EFRAG
European Financial Reporting Advisory Group

September 12, 2002

Sir David Tweedie
Chairman IASB
30 Cannon Street
London EC4M 6XH
UK

Dear David,

Re: Exposure Draft of Proposed Improvements to International Accounting Standards

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Exposure Draft of Proposed Improvements to International Accounting Standards. This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRS on the issues.

In arriving at our comments we have consulted with European national standard-setters, international organisations and corporations. A number of commentators have pointed out that the adoption of IFRS in Europe by January 1, 2005 requires considerable effort and resources from those groups subject to the Regulation. Whilst a majority of these European companies have started their conversion process (or will start it this year) they are concerned that they should, as soon as possible, be made aware of changes still to be made to IFRS that will affect them at the changeover time. In addition, these companies should be given sufficient lead time to implement such changes.

We support the objectives of the Improvements project to eliminate certain choices in the standards, to promote convergence between IFRS and other national standards and to deal with certain issues raised by IOSCO. The project is very extensive and we congratulate the IASB on the outcome. The appendix sets out our answers to the questions raised in the Exposure Draft together with other comments which we believe require consideration.

If you would like further clarification of the points raised in this letter Paul Rutteman or myself would be happy to discuss these further with you.

Yours sincerely

Johan van Helleman
EFRAG, Chairman

IAS 1

Q1. *Do you agree with the proposed approach regarding departure from a requirement of an IFRS or an IFRIC to achieve a fair presentation?*

Response

Whilst we strongly agree with the 'override' provisions we disagree with the proposals to allow alternative treatments according to the regulatory framework. We believe that there should not be alternative treatments according to the regulatory framework of the country where the statements are issued. We sympathise with those countries that have a statutory regulatory prohibition against departures from standards but do not agree that the override provisions should not apply in such a case. Indeed, if IAS 1 itself requires an override when no other means are available to give a true and fair view, then there will be no departure from IFRS taken as a whole. Our view is based on the following considerations:

i. The previous standard stated at paragraph 14 that "the existence of conflicting national requirements is not, in itself, sufficient to justify a departure in financial statements prepared using International Accounting Standards". We agree with that part of the previous statement and regret that it has been removed. The new statement would in our view be in conflict with the original policy. We do not believe IASB is intending to change that original policy despite removing it from the current text. Removal of the text and insertion of new paragraphs 13 to 16 creates great uncertainty about the requirements of IFRS where there are conflicts between national regulatory requirements and IFRS.

ii. The previous standard contained an important principle (in 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 regret that such an important principle is dropped in the new text. Regardless of the decision about the applicability of the override when departure from standards is prohibited by the regulatory framework, we believe this principle should be retained. We note that even in countries where the regulatory framework may be thought to prohibit departure from standards, the courts, (in the Continental Vending case in the US for example), have ruled it unacceptable to fail to depart from a standard if it leads to an unfair presentation.

iii. Financial statements prepared in accordance with IFRS and IFRICs are often used in more than one country (perhaps because the entity has a dual listing). It seems unreasonable that the IFRS compliant financial statements have to be different because the regulatory requirements concerning the use of the true and fair override vary from country to country. In our view the national regulatory framework should not come into consideration when preparing financial statements under International Financial Reporting Standards.

iv. The effect of the override is to place an unambiguous responsibility on management to ensure the accounts meet the reasonable expectations of users, and that they cannot assume that this has been discharged simply because the accounts comply with current standards.

We do accept that departures from IFRS or an IFRIC should be an extremely rare event and only happen when compliance with the standard would be so misleading that it would conflict with the objective of financial statements set out in the framework.

Based on the above we recommend deletion of the words "if the relevant regulatory framework requires or otherwise does not prohibit such a departure" at the end of the new paragraph 13 as well as the deletion of para 15. Further, we propose reinstatement of the wording "the existence of conflicting national requirements is not, in itself, sufficient to justify a departure in financial statements prepared using International Financial Reporting Standards" (old para 14 but IAS replaced by IFRS) and of the principle that "inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used or by notes or explanatory material" (old para 12).

