Comments of the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) on the Exposure Draft of Proposed Improvements to International Accounting Standards

The Institute of Chartered Accountants of India, established Accounting Standards Board in 1977, with a view to harmonise the to harmonise the diverse accounting policies and practices. While formulating the Indian Accounting Standards, Accounting Standards Board gives due consideration to International Accounting Standards and tries to integrate them, to the extent possible, in the light of the conditions and practices prevailing in India.

With a view to draft comments on the Exposure Draft of Proposed Improvements to International Accounting Standards, the Accounting Standards Board constituted various study groups in different parts of India. The draft comments prepared by the study groups were finalised by the Accounting Standards Board. The following are the comments of the Accounting Standards Board (hereinafter referred to as the 'Board') on the exposure draft of proposed improvements to International Accounting Standards.

1. IAS 1, Presentation of Financial Statements

Comments on Specific Questions

Comments on Question 1

The Board agreed, keeping in view the international perspective, 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.

Comments on Question 2

The Board disagreed with prohibiting the presentation of items of income and expense as 'extraordinary items' in the income statement and the notes. It was noted that the regulatory bodies and corporate governance require more transparency in the financial statements. The view was that the presentation of 'extraordinary items' on face of the income statement provides useful information to users of the financial statements in assessing the current year performance and also predicting an entity's future performance. The Board was further of the view that the proposed paragraph 78 should be modified to specifically require presentation of extraordinary items only on the face of the income statement. It is suggested that paragraph 78 may be modified in the following form:

"78. An entity shall present items of income and expense as extraordinary items on the face of the income statement."

It was noted that paragraphs 7 to 9 of IAS 8 (revised 1993) dealing with net profit and loss for the period have been incorporated in the exposure draft of IAS 1. It is suggested that paragraph 10 of IAS 8 dealing with separate disclosure of profit or loss from ordinary activities and extraordinary items should also be incorporated in IAS 1 along with paragraphs 7 to 9. Paragraph 10 of IAS 8 is reproduced below:

"The net profit and loss for the period comprises the following components, each of which should be disclosed on the face of the income statement:

(a) profit or loss from ordinary activities; and

(b) extraordinary items."

Comments on Question 3

The Board agreed 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. The Board agreed with the arguments of the IASB that refinancing a liability after the balance sheet date does not affect the entity's liquidity and solvency at the balance sheet date, the reporting of which should reflect contractual arrangements in force on that date. It was further noted that as per proposed paragraph 61, this amendment does not affect the classification of a liability as non-current when the entity has, under the terms of an existing loan facility, the discretion to refinance or 'roll over' its obligation for at least twelve months after the balance sheet date. The Board was of the view that the classification of liabilities as current or non-current is now more specific as per the proposed changes.

Comments on Question 4

(a) The Board agreed that 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. The Board agreed with the views of the IASB that unless the lender has waived its right to demand immediate repayment or granted a period of grace within which the entity may rectify the breach of the loan agreement, the financial condition of the entity **at the balance sheet date** was that the lender held an absolute right to demand repayment immediately, based on the terms of the loan agreement, and therefore an entity's receipt of a waiver **after the balance sheet date** changes the nature of the liability to non-current only when it occurs.

(b) The Board agreed that 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;

(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.

Comments on Question 5

The Board agreed that an entity should disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amount of items recognised in the financial statements. The Board was of the view that disclosure of these judgements would enable the user of the financial statements to understand better, the accounting policies applied and to make comparisons between entities.

Comments on Question 6

The Board agreed that an entity should disclose key assumptions about the future, and other sources of management uncertainty, that have significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year.

Comments in relation to specific paragraphs

1. **Paragraph 5**

The Board noted that the words, 'other events affecting it', has been added in the first sentence of this paragraph. The Board was of the view that there can be lot of events of non-financial nature which may effect an entity and it would be difficult to represent all those events in the financial statements. It was decided that it should be restricted to other events affecting the items of financial statements and their disclosure. It was suggested that in place of the words, 'other events affecting it', the following words may be substituted:

"other events affecting items of financial statements and their disclosure."

