UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE CHIEF ACCOUNTANT

November 14, 2002

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

Re: Exposure Draft of Proposed "Improvements to International Accounting Standards"

Dear Sir David:

We are pleased to offer our comments on the Exposure Draft, "Proposed Improvements to International Accounting Standards."

Overall, we believe this exposure draft represents an excellent and important effort to improve the existing International Accounting Standards (IASs). We also note that several of the changes would bring about greater convergence between the IASs and domestic standards in the US and some other markets, making financial statements more comparable across national boundaries.

While we agree that the proposal represents an overall improvement to IASs, and that most of the proposed changes individually represent improvements, we do have concerns on some aspects of the proposal. Following, therefore, are our comments on those proposed changes that cause us concern.

<u>IAS 16 Exchange of Similar Assets</u>

The IASB's proposed changes to IAS 16 would require that exchanges of property, plant and equipment be accounted for at fair value regardless of whether a transaction is an exchange of similar or dissimilar assets. However, in our view, the exchange of similar productive assets does not result in culmination of the earnings process which is fundamental to revenue and gain recognition. Without a culmination of the earnings process, we believe it is inappropriate to have gain recognition.

Our experience has shown that recording a gain on transactions of this type is highly susceptible to abuse and not credible to investors since exchanges of similar productive assets will not alter the company's future cash flows from operations. Since this proposal would create greater divergence in this area than exists currently and, in our view, is not supportable on either a theoretical or pragmatic basis, we urge the IASB to retain the *existing* provisions of paragraph 22.

IAS 16— Revaluation of Property, Plant and Equipment

The IASB's proposal would retain the ability to revalue property, plant and equipment. We understand that, in many jurisdictions, this is permissible or required under local laws or regulations. However, a significant amount of subjectivity is involved in determining the fair value of existing property, plant and equipment, especially when there is not an active marketplace for such assets. Reliability is a qualitative characteristic of accounting information. If information cannot be measured with sufficient reliability, then the measurement attribute is not appropriate in the circumstances.

Given the significant amount of subjectivity that is involved in determining the fair value of such assets, the ability to report an increase in the value of such assets without a market transaction could result in improper earnings management. Indeed, many believe that such revaluations should not be permitted because they can and have been done in a manner that is fraudulent and manipulative.

Finally, there is the question of the timing for recognizing the revaluations. The ED retains the provision that such revaluations should be made with "sufficient regularity" so that the carrying amount does not differ materially from the market value. Again, we find this provision to add further subjectivity into a process fraught with problems and ripe with opportunities for companies to improperly manage earnings and equity.

IAS 1—True and Fair Presentation

Some believe that the "true and fair override" of existing IAS 1 is similar in its intent and tone to Rule 203 of the AICPA's Code of Professional Conduct here in the US. Specifically, as with Rule 203, a departure from GAAP would only be allowed when it is clear that compliance with GAAP would result in misleading financial statements *and* it is clear that the standards setters had not contemplated the specific fact pattern in question.

In contrast to that view, others have believed that the override can be used in an abusive manner. In that light, we recently became aware of a research study which examined the instances of true and fair overrides during the period 1998 2000 in the UK which seems to support that impression. That study identified 804 overrides, of which 50 were identified as GAAP overrides. If that study is representative of similar experience with IAS overrides, statistics such as these cause us concern. If, however, the guidance of IAS 1 can be viewed and clarified as an obligation "to do more" rather than an opportunity for "override of' or "to depart from," the potential for abuse would be lessened.

IAS 16 Depreciation Method Issues

We are concerned with the provisions of paragraph 52 of IAS 16. Paragraph 52 requires companies to evaluate the method of depreciation on an annual basis. The requirement to review depreciation annually could lead to a significant number of "opportunistic" changes in depreciation methods. Like inventory cost-determination, depreciation is an area of financial reporting where there often is not one "best" method, but rather. several "acceptable" methods. As a result, we believe it would be a rare circumstance, other than when there has been a fundamental change in the entity's business practices, where another "acceptable" depreciation method could be established as preferable. Under the IASB proposal, management would be able to adopt a new principle each period even though the new principle is not preferable but is merely one of several acceptable methods.

In that regard, the provisions of paragraph 52A of IAS 16 continue the conclusions of existing IAS 16 (paragraph 52), which specify that a change in depreciation method constitutes a change in estimate. This conclusion in both existing LAS 16 and the proposed IAS 16 seems inconsistent with the conclusions found earlier in the standard. Paragraph 47 (of both existing and proposed IAS 16) states that "[a] variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life." (emphasis added) There are, of course, several assumptions within a given depreciation method (e.g., useful lives or units of service, salvage value), revisions of which result in a change in estimate. To continue to classify a change in the overall depreciation method as a change in estimate could invite abuse, as it would permit companies opportunistically to alter their depreciation method without the need to justify the new method on the basis of preferability. Such a change would also continue a divergent practice between lASs and many countries' GAAP. We believe that such a change should be treated as a change in accounting principle rather than as a change in accounting estimate.

