acteo Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

Mouvement des Entreprises de France
MEDEF

Sir David TWEEDIE
Chairman IASB

IASB
30 Cannon Street
LONDON EC4M 6XH
UK

JK/SJ/09.2002/183
RE : Exposure draft on improvements to existing standards

Paris, Tuesday September 17th, 2002

Dear Sir,

We would like to thank you to give us the opportunity to comment the exposure draft on improvements to existing standards.

Please find enclosed the answer on this subject that ACTEO and MEDEF have prepared jointly.

Should you wish further comments or developments, please let us know and we would promptly answer to your requests.

Yours sincerely,

ACTEO
Philippe CROUZET
Le Président

P/O ***Jean KELLER***

Le Délégué Permanent

MEDEF
Agnès LEPINAY

Le Directeur des Affaires Economiques, Financières et Fiscales

Proposed Improvements to International Accounting Standard IAS 1
(revised 1997)

IAS 1 : Question 1

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

Acteo's proposed answer

We do not agree entirely with the proposed approach. We support that the true and fair view override be maintained ; we agree with the conditions set out, in which that exception can take place.
However we do not think that national regulatory requirements should interfere with the presentation of financial statements in compliance with IFRS and hence heavily impair comparability. We suggest that previous §14 « the existence of conflicting national requirements is not, in itself, sufficient to justify a departure in financial statements prepared using International Accounting Standards » be re-affirmed.
It is also our opinion that a true and fair view override applied in the right circumstances does not constitute any departure from IFRS, this exception being expressly included in IAS 1. There is hence no opportunity of conflict with national regulatory frameworks.

IAS 1 : 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) ?

Acteo's proposed answer

Yes, we agree. Present IAS 8 states that extraordinary items arise in so rare circumstances that prohibiting, purely and simply, a separate reporting of such elements on the face of the income statement should not constitute a significant change in IAS compliant accounting practice. It is however essential that management be free to provide information on any reported item in the deemed most relevant fashion. Management would have the choice to, either split the reported item on the face of the income statement, or give detail of constituents thereof, as deemed necessary to let users understand unusual variations, events or transactions.

IAS 1 : Question 3

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

Acteo's proposed answer

Yes, we agree that liabilities be reported and classified as of balance sheet date, on grounds consistent with the basis for recognition. That requirement is also consistent with the treatment of events occurring after the balance sheet date.
It is however relevant to users to provide further information in the notes, in order to allow them to assess the amounts and rythms of future cash-outflows, as they are the most likely to occur.

IAS 1 : Question 4

Do you agree that

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

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

Acteo's proposed answer

Yes, we agree for the same reasons as explained above. Additional information is necessary, in accordance with IAS 32 requirements.

IAS 1 : Question 5

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

Acteo's proposed answer

No, we do not agree. We do not think that § 108 and 109 as proposed are likely to bring any improvement in the information provided to users.
The requirement is too broadly defined and does not help the preparer identify what is exactly expected from him. Disclosures are, in our opinion, best defined within each specific standard.
We however would welcome this as an overall requirement within IAS 1, would the detailed requirements be included in each specific standards.
Also, we wish that "judgements made by management in applying accounting policies" be defined or further illustrated.

IAS 1 : 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) ?

Acteo's proposed answer

No, we do not agree with the proposed paragraphs 110 to 115.
Proposed § 110 is far too broad and general to avoid subjectivity and to lead to consistent sets of disclosures among entities, even though the same key assumptions about future and other sources of uncertainty were involved in the preparation of financial statements.
We think that disclosure requirements for those assumptions which are useful to readers are best included in the standards themselves. That is the only way to ensure both reliability and comparability.
Beyond such requirements, key assumptions about future and other sources of uncertainty mostly relate to risk assessment. This is part of management's discussion and analysis, where it belongs. As such, it is beyond the scope of present IAS 1.

Proposed Improvements to International Accounting Standard IAS 2
(revised 1993)

IAS 2 : Question 1

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

Acteo's proposed answer

Although we are in favour of eliminating options in order to promote more comparability, we do not agree with the Board's proposal. Conceptually, LIFO and FIFO are equivalent and are likely to introduce the same type of distortions, one in one way, the other in the opposite way.

IAS 2 : Question 2

IAS 2 requires reversal of write-downs of inventories when the circumstances that previously caused inventories to be written down below cost no longer exist (paragraph 30). IAS 2 also requires the amount of any reversal of any write-down of inventories to be recognised in profit or loss (paragraph 31).
Do you agree with retaining those requirements?

Acteo's proposed answer

Yes, we do. These requirements are part of well-settled accounting practices in France.

Proposed Improvements to International Accounting Standard IAS 8 (revised 1993)

IAS 8 : Question 1

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

Acteo's proposed answer

Yes, we do.
We support the suppression of the previous authorized alternative treatment.
In our opinion, retrospective application and adjustment of opening retained earnings of the earliest period presented are the most appropriate accounting treatments to ensure a high degree of comparability.
We do not believe, as some argue, that selecting such an accounting treatment for the correction of errors may lead to « voluntary » errors. Revealing errors may be much more damageable to the credibility of the entity than would a non-recurrent and appropriately disclosed downfall of earnings.

