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IMA

Certified Management Accountant Program
Certified in Financial Management Program

September 24, 2002

Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Proposed Improvements to International
Accounting Standards

Dear Sir David:

The Financial Reporting Committee of the Institute of Management Accountants is pleased to respond to the abovementioned exposure draft. We support the overall goal of reducing or eliminating alternatives, redundancies and conflicts within the existing twelve standards evaluated by the IASB and the Board's efforts to make improvements to them. However, in our view, several of the proposals would create additional differences with US standards rather than further convergence. Our specific comments on selected proposals for each standard follow. As a general concern, the changes would be effective for periods beginning on or after January 1, 2003 and as we understand transition, for the most part, the new basic rule for accounting changes requiring retroactive treatment would be applicable. Although the proposal is described as proposing limited improvements, we observe that several are quite substantive and considering when a final standard is likely to be issued, we believe it will not be practical for many companies to get ready in time. Accordingly, we recommend that the effective date be pushed back to allow for orderly adoption.

As a Committee that regularly responds to proposed standards, we would also observe that combining so many substantive proposals into one exposure draft made responding extremely difficult and raises questions regarding the adequacy of due process for these changes. We are hopeful that the IASB will not use this shortcut approach again. Further, we believe the IASB should not finalize certain of the proposals that are important enough to be issued, and therefore should be issued, as separate stand-alone proposals. This would ensure that the Board's due process is robust and broadly representative of constituent views. Proposals that we would include in this group are IAS 2, with regard to LIFO, IAS 8 with regard to accounting principle changes, and IAS 27 with regard to classification of equity, potential voting rights and consolidation.

IAS 1 – Presentation of Financial Statements

The proposal would no longer permit extraordinary item treatment on the income statement. While we support this change, we believe the IASB should wait until it makes progress on its performance project before issuing it as a final conclusion. This would allow for more orderly convergence with other standard setters such as the FASB that are working on similar projects.

The proposal would require disclosing the judgments made by management in applying the accounting policies that have the most significant effect on the amounts recognized in the financial statements as well as key assumptions and measurement uncertainties that have a significant risk of causing a material adjustment within a year. While these disclosures should be helpful for readers, the FRC believes the disclosure decisions by their very nature will be very subjective and we are concerned about second-guessing by third parties with the benefit of 20-20 hindsight. Accordingly, if these requirements are finalized the Board should acknowledge that they are subjective, so that readers could understand that future events that differ from the assumptions would not necessarily mean these earlier judgments were invalid.

In determining if an obligation should be classified as a current liability under the proposal, subsequent events (e.g., entering into a long term financing) would be ignored. We believe users are not better off with this balance sheet date focus and their ability to evaluate liquidity would be more difficult if this proposal is finalized. The proposed approach also would conflict with US requirements (e.g., FASB Statement No. 6) thereby creating more divergence.

IAS 2 – Inventories

We do not support the elimination of the LIFO inventory method as an acceptable alternative. In the United States it is a well accepted and understood inventory valuation method which many believe to be particularly appropriate during periods of rising prices in order to preclude so called inventory profits. Further, the LIFO reserve is disclosed so readers could make their own adjustment to FIFO. In light of the US "conformity" tax laws, many US companies on LIFO would have a significant tax to pay as a price to adopt IASC rules.

The proposal retains the ability for companies to reverse write-downs of unsold inventory that has appreciated after the initial write-down. We do not oppose this but we note it would be inconsistent with US rules and would be based on soft information related to values.

IAS 8 – P&L, Errors, and Changes in Accounting Policies

Accounting changes -- voluntary changes would be made retroactively (i.e., no more cumulative catch up adjustments) unless to attempt to do so would give rise to undue cost or effort, a subjective exemption that is applicable for many of the proposals. Unfortunately, there is only general guidance in the proposal about how one should determine whether this exemption is appropriate. The Board stresses the benefit of period to period comparability and we do not object to this although it certainly is not a move to convergence with the US rules for accounting changes.

The proposal would eliminate the notion of fundamental errors and all material errors would be corrected retroactively. We support this change.

We also support requiring disclosure of pending mandatory accounting changes, similar to current US SEC requirements (SAB 74) and it is helpful for users. However, the proposal requires quantification unless it would cause undue cost or effort while the SEC rule says say what you know – a more reasonable threshold for disclosure.

IAS 10 – Events after the Balance Sheet Date

We support that dividends declared after the balance sheet date are not a liability on the balance sheet date.

IAS 15—Effects of Changing Prices

We support the withdrawal of the standard.

IAS 16 – Property, Plant and Equipment

We do not support eliminating the “similar” exception and requiring non-monetary exchanges (for PP&E and intangibles) to always be recorded at fair value (with gain recognition) unless values cannot be reliably determined. At the same time the Board is proposing more movement to fair value, several companies in the US are being strongly criticized for accounting for such exchanges at fair value (e.g., so-called “capacity” swaps). This proposal if adopted would mandate such treatment even though some argue the companies were in a similar position before and after the transaction and in substance nothing happened. The Board counters this by saying “income is not necessarily earned only at the culmination of the earning process.” Is this the right direction for the IASB to be going at this time? Is it really an improvement and is the reliably determinable criteria enough to stop potential abuses? We do not think so! We note this is one of the few proposals that would be adopted prospectively rather than retroactively perhaps suggesting a lack of conviction that this really would improve financial reporting.

