. Instead, we believe that the entity is acting as a principal when it has primary responsibility for providing the goods or services to the customers or for fulfilling the order. Currently the exposure draft presents this as a factor indicative of the role as a principal in paragraph 21(a) only.

Accordingly, we suggest that the Board revises the guidance to establish clearly that the fundamental principle in determining whether an entity is acting as a principal or as an agent is whether the entity has primary responsibility for providing the goods or services to the customer or for fulfilling the order. The factors provided in determining whether this primary responsibility exists would include an assessment of exposure to risks and rewards.

#### *Question 2*

We note that the proposed amendment does not state an effective date or any transitional provisions as this is an Appendix which does not form part of IAS 18. However, we believe it would be useful that the Basis for Conclusions contains guidance on how entities should make the transition to the new guidance.

*Question 3*

We note that the following factors are also used in practice in establishing whether the entity is acting as a principal or an agent:

- The entity changes the product or performs part of the service;
- The entity has discretion in supplier selection; and
- The entity is involved in determining product or service specifications.

We suggest that these factors be added to the elements an entity would consider in determining its role.

We also believe that an assessment of what customers perceive the entity is delivering to them may also be indicative of the role played by the entity (i.e., do the customers believe that the entity is providing them the goods or services or is it offering a link to another party who will deliver them the goods or services?).

In addition, we note that the proposed guidance includes a single feature that is indicating that an entity is acting as an agent (i.e., the amount that the entity earns is predetermined). This may be interpreted as being a determinative feature. We suggest that the Board should instead indicate that an entity is acting as an agent when it does not have primary responsibility for providing the goods or services to the customers or for fulfilling the order. Accordingly, we suggest adding clarifying words stating that the guidance on identifying a principal applies equal and opposite to identifying an agent.

Finally, we question whether it is necessary to provide the text accompanying the asterisk to paragraph 21 since this explanation is also included in BC1-2.

IAS 36 *Impairment of Assets* – Unit of accounting for goodwill impairment test

*Question 1*

We agree with the proposed amendment.

*Question 2*

We agree with the proposed transition provisions and effective date. However, we believe that further explanation is required on how entities should apply the proposed amended provisions.

IAS 38 *Intangible Assets* – Additional consequential amendments arising from revised IFRS 3

*Question 1*

Yes, we agree. We believe the current wording in the Standard is inconsistent with the valuation techniques used in practice, and that the proposed amendments will correct this inconsistency.

However, we note that the proposed amendments to IAS 38.36 would delete the example of a combination of an intangible asset (trademark for natural spring water) and tangible asset (the spring). We are concerned that this might imply that such a grouping is no longer acceptable under IFRS. This issue arises frequently in practice and we suggest that the Board clarifies the wording if this is not what they intended.

Furthermore, we ask the Board to clarify whether the group of assets in proposed IAS 38.36 would be subject to the ‘similar life’-criterion as set out in proposed IAS 38.37.

*Question 2*

We agree with the proposed transition provisions and effective date.

IAS 38 *Intangible Assets* – Measuring the fair value of an intangible asset acquired in a business combination

*Question 1*

Yes, we agree. We believe this amendment results in no change in the actual content but is merely clarifying the language. However, we acknowledge the ongoing activities of bodies within the valuation profession on this topic, notably the *International Valuation Standards Committee*. We suggest that the IASB co-operates with this body, for example as part of its fair value measurement project, such that any guidance provided in this area is consistent.

*Question 2*

We agree with the proposed transition provisions and effective date.

IAS 39 *Financial Instruments: Recognition and Measurement* – Scope exemption for business combination contracts

*Question 1*

We agree with the intention of the proposed amendment but believe that the current drafting does not provide the necessary clarity on this issue. Specifically, we believe that the amendment should also include ‘in substance’ forwards like a combination of a purchased call and written put with the same maturity(-ies) and the same strike prices or deeply in the money options. Therefore, we propose the wording as drafted be changed to (new text underlined):

“2

- (g) any forward contract, or other instrument(s) that is (are) in substance similar to a forward contract, that results from an agreement entered into before the acquisition date (ie before the date on which the acquirer obtains control of the acquiree) between an acquirer and a vendor, in a business combination, to buy or sell an acquiree at a future date and at a specified price (or on a specified price basis).”

