FAR

FAR is the institute for the accountancy profession in Sweden

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

30 September 2002

Dear Sirs,

Exposure Draft of Proposed Improvements to International Accounting Standards

In response to your request for comments FAR has the following comments on the *Exposure Draft of Proposed Improvements to International Accounting Standards.*

Proposed changes in IAS 33
We would like to express our concern that the level of detail in IAS 33 does not result in what the Board expresses as characteristics of IAS, being principle-based standards.

Undue cost or effort
The concept of "undue cost or effort" has been introduced in the proposed changes to a number of the standards. We believe that this phrase could be interpreted in a very lenient manner that would undermine the quality of financial reporting and comparability between periods and between companies. In our opinion, the previously used concept of "impracticable" is a stronger threshold. If the "undue costs or effort" concept is to be maintained, we recommend that the Board provide guidance, stating that only in very rare cases would it represent an undue cost to obtain the relevant information.

Reference to Preface
The improved standards all include the sentence in the heading that IAS are not intended to apply to immaterial items, with a reference to paragraph 12 of the Preface. The latter should be removed as a consequence of the recent changes in the Preface.

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 paragraphs 13–16)?

No. We strongly support the retention of the true and fair override to be applied when the primary statements are misleading so that they do not give a true and fair view. We therefore do not support the proposal not to adjust the primary statements in jurisdictions where an override is prohibited in the law. We believe that IAS should continue to set standards that are independent of national laws. To do otherwise would mean that IAS-compliant financial statements would not be comparable between jurisdictions.

IAS 1 presently contains the important principle (paragraph 12) that “inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used or by notes or explanatory material”. We support that principle and suggest that it be retained.

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)?

Although we have sympathy for the reasons behind the proposal, we do not believe that deletion of the definition of “extraordinary” in IAS 8 and the proposed paragraph 78 in IAS 1 is a workable (and enforceable) answer. Without a proper solution to the problem, other words are likely to be used. The last sentence of paragraph 76 is an open invitation for such presentation. We believe that the issue should be addressed as part of project Reporting Financial Performance, or the Board should clearly state that separate presentation as required by paragraph 76 should not result in the use of subtotals before and after such items.

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. This reflects the conditions that existed at the balance sheet date.

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 paragraph 62)?

Yes. This reflects the conditions that existed at the balance sheet date.

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

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

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

Yes. We do, however, believe that the probability criterion in Q4b (ii) needs to be strengthened. We suggest including that management has to demonstrate that the rectification is not unlikely and how this will be done, as a condition for a non-current presentation.

Question 5
Do you agree that an entity should disclose the judgments 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)?

Yes. However, the current proposal needs to be clarified in order to achieve meaningful information. Such clarification should also include guidance as to what judgments are meant, on top of disclosures already required in individual standards (for example, the disclosure requirements in IAS 36 are already extensive)

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 paragraphs 110–115)?

Yes. We support greater disclosure of such forward-looking information about risks faced that could have a material effect on assets or liabilities within the next 12 months. However, we have significant reservations about the scope of this requirement and cannot see how it will be practical to ensure that all relevant risks are disclosed. For example, does the disclosure have to anticipate extremes, i.e. refer to maximum or likely risks? More guidance will be needed to implement this in practice. In the absence of such guidance boilerplate disclosures would be likely that do not serve the purpose of financial statements. We also note that the wording in paragraph 7 may lead to confusion as to where this type of information should have its place in IFRS financial statements.

Other comments on IAS 1

We believe that the former paragraph 6, stating that the board of directors and/or other governing body of an enterprise is responsible for the preparation and presentation of its financial statements, should be re-instated.

Paragraph 2. We do not support the deletion of the encouragement (in old paragraph 8) to present a financial review by management.

Paragraph 33. For comparative information, the words “numerical information” in old paragraph 38 have been changed into “amounts”. We do not support this change, as the former is a wider term that includes percentages, head counts of employees etc. that are considered useful information.

