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International Accounting Standards Board
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10 November 2008

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Dear Sir/Madam

Invitation to comment – Exposure Draft of Proposed Improvements to International Financial Reporting Standards

The global organisation of Ernst & Young is pleased to submit its comments on the above Exposure Draft (ED).

We discuss below some of the broader issues raised in the ED. Our responses to specific questions in the Invitation to Comment are set out in the Appendix to this letter.

We support most of the proposed amendments, although we have some suggestions for clarifications. However, we disagree with the proposed amendment to IAS 7 *Statement of Cash Flows*. We believe the amendments proposed create inconsistencies with guidance elsewhere in IFRSs, are not consistent with the purpose of the statement of cash flows, do not meet the criteria for an annual improvement project and should be reconsidered as part of the Board's Financial Statement Presentation Project.

In addition, the amendment to IAS 36 *Impairment of Assets* has triggered some discussion as to the meaning of 'monitoring goodwill' within IAS 36, as in practice, most entities do not monitor goodwill but rather business performance. While we agree with the proposed amendment, we recommend the Board undertake a separate project to align the accounting standard with the manner in which management view goodwill.

Also, we do not believe that the proposed change to IAS 39 *Financial Instruments: Recognition and Measurement* with respect to foreign currency embedded derivatives is an improvement to the existing standard and believe it will create greater uncertainty in its application.

We would be pleased to discuss further our comments with the Board at your convenience. Please contact Lynda Tomkins at 020 7951 0241.

Yours faithfully

Ernst & Young

APPENDIX

Exposure Draft – Improvements to International Financial Reporting Standards

General Questions (applicable to all proposed amendments)

Question #1 – 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?

Question #2 – Do you agree with the proposed transition provisions and effective date for the issue as described in the exposure draft? If not, why and what alternative do you propose?

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

Question #1

We agree with the Board's proposal. However, we believe the wording needs to clarify that the exemption from IFRS 2 *Share-based Payment* also applies to transactions accounted for in accordance with revised IFRS 3 *Business Combinations*. We recommend revising paragraph 5 of IFRS 2 as follows:

"As noted in paragraph 2, this IFRS… However, an entity shall not apply this IFRS to those transactions:

i) in which the entity acquires goods as part of the net assets acquired in a business combination to which IFRS 3 *Business Combinations* (as revised in 2008) applies;

ii) in a combination of entities or businesses under common control as described in paragraphs B1 – B4 of IFRS 3; or

iii) in the contribution of a business on formation of a joint venture as defined by IAS 31 *Interests in Joint Ventures.*

Hence, equity instruments issued…(and therefore within the scope of this IFRS)."

Question #2

We agree with the proposed transition provisions and effective date.

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 Board's proposed paragraph 5A. However, paragraph BC4 does not support these requirements.

In this context, it is not clear what 'disclosures about measurement' actually means in paragraph BC 4. We see two possible interpretations – one being that measurement disclosure is limited to the accounting policy, while another being that this refers to the details about the carrying value ascribed, and would therefore include such items as reconciliations or changes in value during the period.

To avoid confusion, we recommend that paragraph 5A specifically list the standards for which the required disclosures should be made and revise paragraph BC4. The term 'general requirements of IAS 1' is also ambiguous and is subject to different interpretations. Accordingly, we recommend that this is also made more specific.

Question #2

We agree with the proposed transition provisions and effective date.

IFRS 8 *Operating Segments* – Disclosures of information about segment assets

Question #1

We agree with the Board's proposal.

Question #2

We agree with the proposed transition provisions and effective date.

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

Question #1

We do not support the proposed amendment to IAS 7 *Statement of Cash Flows* as we believe that the amendment is not consistent with the purpose of the statement of cash flows identified in paragraph 4 of IAS 7 and the definition of investing activities as outlined in paragraph 6. We believe the proposed amendment will actually result in expenditures that are investing in nature being classified as operating or financing. For example, under revised IFRS 3, contingent consideration may be paid that is greater than the original estimate made at the time the purchase price allocation was finalised. Under the proposed amendment, the difference between what was originally estimated and what is eventually paid would not be presented as an investing cash flow, even though the payment related to the acquisition of recognised assets. We believe such payments are investing in nature and should be classified as such.

The proposed amendment to paragraph 16 also creates an inconsistency with paragraph 39. Under revised IFRS 3, transaction costs incurred as part of a business combination will not result in a recognised asset. Therefore, the proposed amendment to paragraph 16 would result in such payments being classified as operating activities. However, paragraph 39 still suggests such payments are presented as investing activities. We believe such payments are investing in nature and should be classified as such.