Under the proposal, depreciation would not cease for an asset held for sale. We prefer a model in which these assets are carried at the lower of cost or fair value with no depreciation. We also note that changes in residual values are accounted for prospectively by adjusting depreciation. If the revised residual value (i.e., expected proceeds on sale) equals book value after any impairment loss, wouldn’t this result in no depreciation anyway?

We do not agree, due to cost-benefit considerations, with the requirement to use the component method of depreciation. In the majority of situations, the composite approach provides a reasonable approximation of results under the more onerous component approach and is much more cost effective to apply. We recommend the board allow it as a practical expedient where the impact is not likely to be significantly different than the component approach.

Under the proposal, a change in depreciation method is a change in estimate of the pattern that benefits are consumed and is accounted for like any other change in estimate. This type of change is considered an accounting principle change in the US because it is an allocation policy decision and it is a fairly common change. We do not object to the IASB's conclusion but we encourage working with the FASB to see if convergence is possible.

IAS 17 – Leases

We agree that a lease of land and building should be split into two leases for accounting purposes and that a lessor's initial direct costs of entering into a lease should be capitalized.

IAS 21 – Changes in Foreign Exchange Rates

We agree that the functional currency is the currency of the primary economic environment in which the entity operates and we support the guidance for making the decision.

We also do not object to allowing companies to present financial statements in any currency they choose and we concur with removing the alternative to allow capitalizing certain exchange differences in certain circumstances.

IAS 24 – Related Party Disclosures

We agree that disclosure of management compensation should not be required.

Under the proposal, disclosure of related party transactions (RPT) is not required in the separate statements of the parent or subsidiary in certain circumstances when consolidated financial statements are available. We do not agree. While we recognize that the IASB is trying to be practical, we fail to see how these separate financial statements could be a fair presentation if they omit RPT disclosures.

IAS 27 – Consolidated and Separate Financial Statements

We do not agree that a parent that is also a subsidiary should be exempt from the requirement to issue consolidated financial statements. Consolidated financial statements are necessary for a fair presentation of a subsidiary's separate financial statements for the same reason as they are necessary for the parent.

A subsidiary would not be consolidated if it would be disposed of within twelve months – a temporary control notion. We note the FASB recently superseded this exception and therefore this proposal would not achieve convergence with the US.

The proposal would require minority interests to be presented in equity on the balance sheet but would not at the present time change its presentation as a deduction from earnings on the income statement or address related issues such as selling a portion of the subsidiary's stock. We do not believe a minority interest in a consolidated subsidiary is equity of the consolidated group and we do not support addressing this one aspect of this controversial issue as part of the improvements project.

The proposal requires that the same accounting policies be followed by each member of the consolidated group for similar circumstances. We believe there may be practical reasons to use different but acceptable policies in some situations and therefore do not support this change.

In determining if control exists the proposal states that potential voting rights (options, convertible debt, etc. that are presently exercisable) should be considered but no guidance for when these should result in consolidation is provided. We believe this is not operational as it would not result in a consistent assessment by companies in making consolidation decisions. Several years ago the FASB proposed a control based model for consolidation which would have included considering conversion rights and options and a majority of respondents expressed significant concern regarding whether the proposed approach was conceptually sound or operational. Since both the FASB and the IASB have active projects on their agenda dealing with this conceptual issue, we believe that this would be an appropriate choice for a convergence project.

If consolidating a subsidiary with a different year-end (up to three months) "adjustments are made for the effects of any significant transactions or events that occur between the different reporting dates," but the proposal does not provide guidance on how to apply this requirement. Examples would be helpful.

IAS 28 – Accounting for Investments in Associates

We agree that investment companies using the fair value method should be scoped out of IAS 28 and that long-term receivables due from an investee should be included in the investment account when the investor's share of losses are being recognized.

The proposal would require that a difference in reporting dates for the investee should not exceed three months in applying the equity method. We observe that investor's may not be able to obtain more timely information from investees and therefore a practicality exception would be appropriate. We also do not support the proposed requirement for the investee's financial statements to be adjusted to the same accounting policies used by the investor for similar circumstances. The investor may not have access to information to make these adjustments and it could be costly to do even if the information is available.

IAS 33 – Earnings Per Share

Many of the changes would improve convergence with the FASB's EPS rules and we support them.

IAS 40 – Investment Property

We concur with including in the scope, property held under an operating lease when the criteria are met (e.g., using the fair value model) and accounting for the lease as if it were a finance lease.

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We appreciate your consideration of our comments and welcome the opportunity to discuss these issues with the Board at its convenience. If you have questions regarding this letter, please feel free to contact me at (203) 373-3563.

Sincerely,

Mitch Danaher

Mitchell A. Danaher
Chair, Financial Reporting Committee
Institute of Management Accountants