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21 August 2012

Submitted electronically through the IFRS Foundation website (www.ifrs.org)

Exposure Draft ED/2012/1 - Annual Improvements to IFRSs 2010-2012 Cycle

Grant Thornton International Ltd is pleased to comment on the International Accounting Standards Board's (the Board) Exposure Draft *ED/2012/1 Annual Improvements to IFRSs 2010-2012 Cycle* (the ED). We have considered the ED, as well as the accompanying draft Basis for Conclusions.

We largely agree with the substance of all the proposed amendments. We also consider that they are all appropriate matters to be addressed in the annual improvements process.

We do however have detailed comments on several of the proposals, set out in the Appendix to this letter.

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

Yours sincerely,

Kenneth C. Sharp

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Comments on specific proposals

For each amendment proposed in the ED, we have considered the following questions:

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?

For both questions, we agree without comment for the following proposed amendments:

IFRS	Subject of amendment
IFRS 8 *Operating Segments*	Aggregation of operating segments
	Reconciliation of the total of the reportable segments' assets to the entity's assets
IAS 12 *Income Taxes*	Recognition of deferred tax assets for unrealised losses
IAS 36 *Impairment of Assets*	Harmonisation of disclosures for value in use and fair value less costs of disposal

We have the following comments and suggestions on the other proposed amendments:

IFRS 2 *Share-based Payment*

Issue 1: Definition of vesting condition

We agree the revised definitions should improve clarity. We suggest that clarity could be improved further by defining 'non-vesting condition'.

We have a minor concern in relation to the impact of the proposed definition of performance conditions on group share-based payment schemes. As drafted, the proposed definition captures performance targets based on the entity's own operations (or activities) or the price or value of its equity instruments [emphasis added].

A group entity may receive goods or services pursuant to a share-based payment scheme:

- that is settled by its parent or another group entity; and
- with conditions linked to the performance of that other group entity.

When the entity receiving the services accounts for such a scheme (which would be equity-settled on the basis of paragraph 43A of IFRS 2) we suggest it is unclear whether this condition would be a performance condition or a non-vesting condition. This matter could be clarified by adding 'or another group entity' to the proposed definition as appropriate.

We would also note that IFRS 2's references to different types of 'condition' remain convoluted. They would benefit from a broader review and possible simplification in due course.

IFRS 3 *Business Combinations*

Issue 2: Accounting for contingent consideration in a business combination

We support clarification of this area subject to the following comments.

A contingent consideration contract could meet the definition of a derivative financial instrument, or include an embedded derivative. In this situation the proposed requirement to present changes in fair value in the same way as for non-derivative liabilities designated as at fair value through profit or loss (FVTPL) in accordance with IFRS 9 *Financial Instruments* (IFRS 9) would be inconsistent with the treatment of other derivatives. IFRS 9 requires derivatives to be accounted for as at FVTPL and does not permit or require the portion of the fair value gain or loss attributable to changes in own credit risk to be presented in other comprehensive income (OCI).

The extent of this issue depends on the extent to which these contracts are considered to be (or include) derivatives. This can be a complex matter and may require judgment in some arrangements.

That aside, we suggest that it would in any case be simpler to require that contingent consideration is measured at FVTPL. Although we support the Board's amendments to IFRS 9 that require presentation of changes in the fair value attributable to own credit risk of designated financial liabilities in OCI, we note that contingent consideration contracts often have features such as variable cash flows that may increase the complexity of separating the own credit risk portion.

While addressing the matter at hand, we suggest the Board could usefully consider tightening the wording in paragraph 40 of IFRS 3. This states: "The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met." This could be read in two ways. The phrase "...if specified conditions are met" is intended to define a contingent consideration asset. However it could also be read as requiring conditions to be met in order for such contingent consideration to be recognised as an asset.

IFRS 13 *Fair Value Measurement*

Issue 5: Short-term receivables and payables

We welcome clarification of this matter. However, if the Board did not intend to change practice in this area we believe it would be preferable to reinstate the previous text of B5.4.12 of IFRS 9 (and AG79 of IAS 39 *Financial Instruments: Recognition and Measurement).*

Our main reasons for this preference are that:

- we consider that the deletion of the practical expedient permitting non-discounting of certain short-term receivables and payables went beyond the purported scope of IFRS 13
- the Basis for Conclusions is non-authoritative and is not endorsed in many countries around the world;
- the deletion of an unambiguous practical expedient creates uncertainty as to whether non-discounting would be an immaterial 'error' in audit terms (and therefore needs to be quantified, tracked and included in summaries of unadjusted differences or equivalent audit documentation).

