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Sir David Tweedie
Chairman
International Accounting Standards
Board (IASB)
30 Cannon Street
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September 12, 2002

RE: IAS Improvements Project & Private Equity

Dear Sir David:

UBS appreciates the opportunity to comment on the IASB Improvements Project Exposure Draft. UBS utilizes IAS as its primary reporting framework and is one of the largest companies of any kind to have adopted IAS. We have an interest in the further development of these standards and support the work of the Board. We hope you find our comments useful.

Overall we believe that the Board has achieved many of its objectives in the Improvements Project by reducing or eliminating alternatives and redundancies within the existing Standards. Although the majority of the amendments proposed within the Exposure Draft (ED) will improve financial reporting, we are concerned about the impact of a few of these proposed changes. Specifically, we have very serious reservations regarding the proposed amendments to IAS 27, *Consolidated and Separate Financial Statements*, and also some concerns about the proposals on IAS 1, *Presentation of Financial Statements*, and the effective date for the final improved Standards.

We believe that the amendments to paragraphs 13 and 13A of ED IAS 27, will not improve financial reporting for private equity investors, and may in fact make the financial statements of these investors less understandable. At UBS the clarity and transparency of our financial reporting is of paramount importance to our reputation and is broadly recognised as "best in class" for the financial services industry. We are very concerned that the shift from a principle (temporary control) to a rule (temporary being defined as 12 months) will result in a consolidation of UBS's private equity investments which would seriously impair the quality of our financial statements, and investors' understanding of UBS.

We believe that private equity investments should be exempt from consolidation as they are purchased with the intention for disposal and are managed and evaluated by the investor on a fair value basis. As a result, we urge the Board to include criteria to exclude private equity investments from the scope of the consolidation provisions of this ED.

We believe there is a conceptual inconsistency between ED IAS 27 and ED IAS 28, *Accounting for Investments in Associates*. ED IAS 28 exempts venture capital organizations and similar entities from using the equity method of accounting for investments that meet the definition of an associate. Instead, these companies are to account for investments in associates under the guidance of IAS 39, *Financial Instruments: Recognition and Measurement*. We believe that the IASB should strive for consistent rules and requirements and therefore strongly encourage the Board to expand the exemption introduced in IAS 28 to subsidiaries covered by IAS 27. Due to the significance of this issue and the fact that commentators have not been asked specifically to comment on this change, we have included an expanded comment on this issue in Appendix 1 to this letter.

Paragraphs 13-16 of IAS 1 introduce alternative accounting approaches based on whether a specific regulatory framework would require or permit a departure from International Financial Reporting Standards ("IFRS"). We do not believe that IFRS should be governed by local regulatory frameworks. We do not believe that regulatory frameworks should be considered in a decision to apply or not apply a specific accounting standard. Applying such an approach will lead to inconsistent application of accounting standards, and as a result will impair comparability. As such, we urge the Board to reconsider paragraph 13 of ED IAS 1 and omit reference to regulatory frameworks.

The ED indicates that these amended Standards would be effective for annual financial statements covering periods beginning on or after 1 January 2003. If final Standards are published after 1 January 2003 and if the proposed effective date is retained, IAS preparers would be required to retroactively apply the Standards mid-year. We strongly recommend that any final Standard should be effective from a date after their issuance, with early adoption permitted.

We have included our answers to the specific questions that were asked in the Invitation to Comment in Appendix 2 of this letter.

We very much appreciate the opportunity to comment. The private equity issue is of such importance to us that we would appreciate the opportunity of meeting with you to discuss this further in the near future. If you would like to discuss any comments that we have made in relation to IAS 27, please contact either of the signatories to this letter or William Widdowson (+41 1 234 55 65).

Yours sincerely,

UBS AG

Mark Branson
Chief Communication Officer

Hugo Schaub
Group Controller

Appendix 1- ED IAS 27- Consolidated and Separate Financial Statements

ED IAS 27: CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

ED IAS 27, paragraph 13, amends the existing text and replaces the term "in the near future" with "within twelve months from acquisition". Paragraph 13A adds a clarification that venture capital organizations, mutual funds, unit trusts or similar entities are not exempt from consolidating subsidiaries.