Q2. *Do you agree with prohibiting the presentation of items of income and expense as "extraordinary items" in the income statement and the notes (paragraph 78 and 79)?*

Response

Paras 78 and 79 suggest that an entity shall not present any items of income and expense as extraordinary items and that no items are to be presented as arising from outside the entity's ordinary activities. The aim is clearly to abolish what is currently known as an "extraordinary item". Certainly there has been abuse of extraordinary item treatment and. therefore we support the prohibition of presentation of income and expense as extraordinary items.

To avoid a situation where items which are currently often erroneously included under the caption extraordinary items (e.g. goodwill impairment) may in future be presented under a caption called "unusual" items (or the like) we suggest that the following be included in para 78 : "items for which disclosure is considered necessary (see para 80) should not be presented on the face of the income statement under a general descriptive caption such as non-recurring", "unusual", "abnormal" or the like. Instead, their nature should be immediately understandable from the title of the caption on the face of the income statement (see also para 82)". We recognise the importance of providing users of the financial statements with information necessary for a clear understanding of the composition of net income. However we wish to avoid a situation where such disclosure could lead to new subtotals being reported in the income statement such as "income before non-recurring items" or "operating income excluding unusual items". In our view the disclosure of non-recurring items should not distort the income. Whilst para 80 though 82 require a separate presentation of non-recurring elements, either in the notes or on the face of the income statement, we suggest the Board should consider removing an option and simply require the separate presentation in the notes.

In January this year we wrote to you suggesting that steps should be taken to improve the presentation of the income statement to provide more useful and consistent comparisons. We understand that IASB is considering that issue in its Reporting Performance project which is accorded high priority on IASB's timetable. We therefore believe it is premature to delete the line "operating profit" from the minimum requirements of income statement formats. This is something that is best dealt with in the Reporting Performance project

Q3. *Do you agree that a long-term financial liability due to be settled within 12 months of the balance sheet date should be classified as a current liability even if an agreement to refinance or to reschedule payments is completed after the balance sheet date and before the financial statements are authorised for issue (paragraph 60).*

Response

Yes. We do agree. At the balance sheet date the liability was current (due for repayment within next 12 months). If a subsequent refinancing takes place that is an event of the following year and should be accounted for then – it is not an "adjusting event" in the sense of clarifying the situation at the balance sheet date. Nevertheless we would expect a note to the financial statements to refer to the subsequent event if it is important to an understanding of the financial position of the entity. It would be useful to add a sentence to para 60 indicating that in such circumstances para 20 of IAS 10 would apply. Incidentally, the Basis for Conclusions (at A24 (a)) implies that an adjusting event such as reclassification from current to non-current is dealt with by IAS 10 even when the matter involves no change in the balance sheet amount but only in the classification. It is by no means clear that IAS 10 deals with such matters and clarification in IAS 10 would be helpful.

Q4(a) *Do you agree 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 authorized for issue, not to demand payment as a consequence of the breach (paragraph 62)?*

Response

Yes. We do agree for the reasons given in answer to the previous question even though the treatment may seem harsh!

(b) (i) *Do you agree that if an entity is in breach of a loan agreement but is given a grace period and rectifies the breach within the grace period the liability should continue to be classified as non-current.*

Response

Yes. We agree with non-current classification if the breach is rectified within the grace period.

(ii) *Do you agree to the same classification if the grace period is given before balance sheet date, the breach has not yet been rectified but has not expired by the date of issue of the financial statements.*

Response

Yes. We agree provided it is not unlikely that the breach will be rectified. If the breach is a result of a potential going concern problem and it is likely the breach will not be rectified we believe management can only continue to classify the loan as non-current if it can justify the treatment by showing how the breach will be rectified.

Q5. *Do you agree that an entity should disclose the judgement made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements (paragraph 108 and 109).*

Response

We agree with the general principle that management should disclose the judgments made in applying accounting policies that have the most significant effect on the amounts of items recognised in the financial statements. However, para 108 and 109 lack clarity about the information that needs to be disclosed. The first example in para 109 is unhelpful since we believe the judgements made by management in determining whether financial assets are held to maturity or not are very limited. We do fear that the requirement will often result in boiler plate disclosures. The general requirement should supplement disclosure requirements on a standard-by-standard basis. More specific disclosure requirements should be added to those individual standards where the Board considers that disclosures about judgments of this nature are needed.