2. Paragraph 10

In the last sentence of this paragraph, the words, 'is presumed to' has been added. The Board was of the view that it is not appropriate to use the word, 'presume' in the standard. It was suggested that the word, 'normally', may be used in stead of using the words, 'is presumed to'.

3. Paragraph 12 of IAS 1 (revised in 1997)

The Board noted that it has been proposed to delete paragraph 12 of IAS 1 which is reproduced below:

> ***"Inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used or by notes or explanatory material."***

The Board was of the view that this paragraph should be retained in the standard. It was suggested that this paragraph may be given in explanatory form rather than giving in *bold italic*.

4. Paragraph 76

The Board disagreed with deletion of clause (b) of paragraph 75 of the existing IAS 1 which requires that the results of operating activities should be disclosed separately as a line item on the face of the income statement. It is noted that an entity is required to disclose the operating results even segment-wise. The Board was of the view that at the same time, disclosure of the results of operating activities on the face of income statement would provide useful information to users of the financial statements to judge the profitability of overall operation of an entity.

5. Paragraph 102 of the existing IAS 1 (revised 1997)

(i) The Board was of the view that the requirements as to disclosure of an entity's country of incorporation and the address of its registered office should be retained in the standard.

(ii) With reference to deletion of clause (d) of paragraph 102 of the existing IAS 1, it is suggested that the users of financial statements generally require information about size of an entity and its operation. It is felt that information about the number of an entity's employees would help users of the financial statements to judge size of an entity. It is suggested that the information as to the numbers of an entity's employees should be disclosed in the financial statements.

6. Paragraph 108

It is suggested that the word, 'most' should be deleted from this paragraph.

2. IAS 2, Inventories

Comments on Specific Questions

Comments on Question 1

The Board agreed with eliminating the allowed alternative of using the last-in, first-out (LIFO) method for determining the cost of inventories under paragraph 23 and 24 of IAS 2. In this regard, it was noted that Indian Accounting Standard (AS) 2, 'Valuation of Inventories' issued by the Council of the Institute of Chartered Accountants of India also provides that the cost of inventories shall be assigned using the first-in, first-out (FIFO), or weight average cost formula. The allowed alternative treatment of using LIFO method for determining the cost of inventories has not been provided in AS 2 and the IASB's proposal to eliminate the allowed alternative of using LIFO from IAS 2 is consistent with the principals enunciated in AS 2.

Comments on Question 2

IAS 2 requires reversal of write-down 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 and loss account. The Board agreed with retaining these requirements. It was pointed out that reversal of write-down of inventories is also required by AS 2 issued by the Institute of Chartered Accountants of India though such reversal is not specifically recognised in the profit and loss account. The Board was of the view that the requirement of reversal of write-down of inventories is consistent with the provisions AS 2 and should not be dispensed with.

Comments in relation to specific paragraphs

1. Paragraph 1

The Board noted that the word, ‘producers’ has been deleted from clause (c) of paragraph 1. It was discussed that the deletion of the word, ‘producers’ would extend the scope exception to inventories of brokers and dealers of agricultural and forest products, mineral ores etc. The Board was of the view that as per the proposed change, the inventories in case of brokers and dealers would be valued at net realisable value which is not appropriate. It was further noted that paragraph 3 of IAS 2 states that the inventories referred to in paragraph 1 (c) are measured at net realisable value **at certain stages of production**. The Board was of the view that deletion of the word, ‘producers’ from paragraph 1 (c) would make paragraph 3 redundant. If the intention of proposed change in clause (c) is to cover the inventories of brokers and producers within the exception, corresponding paragraph 3 should also be modified in accordance with changes proposed in paragraph 1 (c).

2. Paragraph 16

(i) Attributable overheads which would be included in the cost of inventories of a service provider may be illustrated by giving examples similar to those given in paragraph 14 for ‘other costs’ in case of inventories of producers.

(ii) The Board was of the view that it would be more appropriate to use the words, ‘non-attributable overheads’ in place of the words, ‘non-production costs’ in the last sentence of this paragraph. The Board was of the view that the words, ‘non-production costs’ are generally used in case of inventories of producers.

3. IAS 16, Property, Plant and Equipment

Comments on Specific Questions

Comments on Question 1

We 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.