We believe that the Board should address the overall purpose of the cash flow statement as part of the Financial Statement Presentation project, including appropriate principle based definitions of the components of the statement of cash flows. Until such time, we recommend that this is dealt with by additional disclosures. For example:

"if an entity classifies expenditure as investing that does not result in the recognition of an asset, it shall identify and disclose these amounts separately in the notes to the cash flow statement."

Such disclosure provides the reader with one of the main benefits outlined in paragraph 4, enhancing the comparability of reporting operating performance of entities.

If the Board chooses to proceed with the amendment as proposed, in addition to the inconsistencies noted above, we believe that greater clarity is needed about asset recognition. The amendment to paragraph 16 proposes that expenditure can only be presented as investing cash flows for resources 'that are initially recognised as assets.' It is unclear if 'are' requires the capitalisation of the asset and the cash flow to be in the same period or not. For example, if an entity purchases some manufacturing equipment, but pays for it in the subsequent period (not as a result of deferred payment), is the payment considered an investing or a financing payment?

Question #2

If the amendment is made, we agree with the proposed provisions and effective date.

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

Question #1

We agree with the Board's intention to provide guidance in order to determine whether an entity is acting as a principal or as an agent. In the Board's October 2007 Update, it stated that its intention was to issue "high level guidance based on existing guidance in some jurisdictions." EITF 99-19 *Reporting Revenue Gross as a Principal versus Net as an Agent* includes 8 indicators of a principal relationship and 3 indicators of an agent relationship, compared to the 4 indicators in the proposed amendment. We recognise that some of the indicators proposed by the Board are broader and encompass more than one of the US GAAP criteria, but we believe that on an overall basis these differences could result in divergence in practice. In light of the Revenue Recognition convergence project with the US FASB, we believe that the criteria proposed should be identical with those outlined in EITF 99-19 or the Basis for Conclusion should state that the Board expects the proposed criteria to result in the same assessment as applying the criteria in EITF 99-19.

Under the hierarchy of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, many entities have previously looked to US GAAP guidance since IFRS was silent on the matter. By not proposing indicators that align with US GAAP, the Board may create IFRS and US GAAP differences in the short term only to eliminate them under a converged standard in the future. If it is not the Board's intention to align the indicators of reporting as a principal versus an agent with US GAAP, then we believe this should be made clear within the Basis for

Conclusions so that people do not try to interpret them as if they were despite the use of different terminology.

Question #2

As the amendment is included in the appendix to IAS 18 *Revenue*, there is no specific transition provision and effective date. We recommend that the indicators be included within the standard itself in order to give them adequate importance, with an adoption date of 1 January 2010.

Question #3 – 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?

As noted above, we believe the criteria should be identical with US GAAP. In addition, EITF 99-19 also indicates that certain indicators provide less persuasive evidence than other indicators. We also recommend that the relative importance of the indicators be made consistent with EITF 99-19.

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

Question #1

We believe that the proposed amendment clarifies the standard and its intended application. We believe the confusion has arisen as paragraph 12 of IFRS 8 *Operating Segments* uses the term operating segments to describe segments both before and after aggregation. For further clarification, we recommend the following amendment to paragraph 12 of IFRS 8:

"Two or more operating segments may be aggregated into a single reportable operating segment if aggregation is consistent with the core principle of this IFRS."

If the above amendment is made, it would eliminate the need for the proposed amendment to paragraph 80 (b) of IAS 36.

The proposed amendment raises a more fundamental question - what is meant by 'monitoring goodwill'? Companies generally do not monitor goodwill. Rather, companies monitor the performance of their business. Goodwill is just a residual amount paid on acquisition which in itself does not generate cash flows. The current concept of monitoring goodwill therefore leads to difficulties in practice for preparers and practitioners alike. We believe that the concept of monitoring goodwill and the resulting level at which goodwill is being tested for impairment should be addressed by the Board in a separate project, with the aim of aligning the standard with the way management views goodwill.