Many banks and other companies conduct a substantial private equity business under which they sometimes also purchase majority ownership interests in non-public entities. These entities operate in a diverse range of industries and usually have nothing in common with the industry of the investor. The investor's intent is generally to retain its investment for a period of time, frequently three to five years, during which time the business is developed with an eye towards an exit strategy that typically involves a public offering, sale to management, or sale to a strategic buyer. The goal of the investor is to generate capital gains on these investments, not to incorporate the entity into its operations. In most of these investments, participation of management of the investee (and not necessarily management of the investor) is a key pre-requisite to the participation of the investor, and management in place frequently represents a significant proportion of the value of the investee company. The investor in these situations is a "financial investor" rather than a "strategic investor", which is evidenced by the wide variety of industries it invests in, that it does not gain any operational synergies from its investment, and that it has a clear intention to realize its profit from selling that investment rather than retaining the investment long term.

We believe that consolidation of private equity investments by a financial investor will not improve financial reporting, will add no information of value for users of the investor's financial statements, and may, in fact, make the financial statements of the investor less understandable. Our conclusion is based on the fact that private equity investments are managed or evaluated based on fair value and not on accounting earnings, the use of the equity method is not required for investment companies that meet the definition of an associate, a twelve month period is arbitrary, and the costs of consolidation could outweigh the benefits. Accordingly, we urge the Board to define criteria to exclude private equity investments from the scope of the consolidation provisions of this ED.

Our reasons for our conclusion to exclude private equity investments from the scope of consolidation are as follows:

Private equity investments are not a part of the economic unit.
Consolidated financial statements present the financial position and results of operations of a group of entities as if they were a single economic unit. In many cases the consolidated entities function together by using centralized support services, consolidated funding and cash management, entering into intercompany (intragroup) transactions, engaging in strategic plans designed to further the interests of the group, etc. Private equity investments, on the other hand, operate separately and independently of the group. The expected economic return to the private equity investor does not come from the operations of the investee company *per se,* but rather, from the capital gain that is expected upon sale of the investment after a period of development. The investment made by an investor provides an incubation period for the investee, during which time a key goal is to enable the investee company to develop the ability to stand on its own, or alternatively, to prepare it for integration with a strategic investor with whom the investee will become a part of an economic unit.

We believe that only permanent investments or investments that support the operations of the investor should be consolidated. For example, we believe that financing subsidiaries of manufacturing companies (such as GMAC or Ford Motor Credit) should be consolidated. This is because the financing subsidiary directly supports the operations of the parent, for example by facilitating sales of the parent company's products. Private equity investments are isolated from the investor, and do not support the operations of the investor. In addition, financing subsidiaries are held as permanent investments of the parent company. Private equity investments, on the other hand, are purchased with an exit strategy and exit timetable in mind. Although the timetable generally exceeds the 12-month threshold contemplated by the ED, exiting the investment is nonetheless a key aspect of the plan.

Private equity investments are managed or evaluated based on fair value and not on accounting earnings.

Crucial factors in the evaluation of an investment opportunity, and in the continuing evaluation of the investment after it is made, include the economic value of the business, its ability to generate self-sustaining cash flows on an ongoing basis, its progress against plan, the targeted return on investment, the development of fair value of the investment, and other measures. Investors in companies that conduct a private equity business are aware that the intent is to generate capital gains and that investments are evaluated by management based on their fair value development during the reporting period. We believe that a measure that is not used by senior management of the consolidated group cannot possibly assist a user of the group's financial statements. Further, given the segregation of assets and liabilities of private equity investments, we believe it would be misleading to represent those assets as assets of the consolidated group and those liabilities as claims against the consolidated group.

A fair value measurement concept fits decisively better into a banks capital adequacy requirement framework. Consolidation of majority owned private equity investments would, for example, require a bank to develop a new approach to effectively integrate these entities into their capital adequacy systems. In addition, banks are subject to fairly complex capital adequacy rules which provide guidance related to the amount of capital that is required for each type of asset. These rules do not address assets typically found in manufacturing companies. Consequently, a requirement to consolidate controlled private equity investments would possibly have negative implications on these capital requirements. For example, goodwill would attract a full equity underpinning, intangible assets and property, plant and equipment would attract a capital charge of a quarter to a third of their book value. Such high capital charges would severely deteriorate the investors return on investment and thus reduce the attractiveness of the private equity business.

Use of the equity method is not required for investment companies that meet the definition of an associate.

The ED IAS 28, *Accounting for Investments in Associates*, exempts venture capital organizations, mutual funds, unit trusts and similar entities from using the equity method of accounting for investments that meet the definition of an associate. Instead, these companies would account for investments in associates under the guidance of IAS 39 if such accounting were well established practice in those industries. We believe this represents a conceptual inconsistency to the proposed IAS 27 and strongly encourage the Board to expand the exemption introduced in IAS 28 to subsidiaries. In the venture capital and investment fund industry it is in many countries a well established practice, or even a requirement, to fair value all investments held and record changes in fair value in income.