Comments on Question 2

We 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.

Comments on Question 3

For question 3, we partially agree with the proposals of IASB. We agree that depreciation should not cease when an item of property, plant and equipment become temporarily idle. But we do not agree that depreciation should not cease even if the item is retired from active use and held for disposal. For rationale of our disagreement, please see our comments on para 59.

Comments in relation to specific paragraphs

1. Paragraph 7

There is an important change in para 7(b) which is not even discussed in 'Summary of Changes' or 'Basis of Conclusions'. The change is **not at all acceptable** for the following reasons:

Para 7 deals with criteria for recognition of property, plant and equipment as asset. Clause (b) requires reliable measurement of cost or, in case the asset is carried at a revalued amount, reliable measurement of fair value. While reliable measurement of cost is an existing requirement, reliable measurement of fair value for revaluation cases is a new requirement. It should be noted that as per para 14, initial measurement should *always* be at cost only. [Of course, special treatment is needed in case of business combinations in the nature of acquisition as per IAS-22].At subsequent measurement, in revaluation cases, if fair value is not reliable, should an asset be de-recognised even if inflow of economic benefits is probable? Proposed Para 7(b) leads to that conclusion! In our view, it should not be de-recognised. If fair value is not reliable, then, some other alternative should be found. IAS-38 deals with such situations in the case of intangible assets (paras 72-75). **Similar provisions could be inserted in IAS-16 also.**

There is one more reason for opposing the change. IAS-38 also permits revaluation of intangible assets. But no change has been proposed in recognition criteria given in para 19. Why, then, an unwarranted change has been proposed in IAS-16 only?

A question may arise here. The recognition criteria given in para 89 of 'Framework for the Preparation and Presentation of Financial Statements' refers to reliability of 'cost or value'. What is the significance of 'value' here? In special cases like business combinations in the nature of acquisition (IAS-22), instead of cost, fair value is relevant. It does not refer to revaluation cases. Hence the above para cannot be pressed into service to justify the proposed change in IAS-16.

2. Paragraph 9

This paragraph explained first recognition criterion (para 7(a)). Reason for deletion **not clear**. We feel that **deletion is not warranted.**

3. Paragraph 10

This paragraph explained second recognition criterion (para 7(b)). Reason for deletion is **not clear**. Probably since proposed change in para 7(b) includes reference to fair value for revaluation cases whereas existing para 10 refers to 'cost' only, the deletion might have been proposed. But since proposed change in para 7(b) itself is not acceptable and also because initial recognition should always be at cost and not at fair value, deletion of para 10 is **not acceptable.**

4. Paragraph 12

Existing para 12 refers to appropriateness of 'component' approach in accounting. The rewording implies some sort of compulsion to adopt 'component approach'. The 'Summary of Changes' refers to 'material components' (See page 125 of the 'Proposed Improvements'). The word 'material' is absent in proposed changes. **It may be inserted in the proposed changes.**

5. Paragraph 15(b)

Net proceeds from selling samples is actually 'incidental income'. It may be 'negative' also. Hence the words 'after deducting' in the proposed revised para 15(b) **should be amended** as 'after adjusting'.

6. Paragraph 15A

The deletion of the words 'such as for architects and engineers' in the renumbered item (e) is **unwarranted.**

7. Paragraph 17

Existing para 17 has been changed altogether and broken into three paras viz. 17, 17A and 17B. In para 17, four examples are given for costs that are not components of cost of property, plant and equipment. Now administration and other general overhead costs will not form part of cost under any circumstances. [Under existing para 17, they are excluded unless they are 'attributed to acquisition']. So far administration and general overheads are concerned, **existing exception may be permitted** This is because the exception is permitted in IAS-2 (vide para 14(c)) where the exclusion is qualified by the words "that do not contribute to bringing the inventories to their present location and condition". This implies that the exclusion is not applicable, if administrative overheads otherwise contribute to bringing the inventories to their present location and condition. No amendment is found in the 'Proposed Improvements' in para 14(c) of IAS-2).

