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Exposure Draft on Improvements to IAS

Dear Sir,

Please find below our comments on the above mentioned Exposure Draft. We would first like to give you our general thoughts on this important project, and then we will answer the specific questions of the Exposure Draft.

1. General Comments

1. Some changes will increase the complexity and costs of IAS without resulting in additional material information (eg. fair valuation of all investment properties in IAS 40, Investment Properties, if the alternative cost treatment were dropped; allocation of goodwill and fair value adjustments to currency of the acquired entity(ies) in IAS 21, Effects of Changes in Foreign Exchange Rates).

2. The number of changes proposed in a document with more than 400 pages will lead to substantial efforts in all units that are consolidated. The adjustment of internal guidelines, training and IT-systems will take time (eg. the abolition of the LIFO-method for inventory will result in a large project). Therefore, it would increase the quality of compliance if preparers had more time. It would definitely be helpful if all the drafted changes would become effective on or after 1.1.2004 with encouragement of earlier application, especially bearing in mind that issue of the changes is foreseen only in the first quarter of 2003.

3. A principle-based IAS can lead to situations where required information is not fully defined or the applied methods not fully described. However, a lack of detailed and formalized definitions or methods should not be the reason to abolish well established practices as seems to be the case in various proposed changes (eg. number of employees).

4. The improvement project introduces several new rules which will detract from a true and fair presentation and from best business practice, i.e.

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a) the 12 month time threshold for the non-consolidation of business units held for sale (IAS 27).
b) The deletion of the requirement to disclose the number of employees.
c) The deletion of the requirement to show “the results of operating activities”.

5. Although we fully understand that such an improvement project is an ambitious task, we would have welcomed more guidance regarding the rationale of the proposed major changes, eg. in the form of “Basis for Conclusions”. Commenting on this improvement project would have been further facilitated, if all changes would also have been marked in order to make the “tracking” easier (eg. Earnings per Share IAS 33).

2. Answers to specific Questions

1.1 IAS 1 - Presentation of Financial Statements

2 Question I: Proposed Departure from an IFRS or from an IFRS Interpretation

We agree with the clarification between a departure that is justified under the Framework (IAS I rev. §§ 13-14) and a departure that is prohibited under the Framework (IAS I rev § 15).

3 Question 2: Prohibition of extraordinary items

While we agree with the prohibition of extraordinary items, we consider that § 79 which says that “no items of income and expense are presented as arising from outside the entity’s ordinary activities” is misleading since it could be interpreted as forbidding any disclosure of such amounts or separate disclosure of other exceptional gains/losses. We propose to reword § 79 as follows: “The prohibition of extraordinary items does not prevent an entity from disclosing gains/losses such as losses related to events such as natural disasters or expropriation in accordance with paragraph 82, as long as such gains and losses and other exceptional items are clearly disclosed as part of the ordinary activities”.

Question 3 : Agreement to refinance or to reschedule payments completed after the balance sheet date

No. We disagree that a liability that is due to be settled within twelve months from the balance sheet date should be classified as a current liability when an agreement to refinance has been completed after the balance sheet date but before the financial statements are authorised for issue.

IAS 10 § 2 defines adjusting events as “those that provide evidence of conditions that existed at the balance sheet date”. In the case under review, the entity has a long term loan at the balance sheet date and this is evidenced by the terms and condition of the loan but the company has to classify the loan as current when it is due to mature within 12 months. However, an

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agreement to extend the maturity for an additional long term period that is entered into after the balance sheet date but before the financial statements are authorised for issue is indeed an adjusting event because according to IAS 10 it provides evidence that the company will not incur a cash outflow within 12 months from the balance sheet date. We also consider that requiring that there is an agreement to refinance (i.e. some legal documentation) at the balance sheet date also contradicts § 35 of the Framework that requires that transactions are "presented in accordance with their substance and economic reality and not merely with their legal form".

