

London Society of Chartered Accountants

Regus Centre
75 Cannon Street
London EC4N 5BN

Telephone: 020 7556 7053

Fax: 020 7556 7520

Email: lsca@icaew.co.uk

www.lsca.co.uk

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International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Dear Sir,

**LSCA TECHNICAL COMMITTEE RESPONSE ON THE EXPOSURE DRAFT OF
THE PROPOSED “PREFACE TO INTERNATIONAL FINANCIAL REPORTING
STANDARDS”**

With a membership of over 30,000, the London Society of Chartered Accountants is the largest of the regional bodies which form the Institute of Chartered Accountants in England & Wales. London members, like those of the Institute as a whole, work in practice or in business. The London Society operates a wide range of specialist committees including Technical (accounting and auditing), Tax, Regulation and Ethics Review and Financial Services and Insolvency, which scrutinise and make representations to issuing bodies such as yourselves. The Technical Committee has recently considered the Exposure Draft of the proposed “Preface to International Financial Reporting Standards” and wishes to make the following comments and observations, which include responses to the specific questions asked in the Exposure Draft.

Firstly, the Committee would like to bring to the attention of the IASB, that it considers the failure to refer to the overriding necessity for financial statements to give a “true and fair view” to be a fundamental omission from the draft Preface. The Committee believes the Preface should make clear that the ultimate aim is “fair presentation” of financial statements. Compliance with accounting standards will normally be the minimum necessary to give a fair presentation, and any departure from a standard would be rare indeed (and need to be justified). However, the Committee considers, and recent events have reinforced, that merely complying with accounting standards cannot release those charged with the duty of preparing financial statements from the responsibility to consider whether those statements are still deficient or misleading, even when all

accounting standards have been followed. We would refer you to the Arden Opinion on true and fair, obtained by the Accounting Standards Board, which sets out Counsel's opinion in the UK on this matter. This Opinion makes it clear that what is true and fair is set to a great extent by accounting standards and that standards are the primary means by which the concept of true and fair develops over time, as the concept is one that is constantly under development. It does not mean that preparers have to anticipate potential new standards, but it does mean that they should not simply follow the letter of accounting standards—they must consider their spirit.

“What is the role of an accounting standard? The initial purpose is to identify proper accounting practice for the benefit of preparers and auditors of accounts. However, because accounts commonly comply with accounting standards, the effect of the issue of standards has also been to create a common understanding between users and preparers of accounts as to how particular items should be treated in accounts and accordingly an expectation that save where good reason exists accounts will comply with applicable accounting standards.” (Paragraph 4)

“As regards the concept of true and fair, I would emphasise the point made in the Joint Opinions that the true and fair view is a dynamic concept. Thus what is required to show a true and fair view is subject to continuous rebirth and in determining whether the true and fair requirement is satisfied the Court will not in my view seek to find synonyms for the words “true” and “fair” but will seek to apply the concepts which those words imply.” (Paragraph 14)

Furthermore, and a point which is closely interrelated to the above, the Committee also supports firmly the need to produce standards based on principles as opposed to detailed rules and to this effect believes strongly that use of bold and plain type should be continued so that future standards issued do not drift into a detailed rule format.

RESPONSES TO SPECIFIC QUESTIONS

Scope and Authority

Question 1.

The Board states in paragraph 9 of the proposed Preface that IFRS are designed to apply to the general purpose financial statements of all profit-oriented entities, as defined. The Board also says that although IFRS are not designed to apply to the not-for-profit activities in the private sector, public sector or government, entities with such activities may find them appropriate. It notes that the Public Sector Committee of International Federation of Accountants (PSC) is preparing accounting standards for governments and other public sector entities, other than government business enterprises, based on IFRS.

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

The Committee considers that IFRSs should apply to general purpose financial statements for profit oriented entities. Specific issues that relate to public or not-for-profit sectors, which are not covered in an IFRS, should be addressed through other forms of guidance. e.g. standards issued by IFAC's Public Sector Committee or local guidance (e.g., in the UK, Statements of Recommended Practice). Non general purpose financial statements produced by profit-oriented entities might follow IFRSs, but the acknowledged scope for the IASB should be limited as stated above.

However, the Committee believes that the proposed scope should be made clearer in a number of instances. It appears as though paragraph 6, stating the objectives of the IASB, is contradicted by paragraph 9, as paragraph 6 refers to "public interest"—which could be read to include not-for-profit entities—whilst paragraph 9 refers only to all profit-oriented entities. Also, the Committee notes that at present the scope of paragraph 9 is not limited to the general purpose financial statements of companies. Rather it includes "other financial reporting" of all profit-orientated entities, presumably including unincorporated bodies such as partnerships and sole traders. In the UK at least, such profit-oriented bodies are under no obligation to produce general purpose financial statements to the rigorous standards required by IFRSs. So there must be some overall quality marque that financial statements are purporting to meet in order to define the scope of IFRSs. In our view, it is fundamental to refer to "the general purpose financial statements of all profit-oriented entities that are intended to give a true and fair view" (see our point on true and fair at the beginning of this letter).