8. Paragraph 23

Subsequent expenditure incurred to enhance standard of performance assessed immediately before such expenditure should be capitalised. The existing requirement is that there should be enhancement of originally assessed standard of performance. This change is **not acceptable** .It may be noted that standard of performance assessed immediately before the subsequent expenditure will in most of the cases be increased after the said expenditure is incurred. Hence even routine repairs will qualify for capitalisation, frequently tinkering with 'cost'. Also the change requires assessment of standard of performance before incurring subsequent expenditure. This is **not practicable.** *The exemption on the ground of 'undue cost or effort' is not available*. The lenience given in new para 26 (former para 25 redrafted) in respect of immaterial replacements may not be helpful when a major repair takes place.

Consequential changes from para 23A to para 26 are also **not acceptable** since these changes flow from change in para 23.

[Hence **similar changes in IAS-36** (paras 37(c) ,38(b), 41,42 and 96(d)-vide pp 384-386 of the 'Proposed Improvements) **and in IAS-38** (paras 60 and 61 -vide page 392 of the 'Proposed Improvements) are also **not acceptable**].

Without prejudice to our views, we wish to point out para 25 is not very clear. This para, *inter-alia*, says that if after impairment loss, some expenditure is incurred and future economic benefits are increased, it can be capitalised only to the extent of reversal of impairment loss. But para 23 (standard portion) does not put any ceiling. There is no ceiling on recognition of some expenditure as asset, if some economic benefits is probable. (vide paras 7 and 13). Rather, after recognition, impairment loss is separately recognised. *Para 25, inter-alia, carves out an exception when subsequent expenditure is incurred after an impairment loss.*

9. Paragraph 49

Review of useful life at each balance sheet date is **not acceptable** since it is impracticable. The existing requirements of periodical review can continue. [If still the change is introduced, the words "financial year end" should be changed as "balance sheet date" or "accounting period end"].

10. Paragraph 50

Deletion of the words 'beyond its originally assessed standard of performance' is a consequential change due to change in para 23. Since change in para 23 itself is not acceptable, proposed change in para 50 also is **not acceptable.**

[similar changes in IAS-38 (paras 94 and 95-vide pp 394 and 395 of the 'Proposed Improvements) are also **not acceptable**].

11. Paragraph 51

Review of depreciation method at least at each financial year end- **Not acceptable since it is impracticable**. Exemption on the ground of undue cost or effort is also not available. The existing requirement of periodical review is sufficient. [If still the change is introduced, the words "financial year end" should be changed as "balance sheet date" or "accounting period end"].

12. Paragraph 59

Depreciation in respect of items retired from active use is **not acceptable**. *For all practical purposes*, they are not property, plant and equipment since they are no longer meet the definition criteria. The existing treatment (i.e exhibition at lower of carrying amount and net realisable value) can continue.

4. IAS-17, Leases

Comments on Specific Questions

Comments on Question 1

We agree with the proposals of IASB that in case of land and buildings, the lease should be split into two elements. We agree that land should be generally classified as operating lease while building should be classified as operating or finance lease, as appropriate.

Comments on Question 2

In question 2, there are two sub-questions. We agree with the proposals of IASB for both these two sub-questions. i.e initial direct costs incurred by the lessor in negotiating a lease should be capitalised over the lease term. We also agree that only incremental costs that are directly attributable to the lease transaction including 'internal costs' should be capitalised in this way.

Important change required

An important change is required in para 36 of IAS-17. The first sentence reads as below:

"The sales revenue recorded at the commencement of a finance lease term by a manufacturer or dealer lessor is the fair value of the asset, or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a commercial rate of interest".

The second sentence reads as below:

"The cost of sale recognised at the commencement of the lease term is the cost, or carrying amount, if different, of the leased property less the present value of the unguaranteed residual value".

Generally, fair value will be equal to net investment in the lease which includes present value of unguaranteed residual value. If sales is to be recorded at fair value (assuming that there is no need to adopt present value of minimum lease payments due to artificially low rate of interest) and present value of unguaranteed residual value is to be reduced from cost of sales, where should the contra adjustment be made? Naturally sales. Hence the first sentence of para 36 should be amended by inserting the words "less the present value of unguaranteed residual value" after the words "fair value of the asset".