Question #2

We do not agree with the proposed transition provisions and effective date for this amendment. The retrospective transition provisions of IFRS 8 and the related amendments to IAS 36 as of 1 January 2009 permit entities to record any impairment identified as a result of re-allocating goodwill to operating segments on transition to IFRS 8 as an adjustment to equity. If an entity had not interpreted the IFRS 8 related amendments to IAS 36 as the Board intended, a further impairment may be identified upon the adoption of the proposed amendment to IAS 36 on 1 January 2010. The proposed transition provisions will result in an additional impairment being recorded prospectively. We are unclear how this amendment would be applied prospectively - if an impairment is identified as a result of this amendment, is it recorded in equity or in the income statement? We recommend that the transition provisions to this amendment be retrospective, consistent with the provisions of IFRS 8, with an effective date of 1 January 2010.

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

Question #1

We agree with the Board's proposal. However, the proposed amendment and paragraph B32(b) of revised IFRS 3 are inconsistent. The proposed amendment refers to instances where intangible assets are only separable with "a related contract, identifiable asset or liability." The remainder of the proposed paragraphs 36 and 37 refer to intangible assets being recognised separately from goodwill, and being recognised with another intangible asset only if they have similar useful lives. This suggests that an intangible asset **cannot** be recognised with another tangible asset. On the other hand, paragraph B 32 (b) of revised IFRS 3 states "an acquirer may recognise the fair value of the operating licence and the fair value of the power plant as a single asset for financial reporting purposes if the useful life of those assets are similar." We believe that normally an intangible asset can be separated from a tangible asset, and paragraph B32 (b) of revised IFRS 3 should be clarified accordingly.

Question #2

We agree with the proposed transition provisions and effective date.

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

Question #1

We agree with the Board's intention to clarify that the valuation techniques referred to in the standard are examples of valuation techniques that can be used and are not the only methods permitted.

However, we believe that the order in which the methods are presented is not consistent with valuations methods used in practice. As drafted, the amendments appear to place more importance on the cost and market approach. In practice, we believe that these methods are very rarely used for valuing intangible assets, and an income based approach is more appropriate. We therefore believe the amendment should be redrafted to align with the hierarchy of valuation methods used in practice to value intangible assets. As the market approach is very rarely used for intangible assets, the income approach is the next preferred method, followed by the cost approach. Therefore, we recommend that the market example in proposed paragraph 40 is deleted, and the proposed paragraph 41 be reworded as follows:

"These techniques include, for example:

a) discounting estimated future net cash flows from the asset (an income approach); or

b) to license it from another party in an arm's length transaction (the 'relief from royalty approach' approach); and

c) to recreate or replace it (the cost approach)."

Question #2

We believe the date of transition should be consistent with that of the other amendments to IAS 38, 1 July 2009. We see no specific reason for this amendment to have a different transition date from the other amendment.

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

Question #1

We agree with the Board's intention to clarify that the scope exemption in paragraph 2(g) applies only to forward contracts between an acquirer and a vendor in a business combination to buy an acquiree at a future date. However, we believe the following points require some clarification:

Shareholder Approval

Many contracts to buy a business at some point in the future are subject to shareholder approval. In our letter dated 17 December 2007 to the IFRIC, we noted that there are divergent views as to whether the Annual General Meeting of shareholders is part of the entity, which effects whether shareholder approval is considered to be within the control of the entity or not. Paragraph BC1 of the ED indicates that the exemption was to apply in those situations where "necessary regulatory and legal processes are being completed." It is not clear whether the Board believes acquisitions that are conditional on shareholder approval are considered to be a 'forward contract' or not in this context. That is, is such a decision a necessary legal or regulatory process, therefore resulting in the contract being outside the scope of IAS 39 or is the shareholder meeting considered part of the entity in which case it resembles an 'option' to enter into the acquisition and is therefore within the scope of IAS 39? Therefore, we recommend that the Board resolve this matter (but note that it has wider consequences and is outside of the scope of an annual improvement) or specify that these particular contracts are encompassed by paragraph 2 (g) if shareholder approval is the only legal process to be completed.

Option contracts

BC3 states that "…the exemption applies only to forward contracts, and not to currently exercisable option contracts that on exercise will result in control over an entity, as such option contracts are excluded from the scope of IAS 39 by paragraph 2(a)." We do not believe this is a sufficient explanation as to why the Board has limited the exemption to only forward contracts (excluding option contracts) and is therefore unhelpful to ensure it is interpreted consistently.

In addition, entities often enter into simultaneous call and put options in order to achieve the same economic result as a forward contract. We recommend that the Board clarify that such transactions are intended to be caught by paragraph 2 (g) (and not within the scope of IAS 39), rather than such transactions being artificially split into two options which would be within the scope of IAS 39.

