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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: Proposed improvements to International Accounting Standards

Dear Sirs

I am writing to you on behalf of Telefónica.

The purpose of this letter is to comment on the Exposure Draft of Proposed Improvements to International Accounting Standards. In Exhibit 1 you can find our answers to the questions raised in the Draft, as well as other comments which we consider relevant.

Thank you for giving us the opportunity to raise comments on the Exposure Drafts you publish.

Yours sincerely,

Marta Soto

EXHIBIT 1

IAS 1

Question 1. *Do you agree with the proposed approach regarding departure from a requirement of an International Financial Reporting Standard or an Interpretation of an International Financial Reporting Standard to achieve a fair presentation (see proposed paragraphs 13-16)?*

Answer. Yes, we agree with the proposal.

Question 2 *Do you agree with prohibiting the presentation of items of income and expense as 'extraordinary items' in the income statement and the notes (see proposed paragraphs 78 and 79)?*

Answer. No, we do not agree with eliminating the items considered as extraordinary. We prefer maintaining the extraordinary items because there might take place certain transactions or events that are not related or are not a consequence of the ordinary course of activities of an entity. Because of this fact we understand that the users of the Financial Statements should have the opportunity to identify which items of income and expense are originated from activities different from the ordinary activities of the entity in order not to mislead their analysis of the financial information. Accordingly, we recommend maintaining the line "operating profit" in the income statement.

To avoid arbitrary classification of extraordinary items a solution might be that the improvement to IAS clearly establishes the requirements of transactions or events that should be classified as extraordinary.

Question 3. *Do you agree that a long-term financial liability due to be settled within twelve months of the balance sheet date should be classified as a current liability, even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue (see proposed paragraph 60)?*

Answer. No, we do not agree with the proposal. We understand that the fact of re financing or re scheduling the debt should be considered when classifying the debt as non-current, even if it is completed after the balance sheet date (and before the financial statements are authorised for issue). In this way the entity's financial position will be presented according to the real situation and additionally it the will be correctly perceived by users of financial information.

Question 4. *Do you agree that:*

(a) a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date, even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach (see proposed paragraph 62)?

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Answer. No, we do not agree. As explained in the previous answer, the existing fact that the lender will not demand payment, must be considered in the classification of the debt as non-current in order to present a fair view of the entity's financial position.

(b) if a lender was entitled to demand immediate repayment of a loan because the entity breached a condition of its loan agreement, but agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:

(i) the entity rectifies the breach within the period of grace; or

Answer. Yes, we agree

(ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified (see proposed paragraphs 63 and 64)?

Answer. Yes, we agree. But it should be clarified when it is understood that it is <u>probable</u> that the breach will be rectified. If not, we would doubt of the correct classification of the debt: if the period of grace is more than twelve months, there is no doubt that the loan shall be classified as non-current. But if the period of grace is less than twelve months and at the time the financial statements are issued is incomplete and the entity has not rectified the breach, we understand that the loan might be classified as current, unless there is <u>clear evidence</u> that the entity will rectify the breach.

Question 5. *Do you agree that an entity should disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements (see proposed paragraphs 108 and 109)?*

Answer. No, we do not agree. The information to be disclosed would be different from one entity to another. We have serious doubts that any information disclosed would be useful.

Question 6. *Do you agree that an entity should disclose key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year (see proposed paragraphs 110-115)?*

Answer. No, we do not agree. If we consider literally the requirements, almost every item of the financial statements might be affected by "key assumptions" of that nature.

Additionally, we understand that most of the information required is so crucial and confidential for the entity that it would affect competitiveness.

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We consider that a similar kind of information, but more generic, should be presented under the financial review that the management present outside the financial statements as it does not relate to the components of the financial statements, nor it explains them.

This kind of report is excluded from the scope of the IAS as stated in paragraph 7. So the contents mentioned in paragraphs 110-115 should be regarded as part of the mentioned document, but not as a component of financial statements.

IAS 2

Question 1. *Do you agree with eliminating the allowed alternative of using the last-in, first-out (LIFO) method for determining the cost of inventories under paragraphs 23 and 24 of IAS 2?*

Answer. Yes, we agree.