Paragraph 76. We do not support the deletion of the line item “results of operating activities” (old paragraph 75b). As a minimum, such changes in line items etc. should be avoided until the new standard on reporting financial performance is effective. We therefore also do not support the removal of the Appendix examples and paragraphs 80 and 82, as these help in clarifying the expenditures that should be charged in arriving at operating profit.

Paragraph 105(j). Delete "and investments" since these are examples of financial instruments.

Paragraph 117. We suggest to re-instate the requirement of old paragraph 102d to disclose either the number of employees at the end of the period or the average for the period, as this is considered key information by many users.

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 and IAS 2?

Yes.

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. Reversals should be made when such write-downs are no longer necessary.

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

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

We support the requirement that all changes in accounting policy should be made retrospectively. We believe that the standard should make clear that voluntary changes in accounting policy should be made rarely and then only for good and valid reasons. We therefore question whether the facility not to adjust comparative information in these cases (see paragraph 21) should be available.

We agree that (material) errors in the period(s) covered by the comparatives should be adjusted retrospectively.

Question 2

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

Yes. As all errors are accounted for in the same way, there is no need for such distinction.

Other comments on IAS 8

Paragraph 19. We believe that paragraph 19(d) should be changed into a separate paragraph and changed into the encouragement that presently is used in IAS 8 paragraph 48. We fear that the proposed paragraph 19d will only result in boilerplate statements saying that the entity has not yet been able to assess the effects of a new standard.

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 the principle that exchanges of property, plan and equipment should be measured at fair value, including exchanges of similar assets, except when fair value cannot be reliably determined. In practice, the distinction between similar and dissimilar assets is difficult to make.

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.)

Yes. We agree that the same principles should be applied to tangible and intangible assets. We note however that the fair value of the intangible asset given up might include any value for associated internally generated goodwill, which is inconsistent with the prohibition in IAS 38 to recognise internally created goodwill as an asset. The Board should further clarify how to account for any difference between carrying value and fair value as long as the prohibition on revenue recognition in IAS 18 remains as it is.

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)?

We believe that a plant that is temporarily idle should be depreciated. However, the wording of paragraph 59 does not accommodate the situation where the depreciation is not based on time allocation and actually declines (for example depreciation on a unit of production basis).

We do not agree as far as the asset is held for disposal. Those assets carried at depreciated historical cost should be subject to an impairment test as a separable asset at that point.

Other comments on IAS 16

Paragraph 46. Residual value. We agree with the proposal to amend the definition of residual values in paragraph 6 and 46 to reflect prices current at the balance sheet date, for assets held at historical cost. The proposed wording appropriately suggests that even upward movements would have to be considered. The Board should consider how such upward movement should be treated in case it results in a residual value that exceeds the carrying value of the asset. The Board should also consider whether the proposal should allow assets not to be depreciated at all when the residual value is in excess of or equal to cost.

IAS 17, Leases

Question 1
Do you agree that when classifying a lease of land and buildings, the lease shall 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.

Yes. We agree with 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?

Yes, we support capitalisation, as this is consistent with the model for financial instruments and contributes to convergence. However, the text should make clear that the capitalised costs should only include those directly attributable to the individual lease and should not incorporate the allocation of general overheads, such as those incurred by a sales and marketing team.

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?

Yes, we support the proposed definition of 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. However, the standard should include a requirement to disclose the reasons for reporting in another currency than that of the country of incorporation of the parent company or reporting entity.

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 support the proposed approach, which will increase comparability between entities.

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

Yes.

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 or the foreign operation and translated at the closing rate (see paragraph 45)?

Yes.

Other comments on IAS 21

Paragraph 52. Changes should only be made when the new basis is more relevant than the previous or when there has been a change in facts and circumstances. Thus disclosure should be required of the reason for any change in functional or presentation currency.

Paragraph 53. There is no need to blackletter this paragraph, as the requirement is already in IAS 1.

