INTERNATIONAL ASSOCIATION OF FINANCIAL EXECUTIVES INSTITUTES

International Accounting Standards Board
30 Cannon Street
LON DON EC4M 6XH

13 September 2002

Dear Sirs.

EXPOSURE DRAFT
IMPROVE MENTS TO INTERNATIONAL ACCOUNTING STANDARDS

Having considered the above document, the comments of IAFEI are set out in this submission.

We have been an active supporter of the move to international harmonisation for a number of years and of course the resultant standards should be of a high quality. However, we would make two general points:

– "high quality" is not necessarily the same as more complexity and detail; in some cases quite the reverse is true.
– as a practical measure, particularly for European businesses facing the 2005 deadline with a moving target, it is imperative that a realistic approach is taken to changes prior to that date.

Subject to the specific points in this letter, where we note our agreement with the proposed draft we also concur with the position taken by the Board, including that on issues where there were some dissenting opinions by Board members.

IAS 1

We strongly agree with the overriding comment that minimal changes are appropriate pending resolution of the Reporting Financial Performance project.

We also agree with the proposed draft, including the approach on questions 2, 3 and 4, subject to the following:

Q1: We agree that the standard should address what is a fundamental point for any standard setting mechanism. We also agree with the approach subject to

– we do not agree with the inclusion of the words "if the regulatory framework requires or otherwise does not prohibit such a departure" in paragraph 13. If under IAS I it is necessary to apply an override, then in doing so the company will be in compliance with international standards taken as a whole. If a regulatory framework prevents this then that framework is only accepting international standards on a partial basis. As such, disclosure under paragraph *15* is reasonable but it seems odd to then accept this as compliant with WRS in total. We accept that this circumstance will be extremely rare and therefore the point may be somewhat academic, but is does appear the approach taken is inconsistent with the overall philosophy of internationally accepted standards.

- for consistency paragraph 15(b) wording should be brought into line with paragraph 14(d) wording.
- the words “on each item” should be deleted from paragraphs 14(d) and 15(b). This requirement seems to be unnecessarily detailed, while its removal would not affect the requirement to disclose the key elements of the financial impact.

We have some concern on how this might sometimes be interpreted. We could take some comfort from the examples given, if these are taken as indicative of the requirement in practice. However, on balance we disagree with the approach as we believe that requirements such as these should only be as specifically identified and debated in the context of individual standards.

We disagree with the requirements of paragraphs 110 to 115 in an accounting standard as

- similar to our comment on *Q5,* they are far too general and open ended; requirements such as these should only be as specifically identified and debated in the context of individual standards.
- more general requirements such as envisaged belong more appropriately in the MD&A which, as noted in paragraph 9, are outside the scope of International Financial Reporting Standards.
- including such requirements in audited statements will lead to largely useless “boiler plate” disclosure and/or significant problems for management and auditors.

Para 76: this paragraph now refers to “the <u>after tax</u> profit and loss of associates…..”. We disagree with this on two grounds:

- why after tax and not pre tax which seems more relevant, with the tax applicable identified in the tax note.
- if it is to be after tax, why is this included above the pre tax results for the Group.

This point also applies to para 28 on IAS28.

<u>IAS 2</u>

In general we agree with the standard as drafted. However we would raise one point on the reversal of the option to use LIFO. While many of our members have no problem with this as they already use FIFO, there are some for example in the oil and gas industry where this is a problem. Before any decision to eliminate LIFO as an option, it is necessary to address the concerns of the specific industries affected and ensure that the approach will in particular be used in the US. This is not only necessary as part of the appropriate due process but also to ensure comparability remains in the accounts of major multinational competitors in specific industries.

<u>IAS 8</u>

We agree with the proposed draft subject to the following:

Q2: While we can see the logic of the removal of the distinction between fundamental and other material errors, our agreement is conditional on the interpretation of material. The current approach in the framework provides a basis for this change but we would be concerned if the materiality concept was subsequently extended to smaller items which could not on any reasonably pragmatic basis be seen as influencing the economic decisions of users of financial statements.

Para 29: we assume that the removal of "material" from the wording on disclosure requirements on changes in accounting estimates is because of the overriding basis that standards only apply to material items. However, is this inconsistent with the changes made to paragraph 20 of IAS10

Para 19(d): we strongly disagree with the requirement in paragraph 19 (d). If a standard has been approved with agreed implementation dates, then companies should not be forced into a position where (at the first IAS figures issued after publication of the standard) they are required to estimate the effect or justify why they cannot. Companies may voluntarily give some feel for the impact but this is totally different to a requirement as set out in the proposed standard. Therefore the wording in paragraph 48 of the existing IAS8 should continue to be used.

<u>IAS 10</u>

In the interests of international harmonisation we agree with the proposed draft subject to the following:

Summary: we are unclear as to the point made in the summary of main changes as we understood the existing IAS 10 already meant that an entity should not recognise dividends declared after the balance sheet date as a liability at the balance sheet date.