IAS 8 : Question 2

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

Acteo's proposed answer

Yes, we do. We fully support the Board's basis for conclusions.

Proposed Improvements to International Accounting Standard IAS 16 (revised 1999)

IAS 16 1 : 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)?

Acteo's proposed answer

Yes, we do.
First, we feel that the distinction between similar and dissimilar assets, either tangible or intangible, cannot be based on strictly objective criteria.
Secondly, we think that an entity would not bear the unavoidable cost and effort of carrying out an exchange transaction, would its operations and financial position remain strictly unchanged.
Also we believe that in most situations fair value of the assets exchanged is known, since valuation of the assets constitutes a normal step in the decision-making process.
We therefore support the Board's decision.

IAS 16 1 : Question 2

Do you agree that all exchanges of **intangible assets** should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably? (See the amendments in paragraphs 34-34B of IAS 38, Intangible Assets, proposed as a consequence of the proposal described in Question 1.)
(Note that the Board has decided not to amend, at this time, the prohibition in IAS 18, Revenue, on recognising revenue from exchanges or swaps of goods or services of a similar nature and value. The Board will review that policy later in the context of a future project on the Recognition of Revenue.)

Acteo's proposed answer: same as to question 1

IAS 16 – 1 : 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)?

Acteo's proposed answer

Although we agree with the objective sought by the Board, we believe that § 59, as stated, stresses too strongly on the need for continued depreciation, without enhancing the need for:

- an impairment test of an asset that becomes temporarily idle or that is retired from use and is held for sale,
- a review of the residual value and of the useful life of such an asset,

both at the time the change occurs.

The change in the way future economic benefits are expected to flow from the asset is an indication that the asset may be impaired, in accordance with § 8 and 9 of IAS 36. It also constitutes " a significant change" as meant by § 52 of IAS 16.

We suggest § 59 to be rewritten as follows:

"If an item of property, plant and equipment becomes temporarily idle or is retired from use and held for sale, it shall be tested for impairment and its residual value and useful life shall be immediately reassessed. Depreciation shall be accounted for on renewed bases, if necessary, after any impairment losses have been recognized".

The residual value of an asset retired from use and held for sale should be equal to the net selling price expected from its disposal. In that case, the depreciation charge would be reduced to nil.

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Proposed Improvements to International Accounting Standard IAS 17
(revised 1999)

IAS 17 : Question 1

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

Acteo's proposed answer

No, we do not agree. Entities generally enter into lease of land and buildings to use the real estate as a whole. Sound bases for splitting the contract total consideration into two reliable amounts, one attributable to land, the other attributable to buildings, are very rarely available. This is fact, and not a mere assertion by lessees that want to "avoid finance lease treatment", as § A5 of the basis for conclusions suggests. We recommand that leases of land and buildings go on being tested according to § 8 and 9 of IAS 17. This better induces consistent treatments among entities, and hence better serves comparability.

IAS 17 : Question 2

Do you agree that when a lessor incurs initial direct costs in negotiating a lease, those costs should be capitalised and allocated over the lease term?

Do you agree that only incremental costs that are directly attributable to the lease transaction should be capitalised in this way and that they should include those internal costs that are incremental and directly attributable?

Acteo's proposed answer

Yes, we agree. We both welcome the reduction of options and the treatment retained. This treatment is consistent with the accounting for fixed assets (IAS 16, § 15) and for business combinations (IAS 22, §25).

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Proposed Improvements to International Accounting Standard IAS 21 (revised 1993)

IAS 21 : Question 1

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

Acteo's proposed answer

Yes, we agree.

IAS 21 : 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 ?

Acteo's proposed answer

Yes, we agree.

IAS 21 : 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)?

Acteo's proposed answer

Yes, we agree

IAS 21 : Question 4

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

Acteo's proposed answer

Yes, we agree

IAS 21 : 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)?

Acteo's proposed answer

No, we agree only partly with the proposed change.
We agree that 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.
We fully support §A24 and A26 of the basis for conclusions that state that:

- goodwill is more complex, partly because it is a residual,
- difficult issues can arise when the acquired entity contains businesses that have different functional currencies,
- there is a strong link between the allocation of goodwill and the different functional currencies involved,
- cash-flows supporting the continued recognition of goodwill may be generated in those various different functional currencies.