Question 2. *IAS 2 requires reversal of write-downs of inventories when the circumstances that previously caused inventories to be written down below cost no longer exist (paragraph 30). IAS 2 also requires the amount of any reversal of any write-down of inventories to be recognised in profit or loss (paragraph 31).*

Do you agree with retaining those requirements?

Answer. Yes, we agree.

IAS 8

Question 1. *Do you agree that the allowed alternative treatment should be eliminated for voluntary changes in accounting policies and corrections of errors, meaning that those changes and corrections should be accounted for retrospectively as if the new accounting policy had always been in use or the error had never occurred (see paragraphs 20, 21, 32 and 33)?*

Answer. Yes, we agree with the proposal. However it should be clarified that this requirement doesn't mean the amendment of previous years' financial statements, only the restatement of prior years' figures presented for comparison purposes.

Question 2. *Do you agree with eliminating the distinction between fundamental errors and other material errors (see paragraphs 32 and 33)?*

Answer. Yes, we agree.

Additional comments

The existing IAS, in its paragraph 48, <u>encourages</u> the disclosure of the nature of the future change in accounting policy and an estimate of the effect of the change on its net profit or loss and financial position when a new Standard has been published but not yet come into effect.

The revised standard modifies it by <u>requiring</u> disclosure of the estimate of the effect of the change on financial position in paragraph 19.

From the point of view of entities, when they prepare the financial statements, it is not always possible to estimate the effect of a change in an accounting policy due to the application of a new standard that is not yet in force. It may imply deep changes from the previous rules and consequently it is difficult, not only for the cost or effort but also for restrictions in the timing of the required calculations.

Accordingly we prefer the previous formula of encouraging the disclosure.

IAS 16

Question 1. *Do you agree that all exchanges of items of* ***property, plant and equipment*** *should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably (see paragraphs 21 and 21A)?*

Answer. No, we do not agree with the proposal. It means that in the case of similar assets, where there hasn't been any acquisition nor sale, the asset would be revalued as a consequence of a swap of assets with similar use in the same line of business. We understand that the earnings process is not completed and therefore there shouldn't be a revaluation.

The arguments stated in paragraph A4 are very clear and valid from our point of view.

Question 2 *Do you agree that all exchanges of* ***intangible assets*** *should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably? (See the amendments in paragraphs 34-34B of IAS 38, Intangible Assets, proposed as a consequence of the proposal described in Question 1.)*

(Note that the Board has decided not to amend, at this time, the prohibition in IAS 18, Revenue, on recognising revenue from exchanges or swaps of goods or services of a similar nature and value. The Board will review that policy later in the context of a future project on the Recognition of Revenue.)

Answer. No, we do not agree. Our view is similar to the previous question, we don't see any reason to treat intangible assets differently from tangible assets.

Question 3. *Do you agree that depreciation of an item of property, plant and equipment should not cease when it becomes temporarily idle or is retired from active use and held for disposal (see paragraph 59)?*

Answer. No, we do not agree. When an assets is held for disposal and it ceases to make a contribution to the entity's activity and the way it will contribute to the entity is by the selling process. Accordingly, the asset should be valued as stated in paragraph A10: at the lower of its carrying amount and fair value less cost to sell. We agree with the arguments stated in the mentioned paragraph A10.

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Other comments

Paragraphs 49 and 52 require the annual revision of useful lives and depreciation methods. We understand that a revision should be made only when there are indicators that may lead to a revision of those parameters.

IAS 17

Question 1. *Do you agree that when classifying a lease of land and buildings, the lease should be split into two elements—a lease of land and a lease of buildings? The land element is generally classified as an operating lease under paragraph 11 of IAS 17, Leases, and the buildings element is classified as an operating or finance lease by applying the conditions in paragraphs 3-10 of IAS 17.*

Answer. The proposal is good, but only in theory, because in practice it is almost impossible if the contract does not split both items. Any estimated split would be arbitrary. Accordingly we do not agree with the changes.

Question 2. *Do you agree that when a lessor incurs initial direct costs in negotiating a lease, those costs should be capitalised and allocated over the lease term? Do you agree that only incremental costs that are directly attributable to the lease transaction should be capitalised in this way and that they should include those internal costs that are incremental and directly attributable?*

Answer. Yes, we agree.