The proposed definition of residual value used in the calculation of depreciation is based on what the value of the asset would be currently if this were the end of its useful life. That value could change from one period to the next even if there is no change in the salvage value or residual value as currently defined (the expected value of the asset at the end of its useful life). Adopting the proposed definition of residual value could lead to many unnecessary changes in estimates in company financial statements during the life of the asset. We encourage the IASB to retain the previous definition of residual value rather than creating potential short-term divergence instead of convergence.

IAS 1 Undue Cost and Effort

The IASB's proposal contains certain provisions where companies would be exempted from certain requirements if the requirements imposed "undue cost and effort" on the entity. The previous wording of impracticable is much more consistent with the terminology used in many countries and imposes a higher threshold for compliance with the authoritative standards and, therefore, we recommend that it be retained. If, however, the Board retains the new terminology and the notion of undue cost and effort is intended to convey a similar meaning or is intended to be a materiality consideration, that should be made clear.

IAS 8 Accounting Changes

The IASB's proposed changes to IAS 8 would specify retrospective application for voluntary changes in accounting principles. The proposal does not contain a requirement that the change be justified on the basis of preferability, which is generally required under domestic GAAP. While the proposal does require the disclosure of the reason for the change, because consistency in the application of accounting principles from period to period is a characteristic of financial reporting, we believe that a company must be able to demonstrate that the new principle gives investors a better presentation of financial position and results of operations. As a result, we believe that it should be made clear that the entity must be able to justify the new principle as being preferable to the previously-applied principle in order to overcome the presumption established by the qualitative characteristic of consistency.

In accounting for changes in accounting principles, many countries treat voluntary changes through the cumulative effect recognition approach. We acknowledge that there are differing views on this subject. Some argue that providing comparable information for all periods outweighs the perceived problems from restating previous results, thus justifying the use of retrospective application. Others believe that all items of profit and loss should be recognized in current income, thus justifying the current recognition of the effect of the change. We understand that this is an issue to be considered by the FASB and IASB in convergence deliberations. We encourage the standard setters to work closely to achieve a converged solution on this matter.

The IASB's proposed changes to IAS 8 would eliminate the requirement that a change in estimate be included in the same line-item of the income statement as the original item (existing paragraph 28). We believe that such classification is appropriate because a change in estimate still relates to the original financial statement element (e.g., a change in useful life relates to depreciation expense, a change in the bad debt reserve relates to the bad debt expense, etc.). Therefore, we believe that the original wording should be retained.

Coordination for Closer Convergence

The issue of convergence will require coordination between the IASB and domestic standards setters and we applaud the recent joint announcement of the IASB and FASB to work towards compatible, high quality solutions to existing and future accounting issues with the short-term convergence project serving as one point on that continuum. The two

Boards' stated intention to works towards the issuance of an exposure draft in 2003 intended to eliminate certain identified differences in standards is an important undertaking in achieving greater convergence between domestic and international accounting standards.

We agree with and support the IASB's proposal to eliminate extraordinary item presentation from the income statement and we believe that national standards setters, including the FASB, should be encouraged to consider similar changes.

We understand the IASB's proposal to require componentization of fixed assets is intended to apply to major, large units rather than to numerous smaller units. This should help make the standard operational. However, if this is the IASB' s intent, that should be explicitly stated in the standard. This and other proposed changes to IAS 16 (e.g., accounting for costs to dismantle and remove assets, treatment of costs of major inspections) will require careful coordination between the IASB and domestic standards setters to avoid the potential for divergence. We encourage the staff and the Board members of the IASB to work closely with domestic standards setters to avoid the possibility of reducing rather than enhancing convergence in this area.

IAS 2— Inventories

In the spirit of convergence, the IASB's proposed changes to IAS 2 would eliminate the use of LIFO in determining the cost of inventories. LIFO is one of several acceptable and commonly-used inventory cost-detennination conventions now in force in several countries. We understand and support, as a general goal, the IASB's efforts to reduce accounting alternatives in its standards; however, we do not see value, from a short-term convergence standpoint, in seeking to remove long-standing and accepted alternative accounting principles in areas such as depreciation and inventory cost conventions.

IAS 27— Parent-Company Statements

Paragraph 29 of IAS 27 would require the use of the cost method or the application of IAS 39 to subsidiaries, joint ventures, and equity-method investees in parent-company financial statements. Under many countries' domestic GAAP, the equity method would be required in these situations. Of course, this points to an area of accounting that needs greater convergence: that of accounting for joint ventures and equity-method investees. We understand that the IASB will be preparing a White Paper to form the basis for further consideration of these issues. We urge close cooperation between the TASB and domestic standards setters on this topic in an effort to achieve greater convergence in this area.

We believe that the IASB's efforts towards improving existing IASs have been substantial and we encourage the Board to continue these efforts. We look forward to working with the Board in achieving high-quality, converged solutions to accounting standards.

Sincerely,

Jackson M. Day
Acting Chief Accountant