Para 20: please refer to the point under IAS8 above.

Para 8(a): it would be better to say "…….. <u>if</u> the settlement provides……" rather than "….. <u>because</u> the……" as, in practice, the reason for the Court decision may or may not provide such evidence.

<u>IAS 15</u>

We agree with the withdrawal of this standard.

<u>IAS 16</u>

We agree with the proposed draft subject to the following points:

We disagree with the suggested change whereby all exchanges would use fair value which (as stated) would include value based on discounted cash flow projections. This seems contrary to the measurement principles of an acquired fixed asset. In purchasing a fixed asset the entity obviously believes the resultant discounted cash flows will exceed cost but only recognises cost. However, in then exchanging an asset for a similar asset it must include the carrying value based on discounted cash flows - this is surely inconsistent? We accept that the distinction between similar and dissimilar assets may not always be clear and judgement will be required but attempts to remove all judgemental aspects will just result in meaningless accounts.

The same point as in Q1 applies here.

We disagree with the proposed change in paragraph 59, unless this is subject to the overriding point that when an asset becomes temporarily idle it may prolong the useful life under the definition of that term. Consequently, depending on the depreciation policy, the charge may be lower than previously or even zero.

Where an asset is held for sale, it also seems odd to say that its service potential is still being consumed. This may not be true for the reasons in the prior paragraph, let alone the equally odd result that we continue to write down an asset below the value the company is expected to receive.

Para 17: The explanation in the final paragraph could be taken as being inconsistent with some of the examples given above that paragraph. For example, to be capable of operating in the manner intended by management may well be dependent on some aspects of training new staff in the location in question. It should be clear that if the training is necessary to bring the asset into operation then it can be capitalised.

Para 17A: The exclusion of the costs of relocating or reorganising part or all of the entity's operations again may be inconsistent with the lead in paragraph on operating in the manner intended by management. Under the definitions of useful life, costs incurred in relocating an asset may extend its useful life and/or productive capacity and/or residual value. It seems wrong to exclude these from capitalisation.

Para 46: The blanket requirement for an annual review of residual values will impose an unreasonable burden and the requirement for a review should only be applicable where there are indications of impairment.

Para 53B: The use of the word "received" in paragraph 53B(b) seems wrong as it equates with cash book accounting. Surely the period when income should be recognised is when the amount can be measured reliably?

Para 60: We disagree with the removal of the exemption from disclosing comparative information on the fixed asset reconciliation. While this is not a major point in itself, it continues the seemingly endless trend to clutter the accounts with information which does not add value.

IAS17

Q1 - although it sounds nice in theory, there will be practical problems in always making the separate classification of land and buildings. In many cases the two elements of the lease cannot be sensibly divided if the substance of the transaction is to be reflected in the accounts.
- it should be clear that where the conclusion is that both land and buildings are the same type of lease (operating or finance) then there is no need to record and report land and buildings separately.

IAS 21

We agree with much of the proposed draft and the position taken on the questions raised. However we have a couple of points on which we disagree and the first one noted below we believe to be of major importance.

Main Changes/QI: We do not agree that the conclusion should be that "an entity could not avoid restatement under IAS29 as its functional currency" as on page 179 of the summary of Main Changes; any international standard should not be based on this conclusion. Use of a hard currency to deal with a high inflationary environment is a fairly common approach to this problem. It can be useful and more appropriate in circumstances where inflation indices are unreliable at best. It can also be a more practical approach for management which can give very similar results to an indexed system in the consolidated accounts of the reporting entity. The approach adopted seems misguided in assuming there is one right and precise answer in the varied and volatile environments that characterise high inflationary economies around the world. The approach taken is an unnecessary restriction which will cause problems and cost for reporting Groups, with no benefit to anyone and no apparent real justification for the requirement. It is not an appropriate basis for an TFRS to which companies must change on a worldwide basis.

As the exposure draft states the above conclusion is the result of the definition now used for "functional currency", we therefore disagree with the definition. A broader definition, perhaps more in line with SIC-19, is required which does not result in the prohibition of sensible and useful methodologies for dealing with high inflation.

In this context it should also be made clear that characteristics of hyperinflation as noted in para 3 of IAS29 do not all have to be present. This would be consistent with the comment in that paragraph that restatement is a "matter of judgement."

Para 13: The last two sentences of paragraph 13 should be reworded. What is relevant are long term loans and deferred trading balances which are intended to be, for all practical purposes, as permanent as equity. This is the principle that should be set out and followed rather than the arbitrary split which could be implied by the current wording.

Paras 46/47: While we do not agree with the implications of these paragraphs, we assume they will be reviewed as part of the broader project on reporting financial performance.