IAS 21

Question 1. *Do you agree with the proposed definition of functional currency as "the currency of the primary economic environment in which the entity operates" and the guidance proposed in paragraphs 7-12 on how to determine what is an entity's functional currency?*

Answer. Yes, we agree.

Question 2. *Do you agree that a reporting entity (whether a group or a stand-alone entity) should be permitted to present its financial statements in any currency (or currencies) that it chooses?*

Answer. Yes, we agree. We do not see any problem to permit presentation of financial statements in the currency an entity may choose. However we recommend the disclosure of the reasons of choosing a currency which defers from that of the country of the parent company as well as if it defers from the functional currency.

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Question 3. *Do you agree that all entities should translate their financial statements into the presentation currency (or currencies) using the same method as is required for translating a foreign operation for inclusion in the reporting entity's financial statements (see paragraphs 37 and 40)?*

Answer. No, we do not agree. We understand that the presentation of a currency different from an entity's functional currency, should be considered merely as an expression of the underlying amounts, as measured in the functional currency, in a different currency. Accordingly, no gains or losses should arise on that expression, nor an equity variation. We propose the first method described in paragraph A14: translate all amounts at the most recent closing rate.

Question 4. *Do you agree that the allowed alternative to capitalise certain exchange differences in paragraph 21 of IAS 21 should be removed?*

Answer. Yes, we agree.

Question 5. *Do you agree that*

(a) goodwill and

Answer. No, we do not agree with such view. We agree with the view sustained by some Board members that goodwill should be regarded as an asset of the parent as it is part of the acquisition price paid by it, which is explained in paragraph A25.

(b) fair value adjustments to assets and liabilities that arise on the acquisition of a foreign operation should be treated as assets and liabilities of the foreign operation and translated at the closing rate (see paragraph 45)?

Answer. This case is different because the fair value adjustments of assets and liabilities are clearly part of the cost of the acquired entity.

IAS 24

Question 1. *Do you agree that the Standard should not require disclosure of management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations (see paragraph 2)?*

'Management' and 'compensation' would need to be defined, and measurement requirements for management compensation would need to be developed, if disclosure of these items were to be required. If commentators disagree with the Board's proposal, the Board would welcome suggestions on how to define 'management' and 'compensation'.

Answer. Yes, we agree.

Question 2. *Do you agree that the Standard should not require disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or a* *wholly-owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs (see paragraph 3)?*

(Note that this proposal is the subject of alternative views of Board members, as set out in Appendix B.)

Answer. Yes, we agree.

Other comments

In paragraph 9 d) it should be clarified the limit of which directors (executive or not) are considered to be key management personnel. The big organisations may have personnel structures in which there are many levels of directors each with a certain degree of responsibility in the company's activities. The limit should be clarified with a deeper description of *"authority and responsibility for planning, directing and controlling the activities of the entity"*.

IAS 27

Question 1. *Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?*

Answer. Yes, we agree.

Question 2. *Do you agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity (see paragraph 26)?*

Answer. Yes, we agree.

Question 3. *Do you agree that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, in the investor's separate financial statements (paragraph 29)?*

Answer. No, we do not agree. We understand that the best option for accounting those entities in separate financial statements is the equity method. This method implies that both, consolidated and separate financial statements, show the same amount of equity and net income, which actually they should be. In our country, the rule is to use the cost method, and the result is that users of financial statements actually do not understand why there are differences between the equity and net income of consolidated and parent's separate financial statements. They even get very confused of that fact and often make questions regarding that point.

In our view, the equity method is the best option and should be maintained. The other two options may also be maintained.

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Do you agree that if investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments should be accounted for in the same way in the investor's separate financial statements (paragraph 30)?

Answer. Yes, we agree.

Other comments

Paragraph 21 of the revised statement should maintain the practicability option because in some cases the application of uniform accounting policies regards undue cost or effort, for the results obtained. We consider that the exemption should be retained with the "practical" and/or the "undue cost or effort" formulas.

IAS 28

Question 1. *Do you agree that IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, should not apply to investments that otherwise would be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries (see paragraph 1)?*

Answer. Yes, we agree.

