THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

10 November 2008

Our ref: ICAEW Rep 126/08

Your ref:

Sir David Tweedie
International Accounting Standards Board
1st Floor
30 Cannon Street
London EC4M 6XH

By email: commentletters@iasb.org

Dear David

PROPOSED IMPROVEMENTS TO IFRSS

The Institute of Chartered Accountants in England and Wales (the Institute) is pleased to respond to your request for comments on the Exposure Draft of Proposed Improvements to IFRSs, published in August 2008.

Please contact me if you would like to discuss any of the points raised in the attached response.

Yours sincerely

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW REPRESENTATION

ICAEW REP 126/08

PROPOSED IMPROVEMENTS TO IFRSS

Memorandum of comment submitted in November 2008 by The Institute of Chartered Accountants in England and Wales, in response to the International Accounting Standards Board Exposure Draft of Proposed Improvements to IFRSs, published in August 2008.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the International Accounting Standards Board Exposure Draft of *Proposed Improvements to IFRSs*, published in August 2008.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

4. Our members occupy a wide range of roles throughout the economy. This response was developed by the Financial Reporting Committee of the Institute, which includes preparers, analysts, standard-setters and academics as well as senior members of accounting firms.

ANSWERS TO SPECIFIC QUESTIONS

Improvement Number 1: IFRS 2 – Scope of IFRS 2 and Revised IFRS 3

The Board proposes to amend paragraph 5 of IFRS 2 to confirm that the contribution of a business on formation of a joint venture and common control transactions are not within the scope of IFRS 2 even though they do not meet the definition of a business combination in IFRS 3 *Business Combinations* (as revised in 2008).

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

5. We agree with the proposal to exclude joint ventures and common control transactions from the scope of IFRS 2.

Improvement Number 2: Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations

The Board proposes to amend IFRS 5 *Non-current Assets Held for Sale in Discontinued Operations* to clarify that IFRS 5 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 they specifically require disclosures in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations.

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

6. We support the Board in its attempt to clarify the disclosure requirements of non-current assets held for sale and discontinued operations. Paragraph 5A tries to make it clear that disclosure requirements in IFRSs other than IFRS 5 do not apply to non-current assets held for sale or discontinued operations unless the standard includes a specific statement that the disclosures apply. However this clarification seems to contradict paragraph BC4 which implies that the disclosure requirements of standards for the measurement of assets which are outside scope of the measurement requirements of IFRS 5, apply to those assets. Paragraph BC4 also refers to liabilities, although paragraph 5 only refers to assets outside the scope of the measurement requirements of IFRS 5. Therefore it is not clear whether, for example, financial instruments and pension assets and liabilities are subject to the disclosure requirements of the relevant standards. In addition, it is not clear why reference is needed to the requirements of IAS 1, which apply generally (unless they are otherwise specifically scoped out by paragraph 5A).

7. It would be also useful for the Board to clarify whether a held-for-sale asset is a current or a non-current asset. IFRS 5 refers to a held-for-sale asset as a non-current asset. However, it meets the definition of current (IAS 1.66c). In practice, companies tend to show held-for-sale assets separately within current assets, which is to some extent supported by IFRS 5 IG example 12. It might therefore be helpful if IFRS 5 stopped referring to such items as 'non-current' (by which it presumably means that the items *used to be* non-current).

8. Furthermore, we note that as IFRS 7 demands good quality liquidity disclosures, the current/non-current distinction is arguably redundant and detracts from the overall clarity of the disclosure. We suggest that the Board should consider removing the requirement altogether.

9. The apparent difficulties in drafting this standard contribute to our overall view of IFRS 5 as an arbitrary and unprincipled standard that the Board should be seeking to replace as a matter of urgency.

Improvement Number 3: IFRS 8 – Disclosure of information about segment assets

The Board decided to amend the *Basis for Conclusions* accompanying IFRS 8 *Operating Segments* to clarify its view on the disclosure of segment assets. Paragraph BC35 sets out the reasons for the Board's decision to require a measure of segment profit or loss and segment assets to be disclosed regardless of whether those measures are reviewed by the chief operating decision maker. Some have read this paragraph as contradicting long-standing interpretations of SFAS 131 *Disclosures about Segments of an Enterprise and Related Information* published in the US and hence creating an unintended difference from US practice under SFAS 131.