If adopted by the IASB, we believe that an extension of the exemption to consolidate subsidiaries should be accompanied by a clear and robust definition of these companies to avoid abuse of the exemption. We suggest to use the term "investment companies" for these venture capital organizations, mutual funds, unit trusts and similar entities, and propose the following definition:

Investment companies are entities whose primary business activity is to make equity and debt investments in public or non-public entities for the purpose of generating income from dividend receipts, interest revenue and capital appreciation. Any equity investments in subsidiaries that are not consolidated, or in associates that are not accounted for by using the equity method, must be clearly distinct from the core business activities of the parent and its other controlled subsidiaries that are consolidated. Investment companies are entities that:

a) issue participation shares to the public, or
b) pool funds of a limited number of independent investors, or
c) are separate legal entities held by a parent whose primary business activity is clearly distinct from the operations of the investee enterprises.

To satisfy the criteria under letter c), for each of the investee enterprises the holding entity
- *must have an exit plan;*
- *evaluates the performance of the investee based on fair value, disposal value or a similar measure; and*
- *does not provide management or administrative support in an extent to the investee that the investee could not immediately operate independently upon disposal.*

A twelve month period is arbitrary.
We understand and concur with the concept of granting an exception from consolidation requirements for entities where control is temporary. By including such a company in the consolidated group for only a short period of time, the variations that would occur in the financial statements would reduce the clarity of ongoing trends, and the cost of consolidation could outweigh any potential benefits. Other than as a matter of having a clear rule and of administrative convenience, we see no reason why the period for such an exception should be limited to 12 months. Rather, we believe it should be based on designation of investments as temporary, and documentation of a plan and timeline for exiting.

UBS has been a strong supporter of International Accounting Standards because they are a principles based set of accounting standards. We view the introduction of a twelve months period limitation as an unjustified and unnecessary deviation from that principles based approach. If the Board ultimately decides to keep this threshold of 12 months, companies inevitably will consolidate or not consolidate based on their best estimates of the time horizons. If a company plans to hold a "controlled" investee for a period of less than twelve months and finds that it takes a longer period to complete the sale, what accounting would the Board propose? If this were a revision of an estimate, would the investee then be consolidated for the first time after the twelve month holding period? Or, if the new estimate can be substantiated, would a new twelve month period be initiated? If so, beginning when? Or, alternatively, would such a case be a correction of an error? A goal of accounting should be that similar transactions are accounted for similarly. It seems illogical to us that an investment to be held for eleven months would be accounted for differently from one whose holding period is expected to be thirteen months.

We strongly encourage the IASB to employ its typical principles-based approach to the question of temporary control, rather than a rules-based approach.

The costs could outweigh the benefits.
The costs of gathering and preparing consolidation information could outweigh the benefits.

There are numerous factors that contribute to making the cost of gathering information required to consolidate a private equity investment higher than one might initially expect, these include:

- Private equity investee companies are not managed as part of the overall consolidated (investor) group; rather, their independence is encouraged and developed, as a precursor to their sale.
- The investee may employ an accounting framework different from the investor. (i.e. the investee may be on some local accounting framework other than IAS)
- The investee may have a different fiscal year end than the investor. Further, the year end may be outside of any acceptable "window" for use in consolidation with the investor, so that a second "hard" annual closing could be required.
- Even if the year end is consistent with that of the investor, the closing process may take longer than the time available to permit the investor to file timely reports with regulators and/or securities exchanges. This could be especially true if the private equity investee itself has to prepare consolidated financial statements first before submitting the information to the investor for purposes of preparing the investor's consolidated financial statements.
- Aggregation of information, particularly for disclosures, may not be possible in a timely fashion. Although the private equity investor and the investee may be in entirely different businesses, they may, for example, have credit exposures to the same counterparties or countries. Consolidation would dictate that these exposures also be consolidated for disclosures purposes, although we do not believe such disclosures would benefit the user. Due to differing accounting systems, it may be a lengthy and expensive process to compile such data.
- Even if the investee uses IAS, differences in the application of IAS, or in use of estimates or estimating procedures could differ. Examples include depreciable lives of assets, fair values of financial instruments (note that even if the private equity investee is not a financial services organization, it could still be a user of financial instruments), provisions for uncollectible accounts, and numerous other matters.
- Certain information, particularly historical information, may not be available at any cost. For example, information to determine whether previous business combinations should have used the purchase method or the uniting of interests method may not be available. Also, even with respect to acquisition of "control" by the investor, fair value assessments that would be required to apply the purchase method and determine the resulting goodwill may not be available.
- Private equity investments frequently cross borders. As a result, the underlying books and records of the investee company may be in a language different from that of the investor. The practical implications of adding multiple languages (in addition to multiple accounting frameworks) to the consolidation process is formidable even for a global company, and must not be underestimated.