Question 4 a : Agreement not to Demand Payment After the Breach of Loan Conditions

No. We disagree that a long term loan be classified as current after the breach of the loan terms and conditions 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. Our arguments are similar as those of question 3: we consider that the agreement not to demand payment is an adjusting event in accordance with IAS 10.

4 Question 4 b: Period of Grace After the Breach of the Loan Conditions

No. We disagree that the period of grace be granted by the balance sheet date. We consider that such a period should be granted by the date the financial statements are authorised for issue for the same reasons as those stated under questions 3 and 4 b. Nevertheless we agree with the conditions of items (i) and (ii) of question 4 (b) concerning the rectification of the breach.

5 Question 5 : Judgements made by Management in Applying Accounting Policies

No. We consider that such kind of general information should be part of a future IFRS on Management Discussion and Analysis. For the time being, we consider that the Board should stick to what is already specifically requested in other IASs or implement new specific requirements in various IASs and IFRSs if really necessary. Therefore we propose to delete paragraphs 108 and 109.

6 Question 6: Key Measurement Assumptions

No for the same reasons as under question 5 above. Therefore we propose to delete paragraphs 110 to 115.

7 Move of the accounting policies to IAS 8

We disagree with the move. The selection and application of accounting policies are intimately linked to the fair presentation and the basic accounting conventions explained in IAS 1 (going concern, accrual, etc.). Therefore we recommend not to change IAS I in this respect and § 4-8

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of the proposed IAS 8 should remain part of IAS 1 (IAS 8 § 1 has to be changed as well).

8 Other points

8.1.1.1 Elimination of "the results of operating activities"

We disagree with the deletion of the requirement to show "the results of operating activities" in § 76. Whilst we accept that "operating activities" is not yet a defined term under IAS we nevertheless recommend retaining this disclosure requirement for the following reasons:

a) In many industries operating income or a similar term is one of the key performance measures along with revenue and net income used by investors or analysts for assessing an entity's results.

b) IAS 14 contains the requirement to report a "segment result". Although IAS 14 allows several alternatives to define "segment result", the example in IAS 14 appendix B appears to make a preferred definition of "operating profit" clear. We consider that this total before financial items and taxes is totally appropriate for manufacturing companies and should be retained. Suitable wording should also be introduced to cover financial and non-manufacturing entities.

c) We are aware that the Reporting Financial Performance project may introduce refinements to any definition of "the results of operating activities", however, we do not consider that this justifies elimination of this concept.

Elimination of requirement to disclose number of employees

While we appreciate that the proposed change does not forbid this disclosure, it appears to us desirable to continue to require it as it generally gives a useful concrete indication of the substance and real resources of an entity which is not available from the pure financial figures. It is considered as good business practice to disclose information regarding the workforce e.g. as stated in the OECD Guidelines for Multinational Enterprises, Chapter 3 on Disclosure (revised 2000).

<u>IAS 2 Inventories</u>

9 Question 1: Elimination of LIFO

We do agree with this proposal. However, for companies using the LIFO method, the abolition of LIFO will require a longer preparation period to adapt the inventory systems and this change should not become effective before 2004.

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Question 2 : Reversal and disclosure of inventory write-downs

We agree with this proposal. We suggest that § 34(c) is clarified so that it is made clear that the disclosure relates to the income statement charge in the period for writing-down inventory. We do not consider that it is necessary to disclose the total of the write-downs that have been deducted to arrive at the amount disclosed in the balance sheet as this has limited value to the users of the financial statements.

Concerning the general topic of reversals of write-downs, however, we note the absence of a clearly defined and consistent criterion in IAS for determining in the various standards which types of downward value adjustments may be reversed and which not. The proposal on inventories favours permitting reversal, while the proposal in IAS 39 would not permit reversal of impairments of available-for-sale financial assets. Differing criteria apply to reversals of impairments under IAS 38 depending on type of asset. Transparent, high-quality standards should be based on transparent, high-quality criteria for deciding which types of reversal to allow and which not.

<u>IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors</u>

Question I: Elimination of allowed alternative

We agree to the elimination of the allowed alternative treatment of voluntary changes in accounting policies and corrections of errors and thus to retrospective adjustment.