Q6. *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 (paragraphs 110-115).*

Response

Though we support the principle of disclosing key measurement assumptions, we believe the current wording of paragraphs 110-115 lacks clarity about the specific information that needs to be disclosed. Indeed much of the information would be better suited to inclusion in the MD&A, and therefore outside the financial statements. We recommend expanding the current proposal to clarify what is actually expected to be disclosed by means of examples on a standard-by-standard basis. Finally, we suggest adding to the new text a statement that the actual disclosures in this area will very much depend on an entity's specific situation.

Other comments

1. We believe that the former paragraph 6 stating that the board of directors and/or other governing body of an entity is responsible for the preparation and presentation of its financial statements is very important and that deletion of this paragraph may be interpreted as representing a change of view by IASB. In our opinion it should be re-instated.

2. Similarly we would like to retain the encouragement to present a financial review by management outside the financial statements as set out in old paragraph 8. The new paragraph 7 says that many entities present a financial review by management but no longer expresses encouragement of this practice. We further believe that the new paragraph 9, stating that the reports and statements described in the new paragraphs 7 and 8 are outside the scope of International Financial Reporting Standards, may be misunderstood since the preface to International Financial Reporting Standards says that the IASB promotes the use of IFRSs in general purpose financial statements *and other financial reporting*. The change in name from IAS to IFRS suggests that IASB has an interest in all aspects of Financial Reporting and that would include the financial review by management.

3. We note that for comparative information in respect of the previous period (old paragraph 38, new 33): "numerical information" has been replaced by "amounts" which we believe could be interpreted as currency amounts, a more restrictive term than numerical. We believe, for example, that the number of employees should be disclosed together with comparative figures. Consequently, we do not support this change.

4. The improved standards in several places permit exemptions based on "undue cost or effort" (e.g. paragraph 35: "when the presentation and or classification of items in the financial statements is amended, comparative amounts shall be reclassified unless the reclassification would require *undue cost or effort*"). We believe that ''undue cost or effort" is open to very wide interpretation and therefore its use in the standards should be limited. The way the exemption is drafted appears almost to provide an option to apply or not to apply a standard. We suggest the Board gives careful consideration to the use of the exemption. The exemption should be used very infrequently. Further guidance and examples clarifying the meaning and use of the "undue cost or effort" exemption should be provided in order to avoid conflicting interpretations which would undermine overall reliability and comparability of IFRS financial statements. Some, for example believe that the expression allows an entity to regard almost any cost as undue whereas a much more stringent test is clearly appropriate.

5. Other disclosures: old paragraph 102 (d) has been deleted which means that there is no longer any disclosure requirement regarding the number of employees. We believe that this change is not an improvement since headcount is considered by users to be key information. We therefore do not support this change.

6. The adoption of IFRS in Europe by January 1, 2005 requires tremendous efforts and resources from companies subject to the Regulation. A majority of these European companies have started their conversion process or will start it in 2002. It is our understanding that the Reporting Performance project will introduce fundamental changes to the current IAS 1 requirements (e.g. requirement for an analysis by function of the expenses on the face of the performance statement whereas currently para 83 of IAS 1 leaves entities the choice of presenting their expenses by nature or function). In order to allow European companies to complete their conversion process in the most effective and efficient way, it is critical that the number of fundamental changes to be introduced between 2003 and 2005 which require significant implementation efforts is limited to those most urgently needed. The introduction of fundamental changes during the European change-over period will undermine the success of the IFRS conversion. In the case of the income statement presentation, we recommend the Board to take into account the particular timing issue of the 2005 European first-time adopters in implementing the Reporting Performance standard.

7. We believe the deletion of the substance over form concept (old para 20 (b) (ii)), though mentioned in the Framework, is not an improvement. We consider substance over form as a modern and important concept that needs to be reinstated in IAS 1.

8. We note that the Appendix "Illustrative Financial Statement Structure" has been deleted. We believe that this Appendix is important application guidance and therefore recommend that the Board re-instate this guidance in the standard. This would eliminate an inconsistency with the approach taken in the improved IAS 33 where application guidance is included as appendix A.

9. A literal reading of para 54(c) suggests that all assets that will be disposed of within twelve months, including property, plant and equipment in its last year of useful economic life, must be reported as a current asset. We believe this is not the intention of the standard and therefore recommend that the Board amends para 54 accordingly.