The reason for such insertion after the words "fair value of the asset" is that in case sale is recorded at present value of minimum lease payments, the adjustment is automatic. This is because, in such a case, net investment in lease (debit aspect) includes present value of unguaranteed residual value while sales (credit aspect) recorded at present value of minimum lease payments excludes the same. Hence when cost of sales is credited with such present value of unguaranteed residual value, the accounting entry is tallied and there is no need for further adjustment.

Note: The reduction of unguaranteed residual value from cost of sales is a change effected after 1993 in line with US GAAP. In 1993 version of IAS-17 (reformatted, 1994) this requirement is not found in the corresponding para 41. There, both sales and cost of sales will be stated without such reduction.

Consequential amendments:

Reference to concept of practicality has been changed to 'undue cost or effort' throughout the 'Proposed Improvements' and hence consequential amendment to para 12 of IAS-17 is also acceptable. [vide page 364 of the 'Proposed Improvements'].

Related changes:

(i)The amendments proposed in para 56 and new para 58 of IAS-16 (vide pp 150-151 of the 'Proposed Amendments') and paras 104 and 104A of IAS-38 (vide page 395 of the 'Proposed Amendments') have reference to sale and leaseback under IAS-17 and are **acceptable**.

(ii)The amendments proposed in IAS-40 also affect IAS-17. (vide pp 345-350 of the 'Proposed Amendments').These amendments give a *choice* to the lessee to treat a property interest held under a operating lease as if it were a finance lease for accounting purposes. We **suggest** that the proposed change may be applicable for minimum lease period exceeding a threshold limit.

5. IAS 21, The Effects of Changes in Foreign Exchange Rates

Comments on Specific Questions

Comments on Question 1

We agree. However, additional guidance would be useful.

Comments on Question 2

We agree, subject to any legal requirements in the home country or the host country or countries.

Comments on Question 3

We agree. However, share capital should be translated at the historical rate, and not at the closing rate, because the purpose of the translation exercise is to capture the economic effect of foreign operations on the shareholders' equity. Paragraph 37 needs to be amended.

Comments on Question 4

We agree.

Comments on Question 5

We agree.

6. IAS 24, Related Party Disclosures

Comments on Specific Questions

Comments on Question 1

The Board is of the view that the Standard should require disclosure of managerial remuneration which is paid in the ordinary course of an entity's operations. The Standard should not exempt these items from disclosure because, in many jurisdictions, disclosure in financial statements is the primary accountability mechanism for management remuneration.

The term "managerial remuneration" may be defined to include-

(a) any expenditure incurred by the company in providing any rent-free accomodation, or any other benefit or amenity in respect of accomodation free of charge, to any of it's management personnel.

(b) any expenditure incurred by the company in providing any other benefits or amenity free of charge or at a concessional rate to any of it's management personnel.

(c) any expenditure incurred by the company in respect of any obligation or service, which, but for such expenditure by the company, would have been incurred by any of the managerial personnel.

(d) any expenditure incurred by the company to effect any insurance on the life of, or to provide any pension, annuity or gratuity for, any other managerial personnel, or his spouse or child.

Comments on Question 2

The Board is of the view that the Standard should 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. The exemption is not valid on the following grounds:

(a) The financial statements of an entity that is part of a consolidated group, including those of the parent or a wholly owned subsidiary, may include the effects of extensive intra-group transactions . Thus, most of the revenue and expenses for such an entity may be derived from related party transactions. The disclosures required by IAS 24 are essential to understand the financial position and financial performance of such an entity.

(b) The material transactions between a parent or wholly-owned subsidiary and related parties outside the group might be immaterial to the group. In these cases, when the exemption in paragraph 3 is used, these related party transactions would be disclosed neither in the entity's separate financial statements nor in the consolidated financial statements of the group.

7. IAS 27, Consolidated and Separate Financial Statements

Responses to specific questions raised

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

Response We agree with the requirement that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met. Such a requirement would ensure that companies in a group that are required by law to publish financial statements under IASs in addition to the group's consolidated financial statements would not be unduly burdened.

However it is possible that the usage of the word "securities" contained in paragraph 8(b) and 8(c) may be construed differently across the world, resulting in interpretative differences. Accordingly, it would be appropriate if this word is defined/articulated more elaborately.