Question 2: “Errors” rather than “fundamental errors”

We agree with the removal of the distinction between fundamental errors and other material errors. However, we must stress that the key word for us here is not “fundamental” but “material”: we would not wish to see the IASB lose its sense of proportion and eliminate the concept of materiality from financial reporting.

9.1 IAS 10 - Events after the balance sheet date

We agree that dividends declared after the balance sheet date should not be recognised as a liability at the balance sheet date.

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9.2 IAS 16 - Property, Plant and Equipment

10 Question 1: Exchanges of Items of Property, Plant and Equipment

Yes. We agree that all exchanges of PP&E should be measured at fair value, except when such value cannot be determined reliably.

11 Question 2: Exchanges of Intangibles Assets

Yes, we agree in principle because this issue is similar to that of question 1.

Question 3 Items of Property, Plant and Equipment that Become Temporarily Idle or that are Retired from Use

Yes, we agree subject to the addition of the following sentence at the end of paragraph 59:

"If an item of property, plant and equipment that becomes temporarily idle or that is retired from use has been impaired and its recoverable amount has been determined on the basis of the net selling price, then such item ceases to be amortised."

We consider that our proposed addition is justified because the value based on the net selling price in accordance with IAS 36 is the best evidence of the future economic benefits embodied in the items of PP&E. Furthermore any additional depreciation in this circumstance would be a double counting with the impairment loss.

12 Other points

While we welcome the inclusion of costs of testing in the costs directly attributable to bring the asset to its working condition per § 15 (a) we consider that this is somewhat contradicted by § 17 (a) that precludes the inclusion of costs to open a new facility in costs that are not a component of the cost of PP&E. We recommend that additional clarification be given concerning the expenses that contribute to bringing the asset to its working condition and, in that context we do not understand why the example of architects and engineers per § 15A (e) was deleted; we consider that it should be reinstated in the standard.

Paragraph 17 gives examples of costs that are not a component of the cost of property, plant and equipment. Nevertheless we consider that some examples could also be given for costs to be capitalized. In particular, paragraph 17(d) precludes the inclusion of administration and other overhead costs as a component of the costs of PP&E which is correct for general overheads. However, enterprises sometimes delegate full time engineers, technicians and accountants to manage a construction site. We consider that the costs of these people meet the definition of directly attributable costs per § 15A. To avoid any contradiction, we recommend that the beginning of paragraph 17 be reworded by reinstating the part of the old wording marked in italics:
"The following are examples of costs that are not a component of the cost of property, plant and equipment, unless they are necessary to bring the asset to its working condition………"

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While we basically agree with the requirement to use a component approach as was requested in SIC 23 we consider that requiring the component approach in § 12 and treating the replacement and the renewal in §§ 22A to 22D is somewhat confusing. We recommend that one single section regarding the component approach be included. We also consider that the component approach should be requested only if the component is significant as regards to the total cost of an asset. For example, the elevators of an administrative building have generally a shorter useful life than that of the building but, for security reasons, the cables have to be replaced over a shorter life that that of the elevators, we consider that applying a component approach to the cables because they are subject to a major inspection would cause undue cost and efforts in creating unnecessary items in the plant registers of the enterprises without significant benefits to the users.

Questions arise regarding the following sentence in paragraph 25 of the Exposure Draft wording:

“When the carrying amount of the item of property, plant and equipment has been written down to recognise an impairment, the subsequent expenditure is capitalised to the extent that it causes the impairment loss to be reversed”.