10. The minimum contents of the income statement set out in para 76 are confusing in that caption (f) and caption (h) are too similar and incomplete. Net profit or loss is often taken to mean profit after tax so it would be better to use the caption "group profit" or "profit after tax" for item (f). Similarly, item (h) might be captioned "profit attributable to shareholders". We note also that in para 76 c "share of the after-tax profit or loss of associates and joint ventures accounted for using the equity method" is the only item above the tax expense line dealt with on an after tax basis. Many companies show an additional line item "group profit before tax" and it would be inconsistent to mix pre-tax and after-tax items above this line. Accordingly we believe it would be more appropriate to include the contribution of associates and joint ventures to group profit on a pre-tax basis or to bring the item further down the income statement below item (e).

11. Para 61 refers to a situation where an entity refinances a loan under an existing loan facility which is in substance similar to an agreement to extend a borrowing. However, it is possible to interpret para 61 as including an agreed

refinancing with a different lender under other conditions. In such a case we believe the classification as current cannot be modified.

12. IAS 76(b), 82(b): it should be observed that the word "cost" is not used consistently through the standard and its use is not in line with the definition of cost in IAS 16, 38 or 40: "The amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction". Accordingly the word "expense" should be used for a "cost" that will go to the profit and loss account. So for example 76(b) should read "finance expense".

IAS 2

Q1. *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 of IAS 2?*

Response

Yes. We support the proposal to eliminate the LIFO method since this measurement method can and often does result in a distortion of the balance sheet and/or income statement. We agree that tax considerations do not provide an adequate conceptual basis to justify the use of LIFO.

Q2. *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?*

Response

Yes. If an entity were not to reverse write-downs of inventories when the circumstances that previously caused inventories to be written down below cost no longer exist, inventories would be understated. The fact that the circumstances surrounding inventories no longer exist should be accounted for by the reversal of the write-downs. This reversal should be recognised in the income statement of the period since it reflects an increase in economic benefits and such a treatment is consistent with IAS 8, new paragraph 27, IAS 16, paragraph 37 as well as IAS 38 paragraph 76. In our view the change to paragraph 34(c) requiring disclosure of the amount of any write down of inventories also adds useful information and we therefore support that change.

Other comments

1. Para 27 of Appendix B of IAS 34 (Estimating LIFO Inventories at Interim Dates) should be deleted as a consequential amendment arising from the abolition of LIFO.

IAS 8

Q1. *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 (paragraph 20, 21, 32 and 33)?*

Response

i) Voluntary changes in accounting policies.

We agree with the proposed improvement which requires the use of the previous benchmark treatment whereby such changes are dealt with retrospectively as if the new accounting policy had always been in use.

ii) Correction of errors.

We strongly recommend retaining a distinction between fundamental and other material errors. We agree that fundamental errors need to be dealt with retroactively so that the financial statements are presented as if the error had never occurred but suggest that other material errors should be processed prospectively. We believe the distinction reflects on the one hand, the need to reflect all expenses in reported results, and on the other hand the need to correct past financial statements which contain errors so fundamental as to render them unreliable. We believe, however, that fundamental errors will be very rare.

Q2. Do you agree with eliminating the distinction between fundamental errors and other material errors (paragraphs 32 and 33)?

Response

See our response to question 1.

Other comments

1. Paragraph 19 of the improved text modifies the former paragraph 48 by requiring the disclosure of information about the effects of a future change of accounting policy as a result of publication of a new standard yet to be implemented. Previously, paragraph 48 merely encouraged such disclosure. Although we wish to encourage such disclosure it is impractical to require para (d). For example, a company which approves its financial statements for issue just one day after publication of IAS 39 on financial instruments (or IAS 19 on Retirement benefits) would have to assess its impact in too short a timescale to produce reliable information about the effects or resort to the "undue cost or effort" formula. Overall therefore we would prefer to retain the former paragraph 48. If the requirement is to be inserted we believe it should be modified to require disclosure of the effect of the change not just on the entity's financial position but also on its income. Finally it should be made

clear that the estimate of the effect of the change relates to the effect on the current year's income and balance sheet rather than on next year's projected outcome.

2. Para 21 and 33 allow an entity to disclose no comparative information if restatement of information requires undue cost or effort. In our opinion this is too low a threshold, especially in the case of voluntary changes to accounting policies.