Given our belief that the usefulness of financial statements that consolidate private equity investments is limited at best, we would question the wisdom of requiring companies to expend the resources required to produce them.

Recommendations if the Board proceeds to require consolidation:

If the Board decides not to include an exemption for investment companies from consolidation of controlled private equity investments in the final IAS 27, we would ask that the following transition provisions be adopted:

First, in recognition that the information gathering process will be long and expensive, we would ask that the effective date be not earlier than 1 January 2004.

Second, in recognition that certain historical information may simply not be available, we would ask that adoption for private equity investments be made on a prospective basis, rather than restatement of prior periods, and that the difference between the carrying amount pre and post change in accounting policy be recognized as an adjustment of the balance of retained earnings at the beginning of the financial year in which the change in accounting is made. This method of adoption should be made regardless of whether the Board decides to move to the consolidation approach proposed, or to use a fair value approach as we suggest. In the case of the consolidation approach, certain information is unlikely to be available at any cost or in any time frame. Since there was no expectation that information to permit consolidation would ever be required, that information may simply not have been prepared or retained.

Third, as an extension of the second comment above, we would ask that the Board permit new basis accounting on the date of adoption. Specifically, since the private equity investor would be required to apply purchase accounting methods to the investees, we believe that the fair value of the investee should be recognized as the "purchase price", and that the "purchase" should be deemed to have occurred on that date. This approach would be consistent with a cumulative effect approach to adoption, and would effectively deal with the problem of missing or incomplete historical data.

Appendix 2- Reponses to Questions in the Invitation to Comment

IAS 1, Presentation of Financial Statements

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 - We agree that entities should only depart from a requirement in the extremely rare circumstance where compliance would be so misleading that it would conflict with the objective of financial reporting. However, we do not believe that regulatory frameworks should be considered in a decision to apply or not apply a specific accounting standard. We believe that such an approach will lead to inconsistent application of accounting standards, and as a result will impair comparability. We strongly recommend that as a principal IFRS should not be influenced by regulatory frameworks or any national influence.

If the IASB insists on including reference to regulatory frameworks, we urge the Board to provide a clear definition of what is meant by "so misleading that it would conflict with the objectives of financial reporting". In addition, we believe that further clarification is needed regarding when a departure is allowed under a regulatory framework. We are not sure if the rule is meant to cover departures in general or on a rule by rule basis. For example, the United States SEC, the regulator for US listed companies, states that overall a departure is never permitted from a standard. This prohibition applies both to US GAAP as well as to the use of IAS, or any other framework, used by US listed companies. Further, US GAAP has different accounting rules from IAS, in areas such as goodwill amortization. IAS requires entities to amortize goodwill, whereas US GAAP forbids amortization. Would the new rules under IAS require amortization even if an entity felt that it was materially misleading on the basis that under US GAAP an entity may never depart from accounting standards, or would the new rules permit non-amortization, based on the fact that US GAAP permits or requires a different treatment? Lastly, we urge the IASB to provide guidance on how an international company that is listed on numerous exchanges would determine their regulatory framework.

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 - We agree with prohibiting the presentation of 'extraordinary items' in the income statement and the notes. As described in paragraph 77 of the ED IAS 1, we agree that the nature of a transaction rather than its frequency should determine its presentation within the income statement. Prohibiting the presentation of 'extraordinary items' will also eliminate potential arbitrary segregation between income and expenses from ordinary activity and income and expenses from the effects of a related external event. To the extent an entity feels it has experienced an extraordinary item, narrative disclosure will be more helpful than presentation in the income statement.

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 authorized for issue (see proposed paragraph 60)?

Answer - We disagree with the proposed change. We believe that a change of a contractual arrangement after the balance sheet date should be considered when determining classification. Although we acknowledge that the refinancing of a liability after the balance sheet date has no effect on an entity's liquidity and solvency as of the balance sheet date, we believe that this information is important for users of financial statements to assess future cash payments and future liquidity. IAS 32, *Financial Instruments: Disclosure and Presentation*, paragraph 48 states that contractual terms and conditions are an important factor affecting the amount, timing and certainty of future cash payments. The disclosure of the contractual terms and conditions under IAS 32 would therefore also not reflect the refinancing after the balance sheet date based on the proposed paragraph 60 of ED IAS 1 and could therefore be misleading for an investor in evaluating the future cash flows of an entity. We are aware that based on IAS 10, *Events After the Balance Sheet Date*, non-adjusting events should be disclosed if non-disclosure would affect the ability of the users of financial statements to make proper evaluations and decisions. We however believe that a change in terms that is completed after the balance sheet date is generally an adjusting event under IAS 10. For example, such a change of terms could likely be in the works prior to the balance sheet date and would therefore be considered an adjusting event under IAS 10.

