GEFIU
GESELLSCHAFT FÜR FINANZWIRTSCHAFT
IN DER UNTERNEHMENSFÜHRUNG E.V.

"Financial Accounting Working Group"

16 September 2002

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

Dear Sir David:

The Members of the GEFIU Financial Accounting Working Group are pleased to comment on the Exposure Draft, *Improvements to International Accounting Standards*.

The GEFIU (Gesellschaft für Finanzwirtschaft in der Unternehmensführung e.V.) is the German Financial Executives Institute. It has some 160 members who are chief financial officers or finance directors of German industrial and trading companies as well as insurance companies, banks, and other financial services. GEFIU is a member of the International Association of Financial Executives Institutes (IAFEI). As a member of the International Group of Treasury Associations (IGTA), GEFIU also cooperates with other treasury associations

The Members of the Financial Accounting Working Group fully support the Board's objectives in the Improvements Project as set out in the Invitation to Comment. However, with regards to certain standards, we have serious reservations and suggestions for improvements.

In addition to answering the Board's questions posed for each standard, we have taken the opportunity to comment on some controversial and significant changes which were not addressed in the Exposure Draft questions.

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)?

Yes, we agree. We consider the "true-and-fair-view overriding principle" sensible and understand the proposed amendments only as clarification and confirmation of the already existing "true-and-fair-view overriding principle".

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)?

Yes, we agree. The prohibition of presenting extraordinary results increases the comparability of different IAS financial statements.

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)?

Yes, we agree. We agree with the Board that a refinancing of a liability which is completed after the balance sheet date should not be taken into consideration for the classification of a liability as long-term or current.

A refinancing after the balance sheet date implies no change in liquidity at the balance sheet date. It is therefore a non-adjusting event under IAS 10.

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 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 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)?

Yes, we agree. The conclusion must be read in conjunction with question 3 and seems appropriate to us.

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 und 109)?

No, we do not agree with this proposal. In our opinion, this proposal is not suited to achieve the goal of providing the user of financial statements with information to better understand and compare accounting policies. The planned provision will rather result in extending the notes by general statements which do not contain any additional information for the user but rather cause an information overload.

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)?*

No, we do not agree with this proposal. The purpose of this provision obviously is to enable the user of financial statements to assess the future development of an entity more reliably.

To inform the user of financial statements about the future development of a company as a whole, it is not sufficient to report on expected individual developments, e.g. development of interest rates or prices, because such factors may influence each other. Certain effects may eliminate each other completely or intensify each other. Synergy and follow-up effects are not taken into account. The distinction between "key factors" and "non-key factors" is not clear so that it is up to the entity on which facts and circumstances it reports.

In our opinion, the goal pursued by the proposed provision can be better achieved by obliging management to disclose in the financial statements a general appraisal of the overall position of the company. This, for instance, could be based on the contents of the proposed IAS 1.7 which has not been binding so far. German companies report on the expected development of a company in their management report.

Specific issues not covered in questions

IAS 1.49- Current/Non-Current Distinction

In our opinion the proposed liquidity presentation of assets and liabilities should be treated as an allowed alternative treatment and not only as an exception of the current and non-current presentation of assets and liabilities.

IAS 1.65- Information to be Presented on the Face of the Balance Sheet

In the past, only profit taxes of an entity, Corporation Tax (including Solidarity Surcharge) and Trade Tax, had to be reported separately as line items on the face of the balance sheet as no other taxes are covered by IAS 12.

The Exposure Draft of revised IAS 1 now provides that "tax liabilities and assets" (proposed IAS 1.65.m) must be indicated separately on the face of the balance sheet. Assuming that "liabilities and assets" are meant to cover taxes payable as well as tax provisions – irrespective of "provisions" being an own position to be reported on the face of the balance sheet –, the new standard is no longer restricted to income taxes. Thus, the proposed wording extends the scope of the minimum information to be indicated on the face of the balance sheet to all taxes, not just Corporation Tax and Trade Tax.

We find that even the obligation currently existing under IAS 1.66 to specify income taxes on the face of the balance sheet is an inappropriate provision. Firstly, depending on the jurisdiction of the reporting entity, monthly or quarterly advance payments of income taxes normally only lead to small tax amounts outstanding at year-end.

Finally, to determine the overall tax burden of the reporting entity, it is generally more informative to rely on the income statement rather than referring to the balance sheet. We think that these deficiencies may partly explain why many companies do not currently comply with the obligation to report income taxes on the face of the balance sheet. After all, most professionals expect the balance sheet to look structured and organised.