Two possible ways of doing so are to substitute the word "securities" contained in paragraph 8(b) and 8(c) with:

- "financial instruments as defined in paragraph 8 of IAS 39 Financial Instruments: Recognition and Measurement". The definition contained in IAS 39 states that "A financial instrument is any contract that gives rise to both a financial asset of one enterprise and a financial liability or equity instrument of another enterprise"; or
- "equity and debt securities".

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)?*

Response We agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity (see paragraph 26). This change would be particularly important for companies in certain industries that are required to maintain a minimum net worth. Clearly in such cases minority interests would be considered to be an integral part of the group's equity (residual interest).

An important result of this change is that minority interests would now be an integral part of the equity of the group. However it is noted that the proposed paragraph 26 states that "Minority interests in the profit or loss of the group shall also be separately presented". Such presentation involving the deduction of minority interests in the computation of net profit and loss may be inconsistent with the classification of the minority interest within equity. Consequently, we recommend that minority interests be treated akin to other components of equity, with movements (including the minority interests in the profit and loss) disclosed in the statement of changes of in equity.

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)?

Response We 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). Further we also agree that 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).

It is possible however that the intended treatment of excluding the equity method of accounting in separate financial statements may not be followed by certain entities due to paragraph 8A of IAS 28 which states that "An investor accounts for an investment in an associate using the equity method irrespective of whether the investor also has investments in subsidiaries or whether it describes its financial statements as consolidated financial statements". This paragraph seems to contradict both paragraphs 24A and 24B of IAS 28 and paragraphs 29, 30 and 33 of IAS 27. A similar contradiction exists between paragraphs 25A, 32A and 38 of IAS 31, Financial Reporting for Interests in Joint Ventures.

Presented below are two possible methods for remedying the possible contradiction noted above.

Option 1

An overall review of the changes proposed in the IAS indicates a desire for an entity to present a set of financial statements representing its economic exposure to associates and joint ventures irrespective of whether or not it has subsidiaries (i.e. irrespective of whether it has a "group"). Perhaps this need could be addressed in a more definite manner by amending the definition of consolidated financial statements in IAS 27 to state "Consolidated financial statements are the financial statements of a group presented as those of a single economic entity. In the event that an entity does not have a subsidiary, but has interests in associates or joint ventures the consolidated financial statements comprise the financial statements of:

– the investor with investments in associates accounted for as per IAS 28;
– the venturer with investments in joint ventures accounted for as per IAS 31; or

– a combination of the above."

Option 2

Without amending the requirement to prepare consolidated financial statements, the existing amendments to IAS 28 could be clarified to state "If an investor does not prepare consolidated financial statements as per IAS 27, Consolidated and Separate Financial Statements, it accounts for an investment in an associate using the equity method. Accordingly, an investor accounts for an investment in an associate using the equity method irrespective of whether the investor also has investments in subsidiaries or whether it describes its financial statements as consolidated financial statements". Similar changes would be required in paragraphs 25A and 32A of IAS 31.

Comments regarding other changes

Paragraph reference	*Comments*
29	This paragraph prescribes the method of accounting in separate financial statements, for 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. The Standard prescribes that such investments be accounted for as per the cost method or in accordance with IAS 39, Financial Instruments: Recognition and Measurement, with "the same method shall be applied for each category of investments". The method of accounting in separate financial statements (cost or IAS 39) shall be applied for "each category of investments". It would appear the intention is that this requirement be applied for each category of control/significant influence, rather than for each category of investment (i.e. debt, equity etc.). It would be perhaps be more appropriate if this sentence were reworded as "the same method shall be applied for each category of control/significant influence (i.e. subsidiary, associate, or joint venture)".
6 and 29B	These paragraphs define and refer to the "cost method". The definition of the cost method includes a statement to the effect that "The investor recognises income from the investment only to the extent that the investor receives distributions from accumulated net profits of the investee arising after the date of acquisition". We recommend the following two amendments to this statement: – The word "receives" seems to imply recognition of income on a cash basis. The clause could read as "only to the extent that the investor has the right to receive". – The requirement of recognising income only on distributions from "profits of the investee arising after the date of acquisition", appears to be based on paragraph 32 of IAS 18, Revenue, which requires that "When dividends on equity securities are declared from pre-acquisition net income, those dividends are deducted from the cost of the securities". However IAS 18 also prescribes an