Lastly, the proposed changes represent a departure from US GAAP. As it is the IASB's stated goal to achieve convergence with national standards, we question the introduction of yet another reconciling item.

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 authorized for issue, not to demand payment as a consequence of the breach? (see proposed paragraph 62)

Answer - (a) We disagree with the proposed change. Please see our answer to question 3 above.

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

Answer - (b) We agree with the proposed paragraph to classify a liability as non-current under the circumstances described. A change in a loan agreement which was concluded by the balance sheet date should be taken into consideration for classifying a liability even if it is only probable that the breach will be rectified during the period of grace.

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 recognized in the financial statements (see proposed paragraphs 108 and 109)?

Answer - We disagree with the proposal to expand disclosures about judgements made in applying accounting policies as we believe such disclosures will not improve financial reporting and may, in fact, cause the financial statements to be misleading. We note that the conceptual framework already requires preparers of financial statements to make any disclosures necessary such that the financial statements will not be misleading. As such, we believe specifically requiring incremental disclosure about judgements or estimates is unnecessary.

Financial statements are summary documents that present an overall picture of an entity as of a certain date and for a specified period of time. They are not, and do not purport to be a completely detailed presentation of every item. Further, they do not have the precision of measurement that some users of financial statements believe is inherent. This imprecision is caused by, among other factors, the use of estimates and judgements. Accordingly, we believe it is appropriate to include general disclosure that judgements are made and estimates are used by preparers of financial statements. However, we do not believe that disclosing specifics about these matters is either necessary or helpful.

As an example, derivative instruments are generally carried at fair value, and the estimation of that fair value requires the use of complex formulas, which in turn require the use of estimates and judgements about a variety of model inputs. In order to make these judgements, management must have substantial levels of knowledge, skill and experience. Disclosure of the judgements made is unlikely to be meaningful to the typical user of financial statements. Further, such disclosures may imply a level of precision in measurement that simply does not exist.

Compounding this concern is the concept of "sensitivity analysis", wherein management might disclose, for example, the effect of a 1% change in interest rates. The user of the financial statements could read such disclosure and reach conclusions based on the disclosures. However, the disclosure of this sensitivity is misleading because it does not (or may not) include disclosure of the further estimates used in computing the impact, the likelihood of such a change, what offsetting or mitigating changes would have or might have occurred in such a scenario, etc. Further, such a disclosure does not take into consideration the fact that management likely would have acted differently and entered into different transactions in such an alternative interest rate environment. In summary, the user has no more capacity to evaluate alternative assumptions or outcomes than he has to make those assumptions in the first place. The outcome will inevitably be that users of financial statements will engage in increased levels of second-guessing management. Anticipating this, managements will spend more time creating and publishing defenses in which to embed the disclosures, with the result that financial statements and notes will become less comprehensible and therefore less useful.

The proposed standard also speaks of disclosing judgements having the most significant effect. For an institution such as UBS, virtually every line item in the balance sheet and income statement are affected by judgements, estimates and assumptions. Once disclosure of such matters have begun, it is extraordinarily difficult to select a stopping point.

Instead, we recommend disclosure simply of the fact that estimates and judgements are used, that the matters are complex, and that both reported and future results could differ had different estimates and judgements been used.

We believe that requiring general disclosure that assumptions, judgements and estimate are used is in line with the principles-based approach of IAS. We further believe that a statement that management is encouraged to consider additional disclosures when it believes such disclosure will be useful to an understanding of the financial statements would be appropriate. To require more specific disclosures of the estimates themselves, apart from the likelihood that it would be misleading, is in our view a step towards a more rules-based approach, which we find inconsistent with the IAS framework.

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 – We do not agree with the Boards proposal. As discussed in our answer to Question 5, we do not believe this requirement would provide useful information. Instead, we believe that a more general disclosure that assumptions have been made and that carrying values could change if the assumptions change (or turn out not to be completely precise) is adequate. We believe that disclosures about key assumptions about the future is something better suited for an MD&A discussion than for financial statements.

IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors

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 – We agree with the general approach to disallow different treatments of accounting for voluntary changes in accounting policies and corrections of errors. This is an important improvement and will increase the comparability of different financial statements prepared under IAS.