IAS 24, Related Party Disclosures

Question 1

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

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

No. The compensation of, and other transactions and balances with, key management of a group is relevant to decisions taken by users of financial statements and regularly results in high-profile comments by analysts and the press. The proposed amendment would furthermore be hard to explain when more transparency is strongly advocated by the entities, environment.

The definition of key management is contained in IAS 24. We believe that it does not need adjustment for this purpose. A definition of "compensation" is unnecessary. The existing requirement is to disclose all material related party transactions. Thus it would include all capital and revenue transactions and balances, and not just compensation.

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).

No. Related party transactions and outstanding balances are important for all entity only financial statements. We therefore support the arguments of the six Board members that disagreed (Appendix B4).

IAS 27, Consolidated and Separate Financial Statements

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

Yes.

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)?

No. The IASB has furthermore indicated that the recognition and measurement of minority interests will be considered in Phase II of the Business Combinations project. We believe that any changes in the presentation of minority interests should be deferred until the results of this project are available.

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)?

No. We see no reason to prohibit carrying them on an equity accounting basis in addition to permitting cost (less impairment), or fair value. We believe that the existing text should be retained.

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)?

Yes.

Other comments on IAS 27

Definitions (Paragraphs 4 and 6). The definition of separate financial statements is given in paragraph 4, which is difficult to read. The other key definitions used in the draft standard are given in paragraph 6. Moving the definition of separate financial statements to paragraph 6 would improve the standard. The second sentence of the definition of separate financial statements could be improved as follows: "Separate financial statements are also financial statements prepared by a parent that meets the conditions in paragraph 8 and does not prepare consolidated financial statements."

Paragraph 12B This paragraph incorporates the conclusions of SIC 33. We believe however that more elements of the discussion in SIC 33 should be retained as part of the revised standard.

Paragraph 29A. The words "that purport" should be deleted.

Paragraph 32 (a). We do not see any reason for deleting the listing of principal subsidiaries, together with information about ownership and location. This is considered useful information by users of financial statements. We believe this disclosure requirement should be retained.

Paragraph 32 (b) (iv) (old). We do not believe the requirement to disclose the effects of the acquisition and disposal of subsidiaries should be deleted. This information is helpful to users of the financial statements to understand the changes in the group and it should therefore be retained.

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. However, the text raises the question whether the same approach should be available for banks and insurance companies who regularly hold such assets. The standard would also need a definition of venture capital organisations.

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)?

Yes. However, it seems to us that long-term receivables are already covered by the impairment requirements of IAS 39.

Other comments on IAS 28

Paragraph 11. This paragraph explains the accounting treatment to be applied when an investor ceases to have significant influence but retains its interest in the associate. We believe the standard should also provide guidance on the treatment to be applied when an associate is (partially) sold.

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. However, having a rebuttable presumption would require the entity to disclose why that presumption is overturned. Such requirement is not proposed.

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 of 7 and 12)?

a) **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).**

No. The proposal is inconsistent with paragraph 31 which states that “dilutive potential ordinary shares shall be deemed to have been converted … at the beginning of the period”. Example 7 does not aid comparability if the year-end denominator is less than the denominator used in the final quarter because a different measurement basis has been applied to the full year calculation.

b) **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.**

No. This proposal is inconsistent with paragraph 47 which states: “if the condition is based on an average of market prices over a period of time, the average for that period is used”. The number of reporting periods (be it half-yearly or quarterly or monthly) in the financial year should not influence the measurement basis of EPS or any other measurement basis in the annual financial statements.

c) **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 for the year-to-date reporting period (or from the date of the contingent share agreement, if later).**

We refer to our answers on a) and b) above.

Other comments on IAS 33

Appendices. We do not believe that IASB is clarifying the issues by having two appendices, where A is and B is not part of the standard.

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 the IAS 40, paragraphs 27–49?

Yes.

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?

Yes.

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.

Yours sincerely,

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Chairman Accounting Practices Committee

Björn Markland
Secretary General