IAS24

We agree with the proposed draft. In particular we agree with

Ql: The approach taken on Q1 and the rationale in paragraphs A3/A4. To the extent that it provides useful information in the differing circumstances of each country, disclosure will be driven by the national regulators and the market as is appropriate.

Q2: The approach taken on Q2 and the rationale in paragraphs A5/A7. Any other conclusion would involve additional requirements out of all proportion to any perceived benefit.

Para 12: Our only point is that we do not understand why paragraph 12, which seems to replace the deleted paragraph 32(a) of IAS27, does not use the old wording of IAS 27 which was much clearer as to the actual requirement. High quality standards should be clear as to their requirements.

IAS27

We agree with the proposed draft, including the approach taken on questions 1, 2 and 3, subject to the points below. In particular we strongly agree with the approach taken by the Board in the basis for conclusions, that subsidiaries in a Group structure, subject to the conditions set out in the draft, should not be required to produce consolidated information. Not only would any other approach open up a very time consuming and irrelevant exercise of sub consolidations in a Group structure, but would also ignore the point that for a separate entity what is important is its investments and dividend income.

Para 13: We are not clear what the change in wording does other than to raise potential problems. The wording is only reasonable if it relates to the companies intention, accepting that circumstances may affect this. For example, it is possible in some industries that regulatory requirements may mean the process of disposal could exceed 12 months. However, it would be illogical if this affected the treatment of a subsidiary which is acquired and held exclusively with a view to its subsequent disposal.

Para 27: We would suggest that this paragraph is drafted from the wrong perspective. What should be relevant in the Group consolidated accounts is not what the minority has an obligation for but whether the Group has an obligation to provide finance for the losses that may not be recoverable. Thus the minority has the residual interest in the net assets or liabilities of the subsidiary, except to the extent that the Group has an obligation which determines another allocation.

Para 32(b): Given that the excluded subsidiaries are as defined in paragraph 13, we do not understand the use of these additional disclosure requirements. The subsidiary is being held for resale and measured as such, so why is there a need for this additional disclosure? Given the apparent proliferation of such contentious disclosures there needs to be a good rationale if international standards are to have credibility as high quality standards which result in readable and focussed financial statements.

IAS28

We agree with the proposed draft subject to the following:

Q2: We agree that the amount to be reduced to nil when an associate incurs losses should include not only investments in the equity of the associate but also other interests such as long term receivables. However, paragraph 22 should be clear that application of this requirement is subject to any security, collateral etc. which would make the write down inappropriate.

Para 8: We have the same problem with this as raised in paragraph 13 of IAS27 above.

Para 8A: We are not clear as to what this paragraph actually implies. It appears to be inconsistent with paragraphs 24A and 24B, which we agree with.

Para 18A: We believe that on practical grounds there may be cases where it is not possible to obtain financial statements at a date three or less months before the Group year end. The requirement should be to use the most recent available financial statements, where the three month limit is not possible, but in all cases to note the date of the accounts used.

Para 22B: While we agree with this paragraph, it seems to reinforce the point made above on paragraph 27 of IAS27.

Para 28: Please see IAS 1 point on para 76 noted earlier in this response.

Para 28B: Again we do not find the wording very clear principally because of the phrase "for which it is also contingently liable “in paragraph 28B(a). Is the requirement intended to simply be

- investors share in contingent liabilities incurred jointly with other investors

and/or - any contingent liabilities where the investor is severally liable.

IAS33

Our main concerns with this draft standard relate to the issues raised under question 2.

Q2: - calculations for the full year should reflect the circumstances applicable to that period as a separate reporting period. The measurement of the annual results should not be affected by the interims including the frequency of interim reporting.

- for the example on retail site contingency, the differences which arise seem to be because of the inclusion of the dilution from the start of each interim period; where there is a specific contingency such as this, which is reflected in business performance going forward from the date the condition is met, then it would seem more appropriate to reflect the dilution in all periods only from the date the contingency is met. Such weighted calculations would in any event make the interim and full year effects consistent.

- for the earnings contingency, it seems more appropriate to reflect the actual circumstances at the year end in the impact on the dilution calculation (which is most relevant going forward) rather than some aggregation of interim periods.

- following on from the above the average market price should be based on the year to date with the annual result unaffected by content and frequency of interim reporting.

Presentation and Disclosure - we are surprised to note that these have been extended without being referred to in the "summary of main changes"? Moreover we remain concerned at the seemingly ever increasing volume of detailed disclosures. At the very minimum paragraph 62(c) should only be required for potentially "significant" dilutions.

Para *65:* we fail to understand the logic in this paragraph which restricts any additional earnings per share calculations to the notes. So long as the notes make clear the basis and they are not given more prominence than the measures required by the standard, why should additional figures not be given on the face of the income statement? Such measures may be those which management and users focus on equally with (or sometimes more than) the standard measures, because they provide useful information.

IAS40

We agree with the proposed draft.

Yours faithfully,

DAVID POTTER
Chairman C.I.A.S.