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

10. We understand the Board's desire to converge with US GAAP while avoiding rewording the standard itself. Nevertheless, assuming the Board's intention is to require reporting of profits for each reportable segment in all circumstances, but to

require amounts for assets and liabilities only when such amounts are regularly provided to the Chief Operating Decision-Maker (CODM), then it would be preferable to amend the wording of the standard itself so that the first two sentences of IFRS 8.23 to make this clear:

> 'An entity shall report a measure of profit or loss for each reportable segment. An entity shall report measures of assets and of liabilities for each reportable segment if such an amount is regularly provided to the chief operating decision maker.'

In our view, this is substantively different from a natural reading of existing IFRS 8.23, which clearly requires segmental reporting of assets whether or not reported to the CODM.

11. The proposed amendment suggests that the Board's view is that segmental reporting of assets is not required and that therefore no amendment to the wording of the standard itself is necessary to achieve it. This appears to depend on the 'logic' that 'the measure for total segment assets would be nil when such information is not provided to the [CODM].' We do not see that this necessarily follows. The reasons given in BC2 for not giving segment assets are unconvincing. They are based on the idea of entities with 'a low base of physical assets' and 'those [ie, specific] industries'. Nevertheless the resulting rule applies to all entities, wherever there are no asset amounts reported to CODM. The entity may have a large amount of assets, but no asset numbers reported to CODM. We agree that non-reporting of segment assets is in line with the idea of 'through the eyes of management', but it is difficult to see how it is consistent with BC2.

12. If the Board still declines to amend the standard, we believe the proposed clarification should be augmented with additional information about the historical development of the standard and the specifics of the potential point of difference with SFAS 131 arising from how the IFRS has been interpreted. In effect, this would involve importing much of the explanatory material from the *Basis for Conclusions* of the amendment into the *Basis for Conclusions* of IFRS 8. It is difficult to see otherwise how a reader unaware of the background could make sense of the fact that the *Basis for Conclusions* contradicts the words in the standard.

Improvement Number 4: IAS 7 – Classification of expenditures on unrecognised assets

In 2008 the IFRIC reported to the Board that practices differ for the classification of cash flows for expenditures incurred with the objective of generating future cash flows when those expenditures are not recognised as assets in accordance with IFRSs. Some entities classify such expenditures as cash flows from operating activities and others classify them as investing activities. The Board proposes to amend IAS 7 *Statement of Cash Flows* to state explicitly that only an expenditure that results in a recognised asset can be classified as a cash flow from investing activities.

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

13. We agree with the intention behind the proposed amendment to IAS 7. In our view, it consistent with the definition of 'investing activities' in paragraph 6 of the standard.

14. IAS 7.14 as amended in May 2008 states that 'cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale…are cash flows from operating activities'. It would be helpful if paragraphs 14 and 16 could be made consistent.

Improvement Number 5: IAS 18 – Determining whether an entity is acting as a principal or as an agent

The Board proposes to amend the guidance accompanying IAS 18 *Revenue* to address the issue of determining whether an entity is acting as a principal or as an agent. Paragraph 8 of IAS 18 specifies the accounting for amounts collected on behalf of a principal. However, IAS 18 does not provide guidance on determining whether an entity is acting as a principal or as an agent.

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

The Board proposes to include in the Appendix of IAS 18 *Revenue* guidance on determining whether an entity is acting as a principal or as an agent. What indicators, if any, other than those considered by the Board should be included in the guidance proposed?

15. We support the proposal to amend the Appendix of IAS 18.

16. We believe that guidance on the principal/agent relationship in proposed paragraph 21 is serviceable, but a more comprehensive analysis is available in the UK standard FRS 5 *Reporting the Substance of Transactions*. We suggest that FRS 5 offers a better principles-based model than the mixture of FRS 5 and EITF 99-19 proposed in the ED.