We feel it would be totally sufficient and thoroughly in line with the standards set by the Framework to discuss the tax liabilities (and assets) at year-end in the notes to the financial statements. The obligation to report the amount of all tax liabilities and assets existing at year-end seems to be inconsistent with the aim of IAS 1.66 (proposed IAS 1.65) to focus on information which is necessary to fairly present an entity's financial position at a glance. (The requirement to include "biological assets" as line item on the face of the balance sheet appears just as inconsistent!) We believe that the great variety of methods applied in dealing with current and deferred taxes in the financial statements is more confusing than helpful. Finally, IAS 1.67 (proposed IAS 1.66) stipulates to report additional items anyway if required by an International Accounting Standard or if necessary for the true and fair presentation of the financial situation.

Last but not least, IAS 1.66 (proposed IAS 1.65) is also applicable for interim financial reporting. Given that the tax expense in interim reporting is determined by applying the estimated average annual effective income tax rate to the pre-tax income of the interim period, the resulting figure is necessarily characterized by a considerable degree of inaccurateness. The requirement to include such amounts on the face of the balance sheet, which is to provide a reliable insight *prima facie*, thus appears controversial.

IAS 2- Inventories

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?

Yes, we generally agree with the proposed elimination of the LIFO method. The application of the LIFO method results in a presentation of the inventory, that is generally not in line with the physical flows of inventories. As a consequence, the application of the LIFO method will generally not give a true and fair view of the assets and the results of the reporting entity. However, the LIFO method should be allowed in cases where the LIFO method actually reflects the physical flows of inventories.

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?

Yes, we agree with the proposed requirements:

a. If the circumstances, that had caused inventories to be written down no longer exist, inventories should be revalued to cost. Otherwise such inventories would be understated.

b. As write-downs of inventories had previously been charged to the income statement, a reversal should be included in the profit or loss of the period as well.

IAS 8- Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies

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)?

We agree with the proposed approach. Voluntary changes in accounting policies, corrections of errors and the first time adoption of a standard should be treated retrospectively.

Question 2

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

We agree with the proposed approach. The distinction between fundamental errors and other material errors are not of relevance in the improved standard.

IAS 10- Events After the Balance Sheet Date

We support the amendments and clarifications concerning the events after the balance sheet date and the relating disclosure requirements.

We understand that the difference between "proposed and declared dividends" in IAS 10.11 and IAS 10.12 is not material and that the deletion of the word "proposed" was made for simplification or clarification purposes only.

"Proposed and declared dividends" are also mentioned in IAS 12.81 (i). It should be reviewed if the word "proposed" could also be eliminated in this standard.

IAS 15- Information Reflecting the Effects of Changing Prices

We support the Board's decision to withdraw IAS 15 because the current standard is considerably out of date and does not give sufficiently clear and meaningful guidance to entities that might wish to reflect the effect of changing prices.

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)?

Yes, we agree with that amendment (assessing the fair value to exchanged assets or, unless fair value cannot be reliably measured, assessing its cost). This presentation is in line with the IAS underlying philosophy of fair value presentation of a company's assets.

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.)

Yes, we agree with that amendment (assessing the fair value to exchanged assets or, unless fair value cannot be reliably measured, assessing its cost). As in the comment on Question 1, this presentation is in line with the IAS underlying philosophy of fair value presentation of a company's assets.

Question 3

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

Yes, we agree. Depreciation should not cease when an asset is retired from active use. The basis of the depreciation however may change to reflect a slower rate of wearing out as a result of the reduced usage. Obsolescence is also a factor and consideration must also be given to impairment.

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.*

Leases of land and buildings do not generally, under current business practice, separate the land from the buildings. The land and the buildings are treated as an integral package. Indeed, in many cases such a distinction could only be arbitrary e.g. in the case of an office leased in high-rise building. Thus not only would the proposed split not reflect the commercial reality of the transaction but the resulting arbitrary allocation would reduce the consistency and comparability of financial statements.

In addition, the term of building leases is most often much shorter than the expected economic life of a building. Accordingly the building lease is very unlikely to meet the criteria set out in IAS 17 indicating a finance lease and would therefore be classified in any case as an operating lease. We would not expect that the time and effort involved in splitting would lead to a different accounting treatment of the building element.

We therefore do not support the proposed changes.

Question 2

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

We agree that, in the interest of greater comparability between IAS users, one of the existing options should be removed. We believe that there are strong arguments for regarding initial direct costs as selling costs which must be expensed immediately (see IAS 2.14(d)). This also avoids the problems of appropriately valuing the capitalised initial direct costs e.g. the method and length of negotiating the contract could lead to a different level of initial direct costs arising for contracts of the same nature. The interests of comparability with other standard setters should not alone lead to the capitalisation of initial direct costs.

If the Board however decides to require capitalisation, the Standard should include further examples of initial direct costs, in particular internal costs.

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?

We agree with the proposed definition and the guidance on how to determine the functional currency.

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?