Question 2. *Do you 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 (paragraph 22)?*

Answer. No, we do not agree. We understand that it should only include the investment in the equity of the associate. The proposal might lead to inappropriate write-downs, because the fact that an entity incurs losses doesn't mean that receivables will be irrecoverable.

Other comments

In relation with paragraph **27 (a)**, we propose to add that the price quotations should be in an active market, if not, the price quotations may not lead to the best estimate of fair value.

IAS 33

Question 1. *Do you agree that contracts that may be settled either in ordinary shares or in cash, at the issuer's option, should be included as potential ordinary shares in the calculation of diluted earnings per share based on a rebuttable presumption that the contracts will be settled in shares?*

Answer. No, we do not agree. The treatment should require that it should be included only when the issuer considers it more probable to settle the contract in shares. If it is probable that it will be settled in cash, it should not be included.

Question 2. *Do you agree with the following approach to the year-to-date calculation of diluted earnings per share (as illustrated in Appendix B, examples 7 and 12)?*

– *The number of potential ordinary shares is a year-to-date weighted average of the number of potential ordinary shares included in each interim diluted earnings per share calculation, rather than a year-to-date weighted average of the number of potential ordinary shares weighted for the period they were outstanding (ie without regard for the diluted earnings per share information reported during the interim periods).*

  Answer. No, we do not agree.

  - **Example 7:** the year-to-date weighted average of the interim information results in 6,250 while the year-to-date weighted average for the period they were outstanding is actually 5,000. The difference is caused by the fact that under the diluted calculation the contingently issuable shares are included from the beginning of the interim period in which the conditions to issue are satisfied (i.e. opening of a retail store). We do not agree with this approach since the necessary conditions were not satisfied at the beginning of the interim period. The described approach results in the disclosure of diluted earnings per share including contingently issuable ordinary shares for which all necessary conditions have not been satisfied which is incompatible with the new paragraph 47. Consequently, we believe the weighted average shares used to calculate the basic earnings per share (i.e. take the number of issuable shares into account as from the moment the contingent event has occurred, not earlier) should be used.
  - **Exaple 12:** under the example of earnings contingency, the number of contingently issuable shares depends on the net profit in excess of 2,000,000 for the year ended 31 December 20X1. Since the information on the number of potentially issuable shares is most accurate at the end of each period and the contingency becomes an obligation at 31 December 20X1, we do not agree with the illustrated approach and recommend taking the actual information (900,000) into account in calculating the full year diluted earnings per share. This method will best reflect the actual dilution that will occur in the next year and therefore provide the most relevant information.

– *The number of potential ordinary shares is computed using the average market price during the interim periods reported upon, rather than using the average market price during the year-to-date period.*

  Answer. No, we do not agree unless the result of using the average market price during the interim periods reported upon approximates the result that would be obtained when using the average market price during the year-to-date period. We believe that our proposed approach (i.e. using the average market price during the year-to-date period and not the average market price during the interim periods reported upon, unless the outcome of the latter method would approximate the result of the year-to-date period when computing the number of potential ordinary shares) is more consistent with the approach described under IAS 21, new paragraph 20.

– *Contingently issuable shares are weighted for the interim periods in which they were included in the computation of diluted earnings per share, rather than being included in the computation of diluted earnings per share (if the conditions are satisfied) from the beginning of the year-to-date reporting period (or from the date of the contingent share agreement, if later).*

Answer. No, we do not agree for the same reasons stated above.

IAS 40

Question 1. *Do you agree that the definition of investment property should be changed to permit the inclusion of a property interest held under an operating lease provided that:*

(a) the rest of the definition of investment property is met; and

(b) the lessee uses the fair value model set out in IAS 40, paragraphs 27-49?

Answer. No, we do not agree. We do not understand why the same transaction can result on recording an asset or not only because of applying a different method of valuation. We consider that an operating lease does not give rise to an asset, accordingly we don't agree with the proposed approach.

Question 2. *Do you agree that a lessee that classifies a property interest held under an operating lease as investment property should account for the lease as if it were a finance lease?*

Answer. No, we do not agree for the same reasons stated above.

Question 3. *Do you agree that the Board should not eliminate the choice between the cost model and the fair value model in the Improvements project, but should keep the matter under review with a view to reconsidering the option to use the cost model in due course?*

Answer. Yes, for practical reasons, we agree.