We request clarification of this sentence. As currently worded, it appears to imply that no subsequent expenditure on impaired assets may be capitalised unless a reversal of the previously recorded impairment charge appears as a credit to the income statement. We would disagree with that position on conceptual grounds. In the case of an impaired asset whose recoverable amount has been valued on the basis of value in use using the present value of discounted cash flow, the cash flows will have included outflows for future capital expenditure necessary to maintain or sustain an asset at its assessed standard of performance, in accordance with paragraph 42 of IAS 36. When these cash outflows occur, capitalisation of the expenditure will increase the carrying amount of the asset, but its recoverable amount will increase by the same amount because future cash flows no longer include the related cash outflow. There is, however, no reversal of the previous impairment loss. Likewise, future capital expenditure that does improve the performance of the asset, although excluded from the cash flows used to assess the previous impairment in accordance with IAS 36 paragraph 37 (b), will also increase both the carrying amount and the recoverable amount when it occurs; however, it may not necessarily cause the previous impairment loss to be reversed.

We therefore suggest that this sentence in the exposure draft is reworded as follows:

“When the carrying amount of the item of property, plant and equipment has been written down to recognise an impairment, the subsequent expenditure is capitalised to the extent that it does not cause the carrying amount of the asset to exceed its recoverable amount”.

We consider that the requirements of paragraphs 49 and 52 to review the useful life and the depreciation method of an asset at each balance sheet date will cause undue cost and effort to the enterprises. We recommend to require such review only when there is an evidence that the current useful life and/or depreciation method is not appropriate and to adopt an “indicators” approach similar to that of IAS 36 on impairment of assets.

While we agree to require comparative information in the table of movement of PP&E per § 60 (e) we consider that it is sufficient to require the comparative figures in total and not by classes of assets since the full details by classes of assets are available anyhow in the previous year’s report.

12.1 IAS 17-Leases

13 Question 1: Classification of Land and Building Lease

While we agree that the classification of land and building leases be clarified, we do not agree with the general requirement of allocating a lease value to the land and building elements and that the classification of the entire lease as either finance or operating is allowed only “if the lease payments cannot be allocated reliably between these two elements”.

We consider that the way the requirements are presented does not reflect the economic substance of real estate lease agreements since enterprises enter into such agreements to obtain the use of both the land and the building. The relevant fact is that the enterprises enjoy (or do not enjoy) the risks and rewards of the whole property. If the present value of the lease payments of the whole real estate lease annuities amounts to substantially all of the fair value of the leased assets (§ 8 d) or if the assets are of a specialised nature (§ 8 e) we do not see why the whole lease would not be entirely classified as a finance one. Requiring to split the land and building elements gives a primacy to the criterion of § 8 (C), i.e., the major part of the economic life, just because the land has an indefinite life. We consider that this would be form over substance.

We thus propose to modify §§ 11 and 11A to I 1C as follows:

Entities generally enter into lease of land and buildings to use the real estate as a whole, in such a case the entire minimum lease payments are tested in accordance with the criteria of paragraphs 8 and 9. Then the lease is classified as a finance lease if one of the criteria is met. If there are persuasive evidence that an entity has entered in substance into separate agreements for the land and building elements, for example when special conditions govern the use of the land, then the land and building elements are tested separately in accordance with paragraphs 8 and 9.

Question 2: Lessors’ Initial Costs

Yes we agree that lessors’ initial costs incurred in negotiating a lease be capitalised over the lease term and that only incremental direct costs are eligible for capitalisation.

Other points

Even with the improvements of 1999 and 2002, IAS 17 on leases is still not satisfactory since it allows some possibilities of arbitrage between finance and operating leases. We consider that the Board should rapidly elaborate an exposure draft based on the G4+1 discussion papers of 1996 and 2000 and review IAS 17 in order to achieve accounting treatments that converge with other important accounting standards.

<u>IAS 21 - The effects of changes in foreign exchange rates</u>

Question I : Proposed definition of functional currency

We strongly disagree with the definition of functional currency because of its emphasis on the currency of the "economic environment in which the entity operates". We see that this takes over word-for-word the FAS 52 definition. Although in general we support convergence to US GAAP we do not consider that this should automatically result in copying US GAAP. Both IAS and US GAAP should converge.