Yes. A number of countries may not allow their companies to use a currency different from that of their country. Nevertheless in others, the free choice of the reporting currency may improve access to capital markets and their participants.

However, we suggest reconsidering whether a concept of a different reporting currency is necessary. The use of a different reporting currency which is in line with the proposed IFRS requires a significant operational investment for the companies to generate the data which is necessary to be able to translate income statement items. Instead, companies might be allowed to "publish" their financial statements in a different currency by simply translating them from the functional currency into the "reporting" currency at the closing rate for all items. This is an alternative which is suggested by IAS 21.55, where it is considered not being in line with IFRS and therefore requires additional disclosures. We suggest that this form of "publishing" the financial statements is accepted. It should be accompanied by explanations of the reasons for the use of the currency different from the functional currency and to eliminate the concept of the reporting 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)?

Yes, we agree. We welcome this simplification of the standard.

Question 4

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

Yes, we agree. We regard the benchmark method as sufficient, especially due to the fact that IAS 29 still requires the capitalisation of exchange differences in a hyperinflationary environment.

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)?

Yes, we agree. The elimination of accounting alternatives is in line with the objectives of the improvement project. We agree that fair value adjustments to assets and liabilities as well as goodwill should be allocated to the entities of the foreign operations. This ensures that the future treatment of these items depends on the currency of the entities to which they are allocated. As a consequence, these items are translated at the closing rate in line with other assets and liabilities of these entities.

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)?

Yes, we agree with the proposed approach.

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)?

Yes, we agree with the proposed approach.

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?

We generally agree for the reasons explained in the basis for conclusions. In addition, we would like to suggest the following endorsement:

(e) it is consolidated in the consolidated financial statements of the immediate or ultimate parent.

We believe that the endorsement is necessary to point out that the exemption from preparing consolidated financial statements for such a parent is only allowed if it is included in the consolidated financial statements of the immediate or ultimate parent.

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)?

We agree with this view. A minority interest does not meet the definition of a liability in the Framework for the Preparation and Presentation of Financial Statements stated in IAS 27.49(b). Minority interests represent the residual interest in the net assets and liabilities of subsidiaries. From the subsidiary point of view, as well as from the group point of view, these interests meet the Framework's definition of equity as the difference between assets and liabilities.

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)?

We agree that investments in subsidiaries, jointly controlled entities and associates should be carried at cost or accounted for in accordance with IAS 39 in the investor's separate financial statements. In our opinion, the investor as a single legal entity should only recognise income to the extent that it receives distributions from an entity. There is no reason for accounting for investments in subsidiaries, jointly controlled entities and associates under the equity method in the separate financial statements. All information regarding the financial positions, results of operations and changes in financial positions of the group are served by the consolidated financial statements. As described in IAS 27.30A, separate financial statements present financial information about the entity's position as an investor and single legal entity. If investments in subsidiaries, jointly controlled entities and associates were treated in the same way in the consolidated financial statements as in the separate financial statements of an investor, why should an entity prepare separate financial statements?

We also agree that if an investment in subsidiaries, jointly controlled entities and associates is 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. We believe that the users of consolidated financial statements as well as the users of separate financial statements need information regarding the current value of investments when control is intended to be temporary and its disposal is intended within twelve months from acquisition.

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 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)?

Yes, we agree with the proposed approach. We believe that the fair value measurement will provide the most relevant and useful information as explained in the basis for conclusions made by the Board.

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 others interests such as long-term receivables (paragraph 22)?

No, we do not agree with the proposed approach. The Board considered (in new IAS 28.22) that the base to be reduced to nil should be broader. The Board proposed that the base should include the carrying amount of an investment in equity shares plus other items that, in substance, form part of an investor's investment in the equity of an associate.

In circumstances in which an associate incurs losses and the carrying amount of the investment is reduced to nil as a consequence, the amount of the above mentioned other investments would have to be reduced, proportionately.

Referring to IAS 28.22, these investments can be items for which settlement is neither planned nor likely to occur in the foreseeable future. Such items may include preferred shares and long-term receivables or loans but do not include trade receivables or trade payables.

Basically, it is reasonable that items are treated as investments in equity of an associate, if these items have, in substance, the character of equity substitutes. This proceeding applies to the principal qualitative characteristic of financial statements as "substance over form". The classification as a component of interest in an associated company and as well as the resulting treatment, creates a more reliable presentation of those investments.

However, it is important that characteristics are defined in order to clarify the classification of items as equity substitutes. Possible characteristics can be: a legal or contractual committed liability, the obligation to set-off losses, obligations in case of bankruptcy or liquidation of associates, as well as capital lending for a certain period. The criterion "foreseeable future" is not exact enough.

Basically, we agree with the proposed changes of IAS 28.22, as long as the classification of those items fits the definition of investments in equity in the sense of equity substitutes.