Paragraph reference	*Comments*
	exception to this rule by stating that "if it is difficult to make such an allocation except on an arbitrary basis, dividends are recognised as revenue unless they clearly represent a recovery of part of the cost of the equity securities". Accordingly, with a view to ensuring consistency with IAS 18 we recommend that the following sentence be included at the conclusion of the definition of the cost method in paragraph 6 of IAS 27 and as the last sentence in paragraph 29B, "if it is difficult to make such an allocation except on an arbitrary basis, distributions received are recognised as revenue unless they clearly represent a recovery of part of the cost of the investment".
13	This paragraph states that "A subsidiary shall be excluded from consolidation when control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal within twelve months from acquisition." Investments in such subsidiaries shall be accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, at fair value with changes in fair value included in profit or loss of the period of the change. Inclusion of the time period of 12 months in the above paragraph is a significant change that has been made in the standard. Such a change would bring a greater degree of definiteness in the exemption from consolidation. However, to be effective the Standard should also specify the action required when the subsidiary has not be disposed after a period of 12 months, i.e. though the designation of the fact that control is intended to be temporary should be made at the time the subsidiary is acquired, there is no mention in the standard of the action required if the intended disposal does not occur within a period of 12 months. We recommend that after the period of 12 months has expired the entity should disclose in its financial statements the effect on the group's assets, liabilities, incomes and expenses of consolidating the subsidiary from the date of acquisition. If the disposal has not been completed at the end of a period of 24 months we recommend that the Standard mandate consolidation of such a subsidiary in the consolidated financial statements, with effect from the date of aquisition.
32(a)	The exposure draft proposes the deletion of a disclosure which required "in consolidated financial statements a listing of significant subsidiaries including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held". We would recommend that rather than deleting this clause in entirety it should be replaced by "in consolidated financial statements a listing of significant subsidiaries including the name, country of incorporation or residence". Such a disclosure would provide the reader an indication of the size and complexity of the group structure. Further, it would help reference a particular entity as a member of the group, particularly when such an entity does not prepare consolidated financial statements based on the exclusion contained in paragraph 8.

Paragraph reference	*Comments*
32(f)	This paragraph requires disclosure of "the nature and extent of any restrictions on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends, repayment of loans or advances (i.e. borrowing arrangements, regulatory restraints etc)". In addition to this disclosure we recommend that an indication be specifically made of cases where control has been precluded due to such restrictions and accordingly a subsidiary has not been consolidated.

8. IAS 28, Accounting for Investments in Associates

Responses to specific questions raised

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)?*

Response We agree with the requirement that IAS 28 and IAS 31 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.

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)?*

Response We 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 28 currently states that "Investments in associates accounted for using the equity method shall be classified as long-term assets and disclosed as a separate item in the balance sheet". In light of the revised treatment of interests in associates, it seems reasonable that an investor would view the investment in the associate on par with interests such as long-term receivables. Accordingly, we recommend that an investor disclose "interests in associates" classified as long-term assets and disclosed as a separate item in the balance sheet, rather than merely investments in associates. Interests in associates could be defined on the same lines as paragraph 22 i.e. "The interest in an associate is the carrying amount of the investment in the associate under the equity method plus items that, in substance, form part of the investor's investment in equity of the associate".

In describing the nature of interests in associates paragraph 22 states that "such items may include preferred shares and long-term receivables or loans but do not include trade receivables or payables". As the intent is to identify items that, in substance, form a part of the investor's investment in equity of the associate, perhaps the reference to "trade payables" is not appropriate. Another matter that might be considered in the evaluation of the definition of interests in an associate, for the purpose of paragraph 22, could be the availability of an offset between receivables and payables with the associate, where legally permissible.