We believe that a restatement of prior period financial statements provides the reader with the most useful and relevant information about trends in income and expense. We also believe that including in the current period the impact of a change in accounting policy or the correction of an error distorts current earnings. However, we would like to inform the Board that it is often extremely difficult, if not impossible for entities to obtain the necessary information for restatement. As such, we strongly support the provision in paragraph 33, which permits non-restatement if restating would require undue cost or effort.

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

Answer - We agree with eliminating the distinction between fundamental errors and other material errors. We believe that there should be no distinction between a fundamental error and a material error.

We suggest that the revised standard explicitly state in the definition that it only applies to material errors. We propose to include to the definition in paragraph 3 the following additional sentence:

"Errors are of such significance that the financial statements of one or more prior periods can no longer be considered to have been reliable at the date of their issue". The additional definition reflects the description in the IAS Framework paragraph 30 and 31. While paragraph 30 describes that materiality depends on the size of the error judged in the particular circumstances of its misstatement, paragraph 31 describes that information is only reliable if they are free from material errors. Although we are aware that International Accounting Standards are not intended to apply to immaterial items we think that this would give clear guidance when to account for an error as proposed under IAS 8.

IAS 10 - Events After the Balance Sheet Date

We agree with the IASB's proposed improvements to IAS 10, *Events After the Balance Sheet Date*. We believe that the requirement to disclose dividends declared after the balance sheet date in the notes to the financials rather than on the balance sheet ensures representation of the true economic position of the enterprise at the balance sheet, while giving financial statement readers useful information about future events.

IAS 16 - Property, Plant and Equipment

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 - We agree that all exchanges of property, plant and equipment should be measured at fair value. We believe that fair value represents the true economic value of the property, plant or equipment upon exchange and provides a better understanding of the initial measurement of such transactions.

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 recognizing 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 – Consistent with out response to Question 1 above, we agree.

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 – We agree with the proposed requirement that depreciation continue to be recognized for temporarily idle assets and assets held for disposal other than by sale. We agree with the Board's view of service potential as a credible and reliable measurement concept. We agree that until an asset is disposed of it has a potential service value that should be reflected in the financial statements.

However, we do not believe that depreciation is appropriate for items of property, plant or equipment that are held for disposal by sale. We believe that such items should be classified as held for sale and valued at the lower of their carrying amount or fair value less costs to sell. We embrace the concept that the Board apparently dismisses, that the carrying amount of property held-for-disposal by sale will be recovered principally through sale rather than future operations, and believe that the accounting for the asset should be a process of valuation rather than allocation.

In addition, the proposed rule for assets to be disposed of by sale reflects a departure from the existing treatment required by US GAAP SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. As it is the stated goal of the IASB to achieve convergence with national standards, we question the necessity of introducing a rule that defies this goal and inaccurately reflects the substance of the situation.

IAS 17 - Leases

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 - We agree that there is a fundamental economic difference between the nature of land and buildings, which warrants a distinction in the determinants of lease classification.

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

Answer - We agree with the proposed change to eliminate the option to expense initial direct costs when incurred and instead require entities to recognize initial direct costs as a reduction to rental income over the course of the lease. However, with respect to balance sheet classification we disagree with the Board's proposal to include initial directs costs paid by a lessor under an operating lease in the carrying amount of the leased asset. We believe that initial direct costs are not part of the cost of the leased asset if they are not directly attributable to the leased asset at the time of acquisition. Therefore we propose that initial direct cost paid by lessors under operating lease should be deferred as a prepaid item and allocated over the lease term in proportion to the recognition of rental income.

Other Comments - We recommend that IAS 17 provide specific guidance on how to account for initial direct costs associated with sublease agreements. Specifically, we would like clarification on how to handle initial direct costs paid to a real estate broker when an entity is acting as the sublessor on property (building and land) and there is a loss on the sublease. We propose that IAS 17 include a rule requiring the sublessor to expense the initial direct costs when incurred, if there is a loss on the sublease and defer and allocate the initial direct costs, if there is a gain on the sublease.

IAS 21 - The Effects of Changes in Foreign Exchange Rates

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 - We agree with the concept of functional currencies and the definition described in the proposed IAS 21. One of the Board's objectives in the Improvements Project is to deal with convergence issues. Introducing well established and successful components from other internationally accepted accounting standards, such as the concept of functional currencies, will improve the quality of the International Accounting Standards, increase comparability between financial statements prepared under different accounting standards and facilitate the administration and risk management of entities which report under two standards or which prepare a reconciliation. We recommend that paragraphs 7 and 8 be combined as we believe that all the factors as described in these paragraphs need to be considered when determining the functional currency of an entity. The way the ED is currently written may infer that the factors in paragraph 7 should be given more weight in determining the functional currency than the factors in paragraph 8.