Improvement Number 6: IAS 36 – Unit of accounting for goodwill impairment

The Board proposes to amend IAS 36 *Impairment of Assets* to clarify whether the largest unit permitted by IAS 36 is the operating segment level as defined in paragraph 5 of IFRS 8 *Operating Segments* before or after the aggregation permitted by paragraph 12 of IFRS 8.

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

17. We agree that the impairment testing of goodwill under IAS 36 should be determined in accordance with paragraph 5 of IFRS 8 (which defines an operating segment). It may perhaps be helpful to explain in the *Basis for Conclusions* that in addition to the points already proposed, the aggregation provisions in IFRS 8 relate to presentation (or reporting) and are, therefore, not relevant to determining the cash generating unit for the purposes of impairment testing goodwill under IAS 36 (which is concerned with recognition and measurement).

Improvement Number 7: IAS 38 – Recognition and Measurement of Intangibles

7(a) Additional consequential amendments arising from revised IFRS 3 The Board proposes additional amendments to paragraphs 36 and 37 of IAS 38 *Intangible Assets* to clarify the effect of its decisions in IFRS 3 *Business Combinations* (as revised in 2008) on the accounting for intangible assets acquired in a business combination.

7(b) Measuring the fair value of an intangible asset acquired in a business combination

The Board also proposes to clarify the description of valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination that are not traded in active markets.

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

18. We support the proposed amendments to clarify the recognition and measurement requirements of IAS 38.

19. We do, however, have a concern about paragraph 41(a). We suggest that the word 'hypothetical' should be removed, in case it could be interpreted as implying that the estimates need not be determined reliably and with due regard to verifiable evidence. The word can safely be removed without detracting from the meaning of the sentence, a fact that can only lead to some readers seeking to find a reason for its inclusion.

Improvement Number 8: IAS 39 – Financial Instruments: Recognition and Measurement

Four amendments are proposed to IAS 39 *Financial Instruments: Recognition and Measurement*

8(a) Scope exemption of business combination contracts

The Board proposes to clarify that the scope exemption in paragraph 2(g) applies only to binding (forward) contracts between an acquirer and a vendor in a business combination to buy an acquiree at a future date.

8(b) Application of the fair value option

The Board proposes to clarify that the fair value option in paragraph 11A applies only to financial instruments within the scope of IAS 39 that contain embedded derivatives.

8(c) Cash flow hedge accounting

The Board proposes to clarify when gains and losses on hedging instruments should be reclassified from equity to profit or loss as a reclassification adjustment (see IAS 1 *Presentation of Financial Statements* (as revised in 2007)) for cash flow hedges of a forecast transaction that subsequently results in the recognition of a financial instrument or for cash flow hedges of recognised financial instruments.

The proposed amendments clarify that the gains or losses on the hedging instrument should be reclassified from equity to profit or loss as a reclassification adjustment in the period that the hedged forecast cash flows affect profit or loss.

8(d) Bifurcation of an embedded foreign currency derivative

The Board proposes to clarify what the 'economic environment' is in determining whether a currency is commonly used in contracts to buy or sell non-financial items and therefore is closely related to the host contract. The proposed amendment clarifies that contracts denominated in foreign currencies that have one or more of the characteristics of a functional currency (as set out in IAS 21 *The Effect of Changes in Foreign Exchange Rates*) are likely to be integral to the contractual arrangement and therefore closely related to the host contract and prohibited from being accounted for separately.

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

20. We agree with the proposed amendments to IAS 39.

21. However, we have a specific comment on amendment 8(d), which introduces the phrase 'integral to the arrangement', in determining whether the 'closely related' test is met in paragraph AG33(d). This new idea is not properly justified, and the implications are not explored. For example, if AG 33(d) is satisfied by the embedded foreign currency derivatives being integral to the arrangement, could 'integration' be achieved irrespective of the foreign currency in question, by having regard to the two reasons given in BC 18 - ie, that they have been entered into for reasons that are clearly not based on achieving a desired accounting result or for speculative purposes? The Board should either provide a better rationale (preferably outside the Improvements project) or alternatively just amend AG 33(d) as a set of rules without implying that there is a principle involved. If AG 33(d) were amended as a set of rules, the list in BC19 is easier to understand than the reference to IAS 21.

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