David Cairns
International Financial Reporting

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International Accounting Standards Board
30 Cannon Street
London
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Dear Sirs,

Proposed *Preface to International Financial Reporting Standards*

I support the revisions to the Preface which are long overdue, indeed as the IASC's secretary-general I initiated a review of the Preface in 1994 which, I understand, was not pursued. The revisions are, of course, all the more necessary with the IASB assuming standard setting responsibilities from its predecessor body, the IASC.

Matters Raised in Invitation to Comment

Scope and Authority of International Financial Reporting Standards and Interpretations

Question 1 – Application of IFRS

I agree strongly that IFRS should be designed to apply to the general purpose financial statements and other financial reporting of all profit oriented entities.

Solely for the avoidance of any uncertainty, and irrespective of the redundancy in the words, the IASB should add 'whether in the private sector or the public sector' to the end of first sentence of paragraph 9. The words are necessary because, in spite of policy announcements by the IASC and the existence of IFAC Public Sector Guideline 1 *Financial Reporting by Government Business Enterprises*, some people remain uncertain about the application of IAS/IFRS to public sector business entities.

There has been a long debate about whether IAS, and now IFRS, should apply to not-for-profit entities, in particular those in the public sector, and whether the IASC/IASB should develop standards for not-for-profit entities. The IASC did consider dealing with such issues and the 1987-1990 IASC/IFAC (Bishop) Working Party recommended that the IASC should deal with public sector non-business activities.

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The IASC took a pragmatic approach. It argued that it lacked the resources and (then) the expertise to deal with not-for-profit entities in the public sector. It recognised that requirements for not-for-profit entities may unduly complicate IAS and may, as a result, confuse users of IAS. Therefore, the IASC supported and participated[1] in the work of the IFAC Public Sector Committee whose Standards programme is now contributing to the improvement of financial reporting by not-for-profit government entities.

The IASB has more than enough to do in dealing with business enterprises. Therefore, it should take the same pragmatic approach to not-for-profit entities as did the IASB. It should do so irrespective of whether the same standards should apply to such entities.

<u>Question 2 – Standards (Principles) and Implementation Guidance</u>

I agree strongly with the need for robust and useful guidance to illustrate the basic principles in each IFRS, including a detailed basis for conclusions. I disagree with the discontinuance of the distinction between standards (principles) and supporting explanatory material and implementation guidance.

IFRS have to be applied in the many circumstances that exist in different jurisdictions. It is vital that IFRS reflect these differences and do so in the body of the Standard rather than in appendices. The distinction between standards (principles) in bold/italic type and implementation guidance (in plain type) is the best way of dealing with different circumstances. It is both necessary and helpful.

Due Process

<u>Question 3 – Proposed Due Process</u>

I agree with the proposals and that all the proposed steps are necessary.

It is important that step (b) - the study of national accounting requirements – should include the requirements of all major countries and not just English speaking countries. At the very least, the step should include consideration of the requirements in the seven countries of the liaison standards setters.

There is evidence already of the IASB ignoring the existing requirements of major countries. For example, the published staff papers on small and medium sized entities omit the requirements in France, Germany and Japan notwithstanding that all three countries distinguish between the requirements that apply to all enterprises and those that apply to publicly listed or traded enterprises (or only to consolidated financial statements). The IASB should ensure that it considers the requirements of non-English speaking countries in all projects. It may find that they provide the best solutions.

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[1] As secretary-general of the IASC, I represented the IASC on the IFAC Public Sector Committee for five years and chaired the Committee's working party that developed Public Sector Guideline 1 *Financial Reporting by Government Business Enterprises*. Subsequently other staff members dealt with the IFAC Public Sector Committee on behalf of the IASC.

Other Issues

Benchmark and Allowed Alternative Treatments (paragraphs 12 and 13)

Paragraphs 12 and 13 of the proposed *Preface* deal with those circumstances in which IAS (and, presumably, IFRS) allow a choice of accounting treatment. I support the IASB's efforts to remove those choices but recognise that some will remain, particularly with respect to measurement.

Paragraph 12 refers to the use of the terms 'benchmark treatment' and 'allowed alternative treatment' in existing IAS. This distinction is no longer necessary and should be removed from any relevant IAS as part of the IASB's current improvements project. The terms are now redundant and all IAS that include a choice should follow the approach now adopted in IAS 40. Furthermore, when an IAS does permit a choice, an entity should be required to follow one treatment for all like transactions and events in a single set of financial statements[2].

The terms 'benchmark treatment' and 'allowed alternative treatment' were used by the IASC only because both the US Securities and Exchange Commission (SEC) and the International Organization of Securities Commissions (IOSCO) suggested that they would require a reconciliation to the 'benchmark treatment' whenever an IAS allowed the use of two or more treatments. In particular, the SEC indicated that if the IASC could identify one method as a reconciling (benchmark) standard, the SEC would be receptive to a proposal to allow foreign companies to reconcile to that reconciling standard rather than to US GAAP.

Given that both IOSCO and the SEC have abandoned the idea of a reconciliation to IAS in favour of complete IAS financial statements, there is no point in retaining the distinction between 'benchmark treatment' and 'allowed alternative treatment'. Furthermore, the IASC has always made clear that the distinction does not indicate a preference[3] and, therefore, the distinction now has no meaning within IASIFRS.

Compliance with IFRS (paragraph 16)

I agree strongly with the need for full compliance with IAS/IFRS. However, I disagree with the requirement in IAS 1 that any compliance statement cannot be made unless there is full compliance. This requirement does not deal with the major compliance issue – undisclosed non-compliance with IAS/IFRS by entities that purport to comply with those IAS/IFRS. It also confuses the roles of regulators and standard setters.

The IAS 1 requirement, as currently expressed, is unworkable. It is being applied inconsistently by companies and their auditors. For example, many companies (with the

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[2] This is currently the case for all IAS except IAS 2 *Inventories* for which SIC 1 allows a mix of treatments notwithstanding an earlier IASB board decision to the contrary.

[3] IASC, *Statement of Intent on the Comparability of Financial Statements*, June 1990, para 10.

support of their auditors) still issue financial statements that disclose exceptions from full compliance with IAS[4]. Such an approach may even be required by some regulators.

While I much prefer full compliance to partial compliance, the ‘exceptions’ approach has merit provided that it is properly administered. It is better that a user of financial statements knows that they have been prepared in accordance, and comply, with IAS with specified exceptions than knows nothing about the basis of preparation and compliance. Furthermore, the ban on the ‘exceptions’ approach may block improvements in financial reporting – it requires that any entity that wants (or is required) to adopt a superior national requirement to drop all references to compliance with IAS/IFRS. ..

As part of the current improvements project, the IASB should amend the IAS 1 compliance requirement to require the following:

- when an entity purports to comply with all IAS/IFRS, it should comply fully with all the requirements of all IAS/IFRS and all applicable interpretations of IAS/IFRS; and
- when an entity purports to comply with some, but not all, IFRS, it should disclose clearly the extent of its compliance with IAS/IFRS and comply with the requirements of all IAS/IFRS that it purports to comply with and all interpretations of those IAS/IFRS.

Please contact me if you have any questions or would like any clarifications.

Yours faithfully

David Cairns

[4] See David Cairns, *International Accounting Standards Survey 2000*, www.cairns.co.uk, chapters 14 and 16.