Comments regarding other changes

Paragraph reference	*Comments*
3	The definition of significant influence requires the "power to participate in the financial <u>and</u> operating policy decisions". An investor may not always participate in both financial and operating decisions. However the power to participate in only financial or operating policies would still give an investor a significant influence over the enterprise. For example, consider a technology provider with a 15 per cent equity holding in an entity that relies heavily on the technology to conduct its operations. The entity relies heavily on the technology provider for matters concerning its operations. This technology provider would thus have the power to participate in operating but not financial policy decisions. Conversely, consider a bank with a 15 per cent equity holding in an entity. The bank is also the largest lender to the entity and is actively involved in setting the entities financial policies. The bank is not involved in the entity's operating policies. The bank would thus have the power to participate in financial but not operating policy decisions Accordingly, we recommend a widening of the definition of significant influence to state "power to participate in the financial <u>or</u> operating policy decisions".
8	This Paragraph states that "An investment in an associate shall be accounted for under the equity method except when the investment is acquired and held exclusively with a view to its subsequent disposal within twelve months from acquisition. Such investments shall be accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, at fair value with changes in fair value included in profit or loss of the period of the change". Inclusion of the time period of 12 months in the above paragraph is a significant change that has been made in the standard. While we agree that the definition of a time period for temporary significant influence, to be effective the Standard should also specify the action required when the investment has not be disposed after a period of 12 months, i.e. though the designation of the fact that significant influence is intended to be temporary should be made at the time the subsidiary is acquired, there is no mention in the standard of the action required if the intended disposal does not occur within a period of 12 months. We recommend that after the period of 12 months has expired the investor should disclose in its financial statements the effect on its assets and net profit or loss of performing equity accounting on the investment from the date of acquisition. If the disposal has not been completed at the end of a period of 24 months we recommend that the Standard mandate accounting for the associate using the equity method. If adopted, similar changes would also be required to be made in paragraph 35 of IAS 31, Financial Reporting of Interests in Joint Ventures.

Paragraph reference	*Comments*
27(a)	This clause requires "an appropriate listing and description of significant associates including the proportion of ownership interest and, if different, the proportion of voting power held". This disclosure would be important to provide the reader an indication of the size and complexity of the group structure. Accordingly, we recommend that this disclosure be retained.
28	The separate disclosure of the investor's share of any extraordinary or prior period items is proposed to be deleted. Income from associates is included in the investor's net profit from ordinary activities. Non-disclosure of extraordinary items could distort the disclosure of the investor's net profit from ordinary activities.
27(f)	This paragraph requires disclosure of "the nature and extent of any restrictions on the ability of associates to transfer funds to the investor in the form of cash dividends, repayment of loans or advances (i.e. borrowing arrangements, regulatory restraint etc)". In addition to this disclosure we recommend that an indication be specifically made of cases where significant influence has been precluded due to such restrictions.

9. Earnings Per Share

Comments on Specific Questions

Comments on Question 1

We agree that the 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 rebuttable presumption that contracts will be settled in shares. We prefer to include this approach to be included in the revised standard.

Comments on Question 2

We agree with the approach presented under Question 2. We believe this new approach will definitely improve the accuracy of the calculation. The earnings per share purport to reflect the performance of the enterprise during the reporting period. Therefore, the new approach to the calculation will improve the parameter being used to measure the performance.

General Comments

We agree with the other changes proposed in the exposure draft. The additional, guidance and illustrative examples will improve the implementation of the exposure draft. Adjustments in calculating basic earnings per share stipulated in paragraphs 13 to 16 are improvements over stipulations in paragraphs 11 to 13 of the existing IAS 33.

10. IAS 40, Investment Property

Comments on Specific Questions

Comments on Question 1

We agree with the proposed changes in the definition of the investment property. We agree to the basis of conclusion.

Comments on Question 2

We 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. We agree to the IASB view as presented in paragraph A6 of the appendix 'Basis for Conclusions'.

Comments on Question 3

We agree that the IASB should not eliminate the choice between the cost model and the fair value model in the improvements project at this stage. There are many situations, particularly in less developed countries, where active market for property does not exist and therefore, observable market price is not available. Moreover, economic models for developing fair value may not produce appropriate results, because it is often difficult to identify or quantity variables that the market takes into consideration in determining the market price. This is because in absence of regular exchange of property, every exchange has different considerations and it is difficult to develop a set of general principles that set prices in exchange transactions.