We agree with the change of nomenclature in IAS to "functional" currency, however, consider that the SIC-19 para 5 definition for "measurement" currency should be retained, i.e. the definition in para 6 of IAS 21 should be "the functional currency should provide information about the entity that is useful and reflects the economic substance of the underlying events and circumstances relevant to that entity. If a particular currency is used to a significant extent in, or has a significant impact on, the entity, that currency may be an appropriate currency to be used as the functional currency".

As a consequence the first sentence of para 7 "The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash" should be deleted.

If the financial statements are to give a true and fair view of the financial performance of the entity, then it must be the specific circumstances of the entity which are reflected in the decision on the functional currency.

Moreover, as explained below we have serious reservations about the quality and robustness of using IAS 29 in the context of consolidating subsidiaries in a hyperinflationary economy into a parent that presents consolidated figures in a non-hyperinflationary currency.

Many entities in high-inflationary economies are able to protect themselves to a large extent from the financial disadvantages of operating in such environments by ensuring that their outputs are either denominated in a hard currency or made in local currency with price adjustment clauses or price lists bound to a hard currency. In most cases there will be a mixture of inputs in hard and local currency, but where a high proportion of the inputs are imported in a hard currency and the output circumstances above apply, the functional currency is quite unambiguously the hard currency.

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Question 2 : Financial statements may be presented in currency of choice

We agree with this concept.

Question 3 : Translation into presentation currency uses same method as translation of a foreign operation

We agree with this approach. We have, however, the following suggestions for improvement.

Since the permitted mechanisms for using the presentation currency concept are very important for preparers to know, we suggest that the standard should take over the following from the existing Basis of Conclusion A-15.

The financial statements of a foreign operation may be incorporated into the consolidated financial statements by being either:

a) first translated into the functional currency of the parent and then into the presentation currency, or

b) translated directly into the presentation currency.

We consider that the present wording in paras 37(a) & (c) and § 39(b) are contradictory. § 37(a) states that equity items, other than those relating to the income for the period, should be translated at closing rate. If this means that retained earnings and other equity items such as fair value adjustments are translated at the closing rate, the amount recorded as cumulative CTA under § 37(c) would include only the difference between translating the result for the period at the average and period end exchange rate. This contradicts § 39(b) which states that CTA should include also the difference between translating a net investment in a foreign operation at the opening and period end exchange rate.

With the present wording of § 37(c) many components of equity, eg. share capital could be interpreted as needing to change in value each period. We consider that components of equity should remain at historical translation rates.

We also consider that § 39(b) should cover all entities not reporting in the presentation currency of the group and not just foreign operations. If a Swiss group decides to present its consolidated financial statements in US dollars then there will be a CTA on the opening net assets of all non-US dollar operations including the Swiss parent and Swiss subsidiaries which are not usually considered to be foreign.

Question 4: Elimination of allowed alternative to capitalize certain exchange differences

Yes - we agree to this elimination.

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Question 5 : Goodwill and fair value adjustments should be allocated to the foreign operation

We believe that your proposal to require goodwill and fair value adjustments to be accounted for in the currency of the acquired entity raises several issues which should be explictly dealt with in any revised standard. We therefore recommend that the proposed change should be removed from this exposure draft. We recommend that any change is included together with the proposed exposure draft on business combinations, as a consequential amendment to IAS 21 at that time, so that the full implications can be considered. In our view, the issues to be considered include the following:

a) fair value adjustments may be made to assets, for example intangible assets related to intellectual property, which are owned by the acquired entity at the acquisition date, but are subsequently transferred to another entity within the combined group which has a different functional currency from the acquired entity. We believe that the currency in which fair value adjustments are deemed to be denominated should reflect any such subsequent transfers prospectively from the date of transfer, since not to do sowould result in accounting inconsistent with the accounting for any other balance sheet item held by the entity to which the fair valued asset has been transferred;