We however disagree with the alternative identified: goodwill would be an asset either of the acquired entity or of the parent.
We consider, in accordance with IAS 36, that goodwill is an asset of the smallest cash generating unit to which it can be allocated and, accordingly, should be translated in the functional currency of that cash generating unit. We observe that this allocation may or may not be consistent with goodwill being allocated on a legal entity basis. We hence conclude that the currency in which goodwill should be translated cannot be defined as being either the parent's functional currency or the acquired entity's functional currency; that such an alternative is arbitrary; that goodwill should be translated into the currency of the smallest cash generating unit to which it can be allocated.
This cash generating unit can be a cash generating unit in which the (or part of the) acquired entity may be merged with other pre-existing activities. In that situation, it is arbitrary to consider goodwill to be part of the acquired entity ; goodwill should be translated in the currency in which the cash flows that it will contribute to generate will flow in.
We therefore recommend that any change be analysed further and be included in the exposure draft on business combinations, as §A27 of the basis for conclusions suggests. Should the Board decide that IAS 21 has to be improved beforehand, we recommend that § 45 be changed to reflect the need to identify the functional currency of the cash generating unit to which goodwill is being allocated.

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Proposed Improvements to International Accounting Standard IAS 24
(revised 200X)

IAS 24 : Question 1

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

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

Acteo's proposed answer

No we do not agree. We agree that disclosure of management compensation is not a typical accounting issue. It is however our understanding that the Board encompasses now the whole « financial reporting » issue.
Management compensation constitutes relevant information for investors and other users of financial reports. Depending on local regulators to decide whether this information should be disclosed does not contribute to convergence and comparability. Removing this requirement from international standards is a backward step not to be welcome in these times when more transparency is required.

We understand that we should not depart from the Board's view without suggesting definitions for « management » and « compensation ». Our proposals are as follow:

- ✓ Management includes Board and Executive Commitee Members.
- ✓ Compensation would include any expense recorded as a company expense that generate a cash-outflow intended to benefit, either directly or indirectly, to the employees. That includes :
  - salary and bonuses,
  - pension shemes,
  - insurance premiums,
  - taxes paid on behalf,
  - financial or operating leases of any kind : lodging, car…,
  - any fixed amount designed to cover professional expenses on a standard basis,
  - other benefits addressed in the scope of IAS 19.

Whatever the outcome of this issue, a clear definition of compensation has to be given by the Board in order to sustain the requirement for disclosure of some expenses by nature, when the entity chooses to provide an income statement by function (cf IAS 1).

<u>IAS 24</u> : 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.)

Acteo's proposed answer

Yes, we agree, provided that disclosures fit the materiality threshold applicable to the subsidiary or the parent. We would not support such exemption, would the financial statements be published separately.

Proposed Improvements to International Accounting Standard IAS 27
(revised 2000)

IAS 27 : Question 1

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

Acteo's proposed answer

We basically agree with the Board. However, for practical reasons, we wish that consolidated financial statements be prepared only if and when at least one party (either an entity or an individual) detaining at least one share of the reporting entity requires it. That request should be expressed at least three months before closing date.

It may indeed be quite difficult in some cases to obtain a formalized unanimous agreement of all parties involved.

IAS 27 : 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)?

Acteo's proposed answer

Yes, we agree. Minority interest represent the residual interest in the net assets held by minority shareholders, and as such meets the definition of equity. Also, that residual interest is distinct from that of the parent and it is relevant to show it separately. We however would have expected the Board to adopt a consistent view in relation to the presentation of income. We disagree with the basis for conclusions of IAS 1, § A-18, and suggest that net income be measured as a whole. Parent and minority shares in net income could be shown below the net income line.

IAS 27 : 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)?

Acteo's proposed answer

We object to the elimination of the equity method as one of the options of accounting for investments in subsidiaries, jointly controlled entitites and associates in an investor's separate financial statements. We consider that the equity method provides a fair economic reflection which investors can meaningfully interpret and thus this should be retained as an option. It indeed allows the equity in the financial statements of the parent and in the consolidated financial statements to be equal. Logically, this should be the case.

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Proposed Improvements to International Accounting Standard IAS 28 (revised 2000)

IAS 28 : Question 1

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

Acteo's proposed answer

Yes, we agree.

IAS 28 : 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) ?

Acteo's proposed answer

Yes, we agree. Losses incurred by an associate are a sign that financial assets held in this associate are at risk. There is no conceptual difference between the different types of assets involved that can sustain different valuation bases. Write-downs should however be limited to the risk incurred. Hence financial assets that benefit by sound collateral should not be written down.

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Proposed Improvements to International Accounting Standard IAS 40 (revised 200X)

IAS 40 : Question 1

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

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

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

Acteo's proposed answer

No, we do not agree. Enlarging the definition of investment property as the Board suggests leads invevitably to answer yes to the question 2 below. We do not think appropriate, for consistency purposes, to bring leases that qualify, according to IAS 17, as operating leases to be accounted for as finance leases. We do not believe that the accounting practice may benefit by such piecemeal amendments. We suggest that this question be raised again as part of the lease project that the Board has launched into research phase.

IAS 40 : 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?

Acteo's proposed answer

Please refer to our answer above.

IAS 40 : 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?

Acteo's proposed answer

Yes, we agree that the choice be retained. We are not in favor of reconsidering the option to use the cost model, now or ever. It is our view that the model selected, either cost or fair value, should reflect the intent of management.