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 that an entity should be able to present its financial statements in any currency.

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 - We strongly support applying the same translation method.

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

Answer - We agree that the allowed alternative to capitalize certain exchange differences should be removed. We believe that the treatment currently set out in paragraph 15 of the current IAS 21 represents the benchmark treatment for accounting for exchange differences and we believe that this method should be applied by all entities without exception. Eliminating this alternative improves financial reporting.

Question 5 - Do you agree that

(a) goodwill and

(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 - We agree since the proposed change is in line with the provisions under IAS 22, *Business Combinations*. The IASB expresses its view in IAS 22, that goodwill represents a payment made by the acquirer in anticipation of future benefits. As benefits will occur in the functional currency of the acquired entity, it is consistent to view goodwill as being denominated in the functional currency of the acquired entity and to translate goodwill at closing rate. However, we would like to draw your attention to the fact that the translation of goodwill in a foreign currency must be revisited upon issuance of the exposure draft of the improved IAS 22 to ascertain consistency with the revised standard.

IAS 24 - Related Party Disclosures

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 - We agree with the Board's proposal that the disclosure of management compensation should not be required. The components of management compensation vary widely from organization to organization and from one geographical location to another. We believe that it would be difficult to obtain comparability between peer organizations and therefore do not believe that such disclosures will be beneficial to readers of financial statements.

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 - We agree that the standard should not require disclosure of related party transactions and balances in the separate financial statements of a parent or wholly owned subsidiary if those financial statements are made available or published with the consolidated financial statements of the group. We agree that the necessary information is made available to investors in the group consolidated financial statements and do not believe that any additional value will be added by disclosing this information again.

IAS 27 - Consolidated Financial Statements and Accounting for Investments in Subsidiaries

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

Answer - We agree with the proposal that a parent meeting the criteria in paragraph 8 should not have to prepare consolidated financial statements. Consolidated financial statements generally provide the most useful information if prepared at the ultimate group level. As long as a parent at a lower level does not have securities outstanding in the public or impair minority shareholder rights, such a parent should not be compelled to prepare consolidated financial statements.

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 - No, we do not agree with the Board's proposal to present minority interests within shareholders' equity. IAS 1 requires minority interests in income to be excluded from determining net income. The proposal to present minority interests within shareholders' equity is in our opinion inconsistent with the presentation in the income statement. It would also require that in the statement of changes in shareholders' equity the minority interest is added back to make total equity balance with the amount disclosed in the balance sheet. We believe that transparency is rather impaired than improved by this proposal.

In addition, we believe that presenting minority interests within shareholders' equity is inconsistent with the term "shareholders' equity". Minority interests are not shareholders of the entity that prepares the consolidated financial statements. Consequently, minority interests should not be included in that measure. In our opinion, the current presentation of minority interests as a separate item between shareholders' equity and liability is well established and understood. Changing the presentation would not make the financial statements more transparent or better understandable.

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)? 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 - We agree with and support the Board's proposal. Generally, we believe that separate financial statements should be prepared using the same accounting principles as applied in consolidated financial statements. We also support the option of measuring investments in subsidiaries, jointly controlled entities and associates either at cost or in accordance with IAS 39. The cost method is a long established and well understood concept and relieves the investor from the burden of determining the fair value of an investee. Determination of fair value of investees would, for example, be very difficult if a controlled group is vertically integrated, where the economic value stems from the integration while a sum the of parts valuation would result in a substantially lower value.

IAS 28 - Accounting for Investments in Associates

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 organizations, 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 - We strongly agree with this scope exclusion. However, we recommend that further guidance be provided to assist entity's in determining what are considered venture capital organizations, mutual funds, unit trusts and similar entities according to this standard. We propose to use the term "investment companies" for these venture capital organizations, mutual funds, unit trusts and similar entities, which would be defined as follows:

Investment companies are entities whose primary business activity is to make equity and debt investments in public or non-public entities for the purpose of generating income from dividend receipts, interest revenue and capital appreciation. Any equity investments in subsidiaries that are not consolidated, or in associates that are not accounted for by using the equity method, must be clearly distinct from the core business activities of the parent and its other controlled subsidiaries that are consolidated. Investment companies are entities that:

a) issue participation shares to the public, or
b) pool funds of a limited number of independent investors, or
c) are separate legal entities held by a parent whose primary business activity is clearly distinct from the operations of the investee enterprises.

