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Contact Mark Vaessen
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Dear Sir David

Preface to International Financial Reporting Standards and Changes in the IASC Constitution (May 2000) Related to the SIC

We welcome the opportunity to comment on the *Draft Preface to International Financial Reporting Standards* and on the *Proposed Changes in the IASC Constitution (May 2000) Related to the SIC*. The views expressed in this letter are those of KPMG International.

Draft Preface

Question 1 - Is the Board's proposed scope clearly defined and appropriate?

We believe that the proposed scope is clearly defined and appropriate; however we would like to draw your attention to the following points related to not-for-profit activities.

While we support the IASB's intention to clarify that IFRS are not designed to apply to not-for-profit activities (paragraph 9), we believe that it would be helpful to state that in the event that such an entity wishes to prepare IFRS financial statements then all IFRS should be complied with, in line with IAS 1.11.

Similarly, we believe that the draft preface also should clarify that financial statements of governments and other public enterprises prepared in accordance with accounting standards to be issued by the Public Sector Committee of the International Federation of Accountants (PSC), based on IFRS, should not be regarded as complying with IFRS unless they actually comply with all IFRS.

We also suggest removing from paragraph 13 of the preface the phrase "...unlike transactions and events to be accounted for differently..." since we believe that the thought would be adequate without this phrase and unnecessary questions would not be raised.

Question 2 - Paragraphs in bold italic and grey type

We support the IASB's intention to clarify that all the text of a standard is required rather than just the bold-letter paragraphs. However we believe that the current distinction between principles (bold-letter paragraphs) and explanations and/or additional guidance (grey-letter paragraphs) should be kept as it is useful and facilitates understanding of the standards. It also reinforces a discipline to state clearly principles and subsequent implementation guidance in the standards.

Therefore, we disagree with the IASB's intention to eliminate differentiation in typeface. We suggest that, instead, a statement be included in the preface stating that both bold- and grey-letter paragraphs state requirements of a standard. Grey-letter paragraphs should not be regarded as optional.

Additionally, the IASB should consider potential inconsistencies within the text of the existing standards. In some instances bold- and grey-lettered paragraphs seem inconsistent, as illustrated below:

- IAS 14.35 (bold-letter paragraph) states that a business segment or geographical segment should be identified as a reportable segment if a majority of its revenue is earned from sales to external customers. IAS 14.40 (grey-letter paragraph) encourages the reporting of vertically integrated activities notwithstanding the fact that the criterion in IAS 14.35 is not met.
- IAS 28.14 (bold-letter paragraph) sets out the three allowable alternatives to measure investments in associates when the investor does not issue consolidated financial statements. IAS 28.15 (grey-letter paragraph) states that it is appropriate that such an investor provides the same information about its investments in associates as those enterprises that issue consolidated financial statements. As IAS 28.8 requires that investments in associates be accounted for in consolidated financial statements under the equity method, it seems that to comply with IAS 28.15 investors would have no alternative but to apply the equity method.
- IAS 7.31 (bold-letter paragraph) states that cash flows from interest and dividends received and paid each should be classified in a consistent manner from period to period as either operating, investing or financing activities (i.e. three choices). IAS 7.33-34 (grey-letter paragraphs) seem to restrict classification of interest and dividends paid as part of either operating or financing activities, while they seem to restrict classification of interest and dividends received as part of either operating or investing activities.

Question 3 — IASB's due process

We believe that the IASB's proposals are appropriate. However, as with any due process, it will be a key factor for the acceptability and credibility of the IASB that exceptions to this process be very rare and clearly justifiable. For example, we were somewhat concerned when the last batch of final SIC interpretations were issued. The interpretations, in some cases, seem to have

inconsistent, and surprisingly tight, effective dates, with retrospective application required at the same time. We also noted that substantial changes were made to some of the final interpretation compared to the draft exposed, which in our view would have benefited from re-exposure.

We also recommend the following amendments:

- Paragraph 19(f) of the preface should read “Publishing for public comment an Exposure Draft approved by at least eight votes of the IASB and inclusion *in the published Exposure Draft* of any dissenting opinions held by IASB members and a basis for conclusion”. The inclusion of the extra words would be clearer and consistent with the language in paragraph 19(i);
- Paragraph 20(f) of the preface should refer to inclusion of the basis for conclusion, similarly to paragraph 19(i), as these are already part of the published SIC interpretations.

It also might be useful to clarify that projects developed in partnership with other standard setters also are subject to the minimum due process requirements specified in the IASC constitution.