b) if a group of several companies has been acquired and not all of those companies have, the same functional currency, your proposal would require that goodwill be allocated on a legal entity basis to each of the functional currencies involved. We believe that any such allocation would be arbitrary, and would not necessarily reflect the substance of the business combination. We believe that goodwill, as a residual, relates to the acquired group of companies as a whole, and should be held at that level as a single amount for foreign currency translation purposes. The currency chosen should be the currency which best reflects the substance of the acquisition transaction; this may be the currency in which acquisition consideration was paid or valued. We also believe that, if goodwill were to be required to be allocated, it would be desirable for the allocation basis to be consistent with the basis of allocation for impairment testing purposes, which in turn should be convergent with US GAAP requirements. A legal entity basis will not necessarily be convergent with the allocation basis in FAS 142;

c) No transition procedure has been proposed. We believe that any change should only be applied prospectively to business combinations initiated after the date on which the revised IAS 21 becomes effective.

Other points

Issues with defining the recycled CTA amount

We would like you to take this opportunity to improve the existing IAS 21 guidance in this area. The following comments still assume that CTA represents deferred exchange gains/losses that have been built up over a number of years. Our comments may require amendments if your resolution of the inconsistency in the CTA definition mentioned above results in a different CTA concept.

The guidance in existing IAS 21 paras 37/38 concerning recycling of CTA has basically been retained in paras 46/47. Experience has shown that this guidance is open to interpretation and should be improved especially in the areas of recycling of CTA on disposals and on repayment of intercompany loans that are considered a component of the foreign entity's equity.

The key conceptual issue that should be addressed is when there is a trigger for the release of the deferred exchange gains/losses accumulated in CTA in equity. In order that the amount of CTA retained in equity for an entity remains in an understandable proportion in relation to the underlying local currency net assets of an entity, we suggest the following clarifications and amendments to the trigger point for recycling CTA through the income statement:

a) In a group situation a foreign entity may be held either
   (i) directly by a parent or sub-holding company that has a functional currency different from the foreign entity or,
   (ii) be held by a local holding company that has the same functional currency as the foreign entity.

   We consider that it should be clarified that only in the case of (i) above, which usually results in a flow of funds into a different functional currency, should a recycling of CTA into the income statement be allowed.

b) New paras 43/46/47 should allow repaying intercompany loans of an equity nature to be an event triggering a release of CIA to income and specify how to calculate it. We consider that this is necessary as such repayments represent cash flows out of one functional currency into another and should therefore trigger a recycling of CIA.

c) The present guidance relating to dividend payments into a different functional currency of the parent should also be reviewed as this should also lead to a recycling of part of the CTA balance. Dividends paid out of a foreign entity to a parent with a different functional currency may well relate to retained earnings accumulated in prior years on which substantial deferred exchange gains/losses in CTA exist. We consider that the transfer of such funds out of the currency of the foreign entity into a different functional currency of the parent should trigger a release of CTA. Without such a release the CTA balance represents a meaningless amount.

Guidance also needs to be given on opening CIA when a new consolidation presentation currency is chosen. US GAAP would start with zero in the first year presented. IAS is at present unclear on the initial year to use and how to determine the opening amount.

Differences in definitions and language between IAS and US GAAP in this area will result in different recognition rules. We suggest that an attempt is made to converge the two frameworks (although this does not mean simply adopting existing US GAAP).

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Issues with currency of monetary item forming part of a net investment in a foreign operation (para 31)

We disagree that the only currencies that can be used for exchange differences arising on such monetary items are the currencies of the parent or the investee.

We see no rationale for this requirement. For practical reasons, very often a third currency will be used even thought this does not change the economic circumstances that the monetary item is a long-term investment in the foreign operation.

Issues with IAS 29— Reporting in hyperinflationary economies

The following remarks regarding IAS 29 are important, but they are not relevant for all preparers. New IAS 21 places yet more emphasis on the very old and inadequately conceived IAS 29.