IAS 1 *Presentation of Financial Statements*

Issue 6: Current/non-current classification of liabilities

We agree with the proposed clarification.

The Board proposes that the amendment to IAS 1 is applied prospectively for annual periods beginning on or after 1 January 2014 "given the potential impact of the change and given that the proposed clarification may cause entities to choose to renegotiate some loans". We are not convinced that prospective application is necessary or appropriate based purely on financial reporting considerations. We feel this approach would not provide the most useful information on trends in an entity's liquidity position.

That said, we do acknowledge that retrospective application could create practical and commercial difficulties, including retrospective non-compliance with loan covenants. We suggest the Board should reconsider whether these concerns are sufficiently serious and widespread to justify prospective application on the basis of its outreach (including preparers' responses to the ED).

IAS 7 *Statement of Cash Flows*

Issue 7: Interest paid that is capitalized

We do not object to the proposed clarification.

However, in March 2012 the IFRIC indicated its view that the primary principle to determine classification of cash flows in IAS 7 is that "cash flows should be classified in accordance with the nature of the activity in a manner that is most appropriate to the business of the entity in accordance with the definitions of operating, investing and financing activities in paragraph 6 of IAS 7." We understand that IFRIC has also recommended that the Board should clarify the primary principle behind the classification of cash flows.

This proposed amendment seems to be based on the alternative classification principle that "...cash flows in IAS 7 should be classified consistently with the classification of the related or underlying item in the statement of financial position." The rationale for taking this approach is not explained in the [draft] Basis for Conclusions. It remains possible that the IFRIC's broader efforts to improve consistency in the application of IAS 7's classification requirements will supersede the ED's proposed clarification on this specific issue.

IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*

Issue 9: Revaluation method – proportionate restatement of accumulated depreciation

We agree with the substance of the proposed clarification.

We suggest, in amending paragraphs 35(a) of IAS 16 and 80(a) of IAS 38, it would be preferable to more fully reflect the rationale in the proposed Basis for Conclusions. BC3 and BC6 to IAS 16 refer to two situations in which the restatement of accumulated depreciation may not be proportionate. These are firstly when there has a been a revision to an asset's residual value, useful life or depreciation method, and secondly when the gross and net revalued amounts reflect observable market data. We suggest that the amendments to paragraphs 35(a) of IAS 16 and 80(a) of IAS 38 should refer to both of these situations.

In the same paragraphs we also suggest changing "observable market data" to "its fair value". This is on the grounds that the key factor is whether the entity obtains fair value estimates on a gross and net basis, not whether the estimates are based on observable inputs.

We also suggest the Board considers adding definitions of the terms "gross carrying amount" and "net carrying amount" in both IAS 16 and IAS 38. At present, IAS 16 and IAS 38 include a definition of "carrying amount" but do not define these terms.

IAS 24 *Related Party Disclosures*

Issue 10: Key management personnel

The proposed paragraph 17A of IAS 24 specifies that, when an entity hires key management personnel services from another entity, the requirements of paragraph 17 to disclose the components of compensation by individual does not apply to the management entity's own employees or directors.

We agree that there are circumstances in which this exemption is necessary or appropriate. This would be the case, for example, when:

- the reporting entity uses a management entity that also provides services to other substantive client entities not related to the reporting entity; and
- the management entity utilises its personnel across various clients.

However, in other cases the use of a management entity may lack substance (at least in the context of related party disclosures). For example, a single individual providing key management services to an entity might choose to contract through a management entity, rather than in person, for tax or other reasons. Also, the proposed paragraph 17A could be used to structure arrangements in order to avoid providing the detailed disclosures required by paragraph 17 of IAS 24.

We therefore suggest that the proposed exemption should be available only in particular circumstances along the lines:

- obtaining the information required by paragraph 17 is impractical; or
- there is no reliable basis to attribute the total compensation paid to the management entity to the individuals that actually provide the related key management services.