Question 4 - Are there any other matters that should be addressed in the Preface to IFRS?

We believe that the following subjects should be addressed:

A common name for the whole body of standards (IAS, IFRS and interpretations) should be established

The existence of two different terms representing the same body of literature may create confusion among users of financial statements and also may represent a practical problem in some other cases. For example, International Standards on Auditing (ISA) 700 requires auditors to indicate clearly in their audit report the framework used in the preparation of the financial statements. As existing IAS are not being renamed IFRS there are doubts as to the most appropriate term to be used: IAS, IFRS or both.

The last part of paragraph 5 of the preface seems to indicate that the term IFRS also encompasses existing IAS, but we believe that it should be stated clearly.

We also would like to point out that the same issue may be applicable to the SIC interpretations given the intention of the Trustees to change the name of the interpretative body and the name of the technical pronouncements it issues.

GAAP hierarchy and fair presentation

As part of the improvements project the IASB has agreed tentatively to articulate the hierarchy of pronouncements, non-mandatory guidance and other sources of accounting guidance (December meeting). We support the IASB's intention to establish such a hierarchy and believe

that it should be part of the preface rather than IAS 1. As part of this process we encourage the IASB to clarify the status of appendices, the basis for conclusion, discussion papers and exposure drafts. The status of the IASB framework also should be clarified. It also might be helpful to clarify that comments of the IASB staff have no formal status.

We also believe that the preface should emphasise the importance of achieving a fair presentation when applying IFRS in the preparation of the financial statements. Although IAS 1.10 already conveys this concept by stating that “appropriate application of IAS, with additional disclosures when necessary, results, in virtually all circumstances, in financial statements that achieve a fair presentation”, we encourage the IASB to include in the preface that the overall objective of financial statements is to achieve a fair presentation (or true and fair view).

The meaning of the words “should” and “may” used in the context of the standards should be clarified

We have received a number of queries on the meaning of the words “should” and “may” in the context of the standards and requests to provide a formal document or interpretation that explains it. It seems that some enterprises, particularly in countries where IFRS are not commonly used, do not understand the word “should” as “must”. Guidance explaining the meaning of “should” and “may” would be useful.

Additional comments

The objectives of the IASB

Paragraph 6 of the draft preface sets out the objectives of the IASB. We believe that among its objectives the IASB should also ensure that:

- Standards are kept current reflecting changes in methods of doing business and changes in the economic environment; and
- Any significant area of deficiency in financial reporting that might be improved through the standard setting process is considered promptly.

Other points

- Paragraphs 12-13 of the preface seem to be misplaced as they do not clearly relate to “scope and authority”. We recommend these paragraphs to be moved to a footnote or an appendix.
- The terminology used in the preface should be consistent with the terminology used in the standards. For example, the preface use the term “entity” throughout while the standards refer to “enterprise”.

Constitutional Changes Related to SIC

Mandate of the interpretative body

We support the proposals of the Trustees and IASB to expand the mandate of the interpretative body to include issues not addressed specifically by IFRS. Entities currently using IFRS must address these issues and it is preferable to have a forum where authoritative guidance can be developed. However, procedures should be put in place to prevent the interpretative body from issuing “standards” rather than interpretations. The IASB should take this into consideration when monitoring the activities of the interpretative body.

Due process

Paragraph 3(b) of the invitation to comment notes that the IASB will “clear” draft interpretations, but there is no explanation of what this clearance entails. Is the interpretative body required to consult with the IASB in a similar way as the IASB is required to consult with the SAC prior to agenda decisions? Will the majority voting rules of the IASB apply? Clarity on the meaning of clearance should be provided. We support a consultation modelled on the SAC/IASB discussions regarding agenda decisions.

Proposed change in the name of the interpretative body

In our opinion the proposed name change does nothing to reflect the expanded mandate of the interpretative body. While IFRIC more closely reflects the new title of the IASB standards, we note that IASB is not changing its name to IFRB. We encourage the IASB to retain established and recognised names.

Size and composition of the interpretative body

We noted that no explanation is given regarding the size of the voting membership or regarding the desired composition of the interpretative body. We believe that the Trustees and IASB should articulate the desired composition, without binding itself absolutely. Further, we noted that there is no discussion of the possibility of observers. Do the Trustees and IASB desire to leave the issue of observers to the discretion of the interpretative body? It still may be desirable to note in the constitution that the interpretative body will determine the role and identity of any observer.

Please contact Mark Vaessen at 020 7694 8089 if you wish to discuss any of the issues raised.

Yours faithfully