Another point relates to smaller entities. These entities represent a large constituency of the IASB and, since some IFRSs may not be appropriate for smaller entities, the Committee believes that an IFRS for smaller entities, such as the UK's Financial Reporting Standard for Smaller Entities (FRSSE) warrants serious consideration now, while the Preface is being formulated. The IASB seems likely to focus on "Big GAAP"—paragraph 6 refers to the "various capital markets of the world"—but the Committee's view is that failure to address the application of IFRSs to unlisted and smaller entities will create difficulties and tensions in the development of new IFRSs which could be avoided by dealing with the issue clearly in the Preface.

Question 2.

The Standards issued by the IASC include paragraphs in bold italic type and paragraphs in plain type. The Board is concerned that some constituents may have interpreted the bold italic paragraphs as having more authority, although IASC commentary has suggested otherwise. Paragraph 14 of this proposed Preface states that paragraphs in bold italic type and plain type have equal authority and sets out the Board's intention to discontinue the use of different type styles. The Board intends to provide, in IFRS, robust and useful guidance to illustrate the basic principles in each Standard, including a detailed Basis for Conclusion.

Do you agree with these proposals? Why or why not?

The Committee believes that in order to meet the Board's objective in the Preface "to require like transactions and events to be accounted for in a like way and unlike transactions to be accounted for and reported differently", IFRSs should be developed

based on principles rather than detailed rules. To this end the Committee believes that the current IAS style of using bold italic type to indicate the main principles and plain type for explaining the principles should be retained. It offers a rigorous basis on which standards should be developed, preventing them drifting off into unstructured lists of rules.

Additionally, the Committee believes that the IASB should ensure that the non-bold paragraphs interpret the bold paragraphs and do not revise them nor stand in isolation. Accordingly, the Committee would support the IASB adding an introductory paragraph stating “Both the bold italic text and the normal text paragraphs contained in the IFRS shall be regarded as part of the standard”. The failure of users of IFRSs to read or accept such a statement is a matter for any enforcement mechanism; it is not a reason to abandon the practice of black/grey letter if that leads to better standards. Moreover, if the IASB accepts that standards should be based on principles, it would seem natural to follow this approach.

Due Process

Question 3.

In paragraph 19 and 20 of this proposed Preface, the Board sets out the due process normally expected to be followed in issuing Standards and Interpretations.

**Are the Board’s proposals appropriate? Are any proposed steps unnecessary?
Are there additional steps that should be incorporated?**

The Committee regards the due process as set out in the proposed Preface to be appropriate.

General

Question 4.

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

Whilst the Committee has no other matters that it believes should be included in the Preface, it wishes to raise the following additional comments on the draft: -

- ❑ The Committee considers that the IASB needs to define clearly its remit regarding financial statements in Paragraph 11 of the Preface. In particular the Management Discussion and Analysis (in the UK the Operating and Financial Review (“OFR”)) should be outside the remit of the IASB. If this exclusion is the aim of the paragraph, it should be so stated.
- ❑ Paragraphs 11 and 16 of the Preface cross refer to existing IASs. The Committee believes it is inappropriate for the Preface, which is meant to stand in front of all the existing standards, to cross refer to standards in this fashion, and that the Preface should simply state what is meant, even if repeating the content of a standard.

- ❑ The Committee would welcome a detailed basis of conclusion in the bound version. This is particularly important where dissenting opinions have been given by Board members, so that it is clear which options have been considered by the Board and why certain options were rejected by the majority. Such material tends to act in the same way as ‘obiter dicta’ material does in legal judgements: it is not binding, but it adds to the force of the standard by indicating what the Board was aiming for when the standard was drafted.
- ❑ Paragraph 24 refers to both approved and licenced translations. The Committee considers that the IASB should only adopt one level of approval for translations of IASB documents in other languages. Otherwise there will be confusion over which is the ‘true’ standard and quality control of translated material will suffer, i.e. a translation should be either “IASB-approved” (whether or not it is carried out by the IASB) or not.

If there are any matters arising from this letter that you would like to discuss, please do not hesitate to contact me on 020 7731 6163 or the chairman of the working party which drafted this response, Steven Brice on 020 7220 3231..

Yours faithfully,

Danielle C. Stewart
Chairman, LSCA Technical Committee