IAS 29 may be acceptable for an entity reporting and presenting its financial statements at a leisurely pace in a hyperinflationary country. It does not adequately address key issues important for major multi-nationals reporting very quickly in non-hyperinflationary economies due to the following:

a) It assumes that reliable and appropriate inflation indices are available when the reporting to Group headquarters occurs. Normally such indices are unavailable when the reporting within 1 or 2 days after month end is required.

b) IAS 29 provides almost no guidance on the appropriate income statement translation approach eg. Where the sales invoice includes an assumption about future inflation until settlement this “implicit interest” is incorrectly included in sales revenue and not shown as a financing item. This results in disclosure of inappropriate sales revenue in the consolidated financial statements.

c) Operationally we have also experienced considerable difficulty in correctly allocating the monetary correction to the appropriate lines in the income statement and to the business segments.

d) In cases of very high-inflation the whole business environment usually thinks and manages its business on a hard-currency basis. If this is the reality for the business world then it makes sense to also use this in the financial reporting. Depending on the specific circumstances of the individual entity, local and HO management often find local currency financial information unusable for managing the business and rely on data which is expressed in a reliable unit of measurement.

The IAS 29 concept is fundamentally different to the FAS 52 concept which uses discounting by applying forward exchange rates for translation instead of price indices. We consider that forward foreign exchange rates are more reliable than price indices. The IAS 29 approach in fact doubly reduces the reliability of financial data: where indexing of local-currency values is performed, official indices in such countries are notoriously, often wilfully, inaccurate, rendering revalued data highly dubious; and exchange rates, necessary for the translation of those local-currency values into “real money”, are also frequently massively managed and barely reflect economic reality.

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We consider that it is unacceptable that IAS and US GAAP use fundamentally different approaches (even if the SEC does not require restatement for this difference) as it reduces comparability of consolidated financial statements. We suggest that the IASB urgently reviews the fundamental issues involved in accounting for activities in hyperinflationary economies with a view to converging the accounting frameworks in this area.

IAS 24— Related Party Disclosures

Question 1: Elimination of requirement to disclose "management compensation"

Yes - we agree because this area is a topic best covered by applicable stock exchange or corporate governance requirements.

Question 2: Reduction in disclosures for parent or wholly-owned subsidiary

We disagree with the Board's majority view and agree with the minority view. Where there is a statutory or other requirement to produce separate financial statements of the parent or a wholly-owned subsidiary that comply with IAS then disclosures of related party transactions, including those with the rest the Group, should be made.

IAS 27 Consolidated and Separate Financial Statements

Question 1: Consolidated Financial Statements

We agree with the conditions for the exemption of consolidation.

Question 2: Minority Interests

Yes. The inclusion of minority interests as a separate component of equity is justified since minority shareholders also have an equity interest but one that is distinct from that of the Group's shareholders.

Question 3 : Investments in subsidiaries, Jointly Controlled Entities and Associates

We agree that investments in subsidiaries, jointly controlled entities and associates are consolidated either at cost or in accordance with IAS 39 in the investor's separate consolidated statements.

However we do not agree that investments in subsidiaries, jointly controlled entities and associates that are accounted for in accordance with IAS 39 on consolidation must be consolidated in accordance with the same method in the investor's separate financial statements. Such statements are very often prepared for legal or statutory reasons so it does not make sense to create differences between the legal and statutory separate financial statements and those prepared under IAS.

Other points

Non-consolidation when an investee has severe long-term restrictions on its ability to transfer funds to the investor (§ 12c)

We disagree that severe long-term restrictions on an investee's ability to transfer funds to the investor should be assumed to result in non-consolidation. Such an exemption may lead to legal structures which prohibit funds flow to the sponsoring entity (eg. trusts or foundations) being contemplated which will result in non-consolidation of certain entities even though these entities are clearly controlled by the Group and are performing activities which are for the benefit of the Group.

We consider that where there are severe long-term transfer restrictions this will result in valuation and impairment issues requiring disclosure but that consolidation is still necessary. "The power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities" is sufficient as a criterion here.

12 month limit for non-consolidation

We disagree with the 12-months threshold for allowing to exclude from the consolidation a **subsidiary that is held for re-sale** (paragraph 13). Very often a group of companies has to re-sell subsidiaries after an acquisition because it has been required to do so by anti-trust authorities. If such authorities allow a limit that exceeds 12 months, we consider that such limit should be accepted by the Board. The same remark also applies to the proposed change of IAS 28 paragraph 8.