Definition of a business

Paragraph BC2 states that "the purpose of paragraph 2(g) is to ensure that the structure of an acquisition does not result in different accounting for the acquisition." If an entity enters into an option to acquire assets, this would be a non-financial contract that is not within the scope of IAS 39. However, an option to acquire shares would be within the scope of IAS 39, as it is a financial instrument. We do not believe that the proposed paragraph 2(g) will ensure that the structure of an acquisition does not affect the accounting. We recommend that the Board be much clearer as to what they believe to be in the scope of IAS 39, particularly given the amendment to the definition of a business in revised IFRS 3.

Question #2

We agree with proposed transition provisions and effective date.

IAS 39 – Application of the fair value option

Question #1

We agree with the Board's proposal. For clarity, we believe that paragraphs 12 and 13 should also be amended to clarify that it relates only to financial instruments within the scope of IAS 39.

Question #2

We agree with the proposed transition provisions and effective date.

IAS 39 – Cash flow hedge accounting

Question #1

We agree with the Board's proposal.

Question #2

We agree with the proposed transition provisions and effective date.

IAS 39 – Bifurcation of an embedded foreign currency derivative

Question #1

We agree with the intention of the Board to address the diversity in practice in applying paragraph AG33 (d). However, we believe the amendment as currently drafted will cause further confusion as the guidance on which currencies are likely to be integral to the contractual arrangement is contained in three different places, each using different words (paragraphs 9 of IAS 21, AG33 of IAS 39 and BC 19 of IAS 39).

The proposed paragraph AG33 (d) (iii) of IAS 39 points to the characteristics in Paragraph 9 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* and the rationale is outlined in paragraph BC 20 of the proposed amendment. We have the following concerns with respect to the proposed wording:

- It is not clear whether there is a difference between AG33 (d) (i) and AG33 (d) (iii). One interpretation would be that AG 33 (d) (i) would no longer be required, as the functional currency of a substantial party to the contract would be captured by proposed paragraph AG 33 (d) (iii).

- It is not clear if paragraph 9 of IAS 21 should be applied as a single criterion, two criteria (9 (a) and 9 (b)) or three criteria (9 (a) (i), 9 (a) (ii) and 9 (b)).

- BC 20 does not refer to the functional currency of a substantial party to the contract.

- Paragraph BC 19 lists foreign currencies that are likely to be integral to the contractual arrangement. However, we do not believe that all of the currencies listed in paragraph BC 19 have the characteristics of the currencies that would be identified by paragraph 9 of IAS 21. Since BC 20 links the currencies in BC 19 to the characteristics in paragraph 9 of IAS 21, we believe paragraphs BC 19 and BC 20 of the proposed amendment are inconsistent. For example, a liquid international currency used by parties domiciled in two small developing countries, as a convenient means of cross border exchange (paragraph BC 19 (d)) will not necessarily have the characteristic of a functional currency in accordance with paragraph 9 of IAS 21 for either party. We recommend that AG 33 (d) be broadened to include the types of currencies which the Board believes are likely to be integral to the contractual arrangement.

- Paragraph BC 19 introduces new terms which may lead to inconsistent interpretation. The terms ‘small countries’, ‘local currency’, ‘liquid international currency’, and ‘hard currency’ are not defined, and different interpretations will likely lead to wider diversity in practice. We recommend that the Board provide definitions for these terms.

Moreover, we believe the current proposal does not address all of the situations in which the Board believes separately accounting for the embedded derivative is not required. Often, companies domiciled in the same country will use a foreign currency for transactions between them, even though that currency might not have the characteristics of a functional currency of either party. The use of these currencies is not to achieve a desired accounting result or for speculative purposes, but is the result of different factors. For example, companies in Russia often transact in the US dollar as it was the historical norm, Canadian companies also use the US dollar due to Canada's proximity to the United States, and in Poland companies often transact in US dollar or Euros, driven by the historical norm or the close proximity to Europe. We believe that the proposed amendment would still result in such contracts being separately accounted for as embedded derivatives. The Board may have intended BC 19 (f) to address such situations, however, this is not clear. The statement "when monetary amounts are viewed by the general population not in terms of the local currency but in terms of another related currency" is open to different interpretations. We believe this will create the same difficulties that exist with the current AG 33 (d) (iii), and is therefore not an improvement.

Question #2

We agree with proposed transition provisions and effective date.