To satisfy the criteria under letter c), for each of the investee enterprises the holding entity

- *must have an exit plan;*
- *evaluates the performance of the investee based on fair value, disposal value or a similar measure; and*
- *does not provide management or administrative support in an extent to the investee that the investee could not immediately operate independently upon disposal.*

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 - We agree as this change incorporates the rules of Interpretation SIC - 20 into IAS 28. We support the IASB's initiative to incorporate the rules included in SIC interpretations into the actual standards.

Other Comments - The disclosures required in paragraph 27 of ED IAS 28 are very comprehensive. We believe that these disclosures expand the quantity of the financial statements, but do not necessarily improve their quality. The proposed disclosures (e.g. summarized form of financial information of the associates) are not relevant to the decision-making needs of users as they do not provide useful information to help assess past, present or future events of the company. We believe that the current disclosure requirements are adequate as they require an entity to identify and describe the significant investments in associates. This information will help users to evaluate past, present or future events of the company.

IAS 33 - Earnings Per Share

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 - We agree. This change will ensure that the earnings per share calculation reflects the substance of the transaction rather than the contractual terms. The change will also eliminate the difference with US GAAP.

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 (i.e. without regard for the diluted earnings per share information reported during the interim periods).

- 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.

- 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 - We agree that, for an entity that publishes interim diluted EPS, it is more relevant for the year-to-date calculations to be based on the 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. However, we encourage the Board to examine 1.) the logic of mandating the quarterly approach for entities which do not report quarterly results and 2.) the comparability issues which would arise by allowing exceptions or alternative treatments. Further, we suggest that the Board address the necessary guidance directly and explicitly in the standard rather than via example.

We recommend that the board clearly define the method of calculation. Does the sentence, "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" mean that the year-to-date adjusted weighted average shares is the weighted average of the four quarterly adjusted weighted average shares? If this is the case, the year-to-date dilutive common shares in example 12 should be 547,885 ([1,280,000 + 650,000 + 261,538 + 0] / 4 = 547,885) and not 597,884; or should anti-dilution due to negative control numbers be excluded from this rule?

Other Comments - We note that the exposure draft has been extensively altered from the current version of IAS 33, and as a result the Board has issued a clean version rather than illustrating the changes that are subject to the improvements process. We also note a large proportion of the changes have been lifted from SFAS 128. Whilst we are in favor of international convergence, we believe that the Board should consider looking at EPS as a separate project that will take into account the accounting treatment differences between US GAAP and IAS for the underlying instruments that are subject to the EPS standard.

An example of a significant difference between IAS and US GAAP is the treatment of convertible debt, where under IAS the hybrid instrument is bifurcated, yet under US GAAP it is not. The current exposure draft continues to incorporate both the 'if-converted' and 'treasury-stock method' from US GAAP without considering whether the application of these two methods under IAS are appropriate when hybrid instruments are accounted for differently to US GAAP. As IAS recognizes the bifurcated written call option within equity upon issue of convertible debt, the application of the if-converted method, which assumes the instrument is fully converted, is inconsistent with the treatment of standalone written calls where the treasury stock method is applied. We understand the rationale for applying the if-converted method when convertible bonds are considered to be entirely a liability, but question the rationale for applying this method when a separate equity instrument is recognized on initial issuance. EPS should be concerned about the potential dilutive effect to existing shareholders where equity is issued at below fair value. We consider that this principle is well understood and is conceptually sound when determining the extent of dilution using the treasury stock method.

As EPS is an area where the investor community places considerable reliance, we believe that a more comprehensive review of EPS should be undertaken. This review could then appreciate the differences in the accounting treatment for the underlying instruments between IAS and other GAAPs, and ensure that inconsistencies in the methods of calculation of EPS are eliminated.

IAS 40 - Investment Property

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 - We disagree with this change as the risk and rewards of the property interest held under an operating lease are not with the lessee. Therefore this property interest should not be classified as an investment property and capitalized and measured at fair value. In addition, the capitalization of a leased property under an operating lease is contradictory to the guidelines in IAS 17. We recommend that the property interest under an operating lease should not be included in the definition of an investment property and should be accounted for as described in IAS 17.

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 - We disagree with this change. The substance of the transaction reflects an operating lease in accordance with IAS 17. Therefore such a change will contradict IAS 17. As such, we recommend that property interests be excluded from the scope of IAS 40 and accounted for according to the rules of IAS 17.

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 - We agree that the choice between the cost model and the fair value model should not be eliminated. We believe that the accounting for investment properties should be in line with the effective business purpose of a company. The cost model is appropriate for companies that are not directly involved in the real estate business or in the real estate investment business, while the fair value model is appropriate for those entities with a direct involvement in the real estate business.