However, we do not agree with the proposed approach that generally all long-term receivables should be included in the amount to be reduced to nil when an associate incurs losses. The equity method is a method of evaluating the investment in an associate to reflect the development of the proportional equity of the associate. Generally, normal long-term receivables are not investments in equity. They are not associated with unlimited rights of profit participation and do not form part in a residual equity interest in the associate. The unlimited and undifferentiated consideration of long term receivables as equity is not consistent with the character of the equity method as well as with the character of long-term receivables. This treatment would not meet a true and fair view of the financial position.

The Board notes that if non-equity investments are not included in the base to be reduced to nil, an investor could restructure its investment to avoid recognising the loss under the equity method. This argument is not convincing because incurred losses of an associate are an indication of impairment. If losses have an impact on the recoverability of long-term receivables, the investor will have to pay attention to it and account for impairment losses in the income statement.

A swap from investment to a long-term receivable would have, besides the loss allocation, a multitude of consequences that have to be considered anyway, i.e. participation influence on the associate's management.

In summary we do not agree with the proposal that all long-term receivables should be included in the amount to be reduced to nil when an associate incurs losses. Only long-term receivables or other items having the character of equity substitutes should be included. In other cases, an impairment loss should only be recognised where the losses of the entity have an impact on the recoverability of the long-term receivables.

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?

Yes, we agree. It is the choice of individuals and/or organisations outside the company to settle their options into shares. These potential shares must therefore be included in the calculation of diluted earnings.

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)?

Question 2.1

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).*

Concerning the topic "retail site contingency" the year-to-date calculation using the interim period information leads to a different result than the full year-to-date calculation. This is caused by the fact that in the interim periods, the actual outstanding time is not taken into account. There is no correct weighting of the figures according to the real days the issuable shares are outstanding. This leads to inaccuracies within the interim periods and the calculation for the whole year. In the example, we have 6,250 shares with the interim period solution but 5,000 shares for the calculation by the year-to-date approach. We thus propose to always take the exact dates into account in order to reflect the real situation as precisely as possible.

Regarding the "earnings contingency", the number of contingently issuable shares depends on the net profit in excess of 2,000,000 for the year-end within the given example. We think that the most relevant figure for the potentially issuable shares is the 31st December. Therefore, the cumulated year-to-date information in example 7 of the illustrated scenario with the amounts of 2,900,000 – 2,000,000 equal to 900,000 should be used. This seems to us to be the most suitable figure to use in order to anticipate the actual dilution that will potentially occur within the next year.

Question 2.2

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.

We agree with this approach. There is the possibility to show the results on a quarterly basis which is a useful information for the quarterly reporting. The average weighted figures for the total year-to-date will show a different value than is the case when adding the different interim periods of the year. However, as no consistency is necessarily required, we think that it is acceptable to have quarterly amounts and ratios available but also one key figure that is calculated for the whole year.

We therefore agree with the statement in the example:

"As it can be seen in the example, the table includes the quarterly and annual earnings per share data for the company A. The purpose of this table is to illustrate that the sum of the four quarters' earnings per share data will not necessarily equal the annual earnings per share data. The Standard does not require disclosure of this information."

Question 2.3

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).

For this question we would like to make reference to our answer to question 2.1. We stated that it seems to be preferable to use the most precise dates that are given in order to calculate the correct annual weighting of the given conditions. In terms of the "earnings contingency", we think that only the year-end value should be used for the calculation.

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 27-29?

Yes, we agree with this proposal. Operating leases were not classified as investment property under IAS 40. Leases with an indefinite economic life as stated in IAS 17.11 used to be classified as operating lease unless the title passes to the lessee at the end of the lease term.

Long-term leases (operating leases) should be included in the definition of investment property because it leads to a better reporting of such activities.

Question 2

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

Yes, we agree. Certain interests in property (including land) are commonly - or exclusively - held under long-term leases, but do not meet the criteria for classifying the lease as a finance lease. We agree that a property interest held as an operating and classified as an investment property should be accounted for as a finance lease. It is a practical way of addressing the situation. Problematic is the recognition of the leased item in the financial statements of both the lessor and lessee.

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?

Yes, we agree. Preparers and users need additional time to gain experience in using the fair value model. It is a challenging effort for preparers.

Effective Dates

The Exposure Draft indicates that the changes to existing Standards will take effect as of 1 January 2003. It must remain a matter of principle that no new accounting Standard should apply retrospectively. We are concerned that the improvements project of the Board will not be completed by the year-end 2002. Therefore, if the final standards are issued during 2003, but retain their proposed 1 January 2003 effective dates, they will require retroactive application. In these circumstances we recommend that the final standards should only apply from a date after their issuance, with earlier adoption encouraged.

Yours sincerely,

Dr. Peter Siebourg

Chairman Financial Accounting Working Group