Disclosures about non-consolidated subsidiaries

We also disagree with paragraph 32 (b) that requires to **disclose summarised financial information of subsidiaries that are not consolidated.** As subsidiaries that are held for re-sale are recognised at their expected net selling price, we consider that such value, which represents the future cash flows out of the subsidiary, is more informative than the selected financial information.

IAS 28 Accounting for Investments in Associates

Question 1 : Scope exclusions

Yes. We agree that investments held by venture capital organisations, mutual funds, unit trusts and similar entities and that are measured at fair value in accordance with IAS 39 shall not be included in the scope of IAS 28 and of IAS 31.

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Question 2: Losses of associates

Yes. We agree that the amount to be reduced to nil when an associate incurs losses should also include investments such as long-term receivables.

Other points

We see that para 28 now states that the investor's share of after-tax profit or loss of associates should be disclosed as a separate item in the income statement. We do not understand the rationale for such a clear statement as whether or not this makes sense depends on where this line item is shown in the income statement.

Our comments made under IAS 27 concerning severe long-term transfer restrictions and the 12-month limit are also applicable for IAS 28.

<u>IAS 33 - Earnings per share</u>

Question 1: Contracts settled either in **cash or in shares at the issuer's option**

We agree that such contracts should be included as potential shares in the calculation of diluted EPS based on a rebuttable assumption of settlement in shares.

Question 2: Year-to-date calculation of diluted EPS

We agree with the proposed approach.

Other points

We note, without any mention in the "summary of main changes" on page 281, that there are significant increases in disclosure requirements on EPS proposed in para. 58 (continuing operations), 60 (discountinuing operations) and 62 (points (c) and (d)). We doubt whether the addition of such statistics make a significant contribution to users' understanding of the financial statements especially those in para. 60 and 62 (c) and (d). However, if they are introduced, the face of the income statement should not be further burdened but all EPS data should be confined to the notes. Moreover, while the Board's efforts to help readers of exposure drafts by including summaries are much appreciated, these should be made reliable by including explicitly and transparently indications of any such significant additions to disclosure requirement.

<u>IAS 40 - Investment Property</u>

Question I : Operating leases

Yes. We agree that operating leases should be included in investment property if the rest of the definition of investment property is met and if the lessee uses the fair value model. It is also justified not to include operating leases when the lessee utilises the cost model but this reinforces our proposal that the Board should deal rapidly with the capitalisation of all leases. In

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effect operating leases are in substance investment property under the cost model but IAS 17 prevents their recognition in the balance sheet.

Question 2 : Accounting of operating leases

Yes. We agree that a lessee that classifies a property held under an operating leases as an investment property should account for the lease as if it were a finance lease because such method is the best estimate of the fair value of the lease.

Question 3: Removal of cost method for investment properties

No. We disagree with the removal of the option to use the cost method for investment properties. Sometimes industrial and commercial enterprises hold some investment properties, the fair valuation of which would cause them undue cost and effort with very little benefits since such properties are not important compared to the rest of their business.

14 Effective date

The Board seems to be aiming for an effective date of 1.1.2003 for all the proposed changes. We would propose 1.1.2004 with earlier application encouraged. It is vital for the Board to bear in mind that they have to be implemented in many cases in local accounting systems if they are to be soundly based. The changes to IAS 16 are a case in point. Even where the change is "merely" one of disclosure, an entity's data collection systems have to be adapted in many cases to ensure that the information will be available - not to mention the need to train and instruct local companies in the new requirements in the case of a multinational group. It would be encouraging to see the IASB taking cognisance of the practical difficulties which preparers have to resolve when setting effective dates.

Thank you very much for your attention to the above.

Yours sincerely

Sulzer AG

G. Mueller
Head of Corporate Management Accounting

Qi Wang
Head of Corporate Consolidation