While we acknowledge that scope exclusions generally cannot be applied by analogy as they are an exception from the underlying principle of an IFRS, we question why such an exemption is not granted to contracts that result in an investment in an associate accounted for under IAS 28 *Investments in Associates*. IAS 28.20 states that “*the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in*

*accounting for the acquisition of an investment in an associate.”* We consider it useful if the IASB would clarify why this scope exemption is not granted to investments in associates.

#### *Question 2*

We agree with the proposed effective date. However, we consider it useful if the transition provisions were clarified to state whether the amendment should be applied only to contracts entered into on or after the effective date or also for contracts existing at the effective date.

#### IAS 39 Financial Instruments: Recognition and Measurement – Application of the fair value option

##### *Question 1*

While we agree with the intent of the proposed amendments to clarify that IAS 39.11A is only applicable in situations where the host contract is also a financial instrument, we believe the wording as currently drafted does not reflect that intent.

To illustrate, an entity may enter into a forward contract to purchase a non-financial item (such as gold or natural gas) and prepay the cash consideration to be paid at settlement of the forward contract. That contract does not meet the definition of a financial instrument in its entirety because it involves the receipt of a non-financial item (the physical receipt of gold or gas at settlement). However, the contract contains an embedded derivative (a forward contract) that may be required to be separated under IAS 39 unless it was entered into in accordance with the entity’s expected purchase, sale, or usage requirements. The host contract in that situation would be within the scope of IAS 39. In the example the proposed words seem to prevent an entity from designating the whole contract as at fair value through profit or loss as the contract in its entirety is not a financial instrument.

We therefore propose amending the current wording of paragraph 11A which we believe better reflects the intent of the proposed amendment (new text underlined, deleted text struck through):

“11A            Notwithstanding paragraph 11, if a ~~financial instrument~~contractual arrangement wholly within the scope of this Standard contains one or more embedded derivatives an entity may designate the entire (combined) ~~financial instrument~~contractual arrangement as a financial asset or financial liability at fair value through profit or loss unless: [...]”

#### *Question 2*

We agree with the proposed transition provisions and effective date.



IAS 39 Financial Instruments: Recognition and Measurement – Cash flow hedge accounting

*Question 1*

Yes, we agree. We believe that recognition of gains and losses recognised in other comprehensive income in a cash flow hedge when the hedged cash flow affects profit or loss is consistent with the inherent logic of the cash flow hedge accounting model in IAS 39.

*Question 2*

We agree with the proposed transition provisions and effective date.

IAS 39 Financial Instruments: Recognition and Measurement – Bifurcation of an embedded foreign currency derivative

*Question 1*

We agree with the intention of the proposed amendment. Determining whether an embedded foreign currency derivative should be separated from the non-financial item has proved problematic in practice due to a number of reasons, particularly, how to determine the ‘economic environment’. We therefore welcome an amendment that makes the concept easier to understand and easier for entities to apply. However, the proposed wording does not achieve this objective.

The amendment changes the approach in IAS 39 by looking at the indicators of a functional currency in IAS 21 *The Effects of Changes in Foreign Exchange Rates* and hence, focuses on the aspects of the functional currency of entity (which is already included in AG33(d)(i)), and not the economic environment it operates in – the approach currently taken in IAS 39.AG33(d)(iii).

We believe the indicators in BC19 are better suited to meet the objective of distinguishing between currencies that are integral to a contract from those which are not. We believe these indicators should be incorporated into the Application Guidance of IAS 39, not the Basis for Conclusions. However, we believe the words used in the proposed Basis for Conclusions need to be amended to reflect the fact that also in larger countries in some cases other stable currencies are used. The size of a country is not necessarily a determinant as to whether an alternative to the local currency is used. Furthermore, liquidity should be assessed relatively to the local currency of the country and hence, we propose adding the word “relatively”. In addition, to ring fence this exception we propose to add reference to common usage. Our suggestion for incorporating these factors into IAS 39.AG33(d) is as follows:

“AG33

- (d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:
- (i) the functional currency of any substantial party to that contract;
  - (ii) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or
  - (iii) a currency that has one or more of the characteristics:
    - (a) a local currency of any substantial party to that contract
    - (b) a relatively stable and liquid international currency, compared to a local currency of any substantial party to that contract that is commonly used by parties domiciled in small countries, as a convenient means of exchange in external trades
    - (c) a hard currency used by an entity operating in a hyperinflationary economy to protect against inflation
    - (d) a foreign currency commonly used in local business transactions – for example, when monetary amounts are viewed by the general population not in terms of the local currency but in terms of another related currency.”

*Question 2*

We agree with the proposed transition provisions and effective date.