3. Para 5 requires the selection of accounting policies to be made by reference to relevance and reliability only. We believe that this requirement should include understandability and comparability, which are the other two main qualitative characteristics dealt with in the Framework and which are of equal importance.

4. We note the reference to materiality has been removed from the Preface. Whilst materiality is dealt with adequately in the context of presentation in IAS 1 it is important to relate it to measurement and recognition also. We therefore believe it should be dealt with in IAS 8.

IAS 10

No question is put forward for the changes to IAS 10. The principal change to this standard is to prohibit the recognition as a liability at balance sheet date of dividends on equity shares declared after that date.

We support the proposed changes. See also our answer to Q3 of IAS 1.

IAS 15

We support the withdrawal of IAS 15.

IAS 16

Q1. *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)?*

Response

We do *not agree* with the proposed change. In our view the old paragraphs 21 and 22 make a sensible distinction between exchanges which are in effect sales of dissimilar items and swaps of similar assets that have a similar use in the same line of business (and have a similar fair value). Old paragraph 22 makes it clear that in the latter case the earnings process is incomplete so no gain or loss should be recognised on the exchange transactions (i.e. the cost of the new asset is the carrying amount of the asset given up). In the basis for conclusions at para A4 further arguments are set out in favour of the original IAS 16 treatment and we believe those arguments remain valid. The counter arguments in A5 are less convincing.

We do understand the difficulty in recognising a dividing line between exchange of similar and dissimilar assets but believe that judgement can be exercised based on how the assets are used to determine the appropriate treatment.

However our most fundamental concern is that accounting for exchange of assets of this kind is only part of a much broader issue – accounting for exchange of non-monetary assets in general which we believe should be dealt with comprehensively in a separate standard. Such a standard would deal with barter transactions, exchanges of intangibles, goods and services as well as property, plant and equipment. It would provide guidance on when to regard assets as similar or dissimilar (unless accounted for in the same way) and with how to measure fair value (if this is to be the basis used for any such transactions) and how and when revenue should be determined.

Q2. *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 (Note that the Board intends to retain the policy in IAS 18, Revenue, prohibiting the recognition of revenue from exchanges or swaps of goods or services of a similar nature and value.)?*

Response

We do not support the proposed change for the reasons explained in answer to question 1. There should be no reason to treat intangible assets differently.

Q3. *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)?*

Response

We agree that depreciation should not cease when an asset becomes temporarily idle although the basis of depreciation may need to be changed to reflect a slower rate of wear resulting from the reduced usage. However, if an asset is retired from active use and held for disposal, we believe depreciation should cease but an adjustment may need to be made to reflect the impaired value.

Other comments

1. Though we agree in principle with the distinction between incidental income as mentioned in paragraph 17B (to be recognised as income) and net proceeds from selling any items produced when bringing the asset to the necessary location and condition (e.g. samples produced when testing equipment) to be deducted from the cost of the asset according to improved paragraph 15 (b), we believe that in practice such a distinction will be difficult to make and therefore we suggest treating the net proceeds from selling any items produced when bringing the asset to the necessary location and condition in the same way as incidental income. We further suggest presenting such income under a caption called "other income" in the income statement.
2. The new paragraph 60 requires the disclosure of comparative information regarding the reconciliation of carrying amounts at the beginning and the end of the period. Previously comparative information was not required for such a reconciliation. It is not clear why the change has been made. Whilst the additional information simplifies comparisons of additions and disposals of equipment and depreciation charges by class of asset it does make the presentation more complex and does not seem necessary for an assessment of the current period.
3. Paragraph 46 of the improved standard suggests that residual value is reviewed at each balance sheet date. This implies that not only must potential impairment of residual value be considered but that any change in estimated residual value, up or down, must be reflected. Such an annual reassessment of residual values of all assets (where residual values are not insignificant) represents a major change**,** introducing fair value for residual value thereby mixing the historical cost and fair value models in the measurement of the same asset. We are concerned that such a mixture creates conceptual problems in the area of accounting for Property, Plant and Equipment. In addition, we believe para 46 imposes an unreasonable burden particularly since residual values are likely to fluctuate according to current economic conditions. We believe the text should be amended to remove the requirement for annual reassessment of residual value where there are no indications of impairment.

IAS 17

Q1. *Do you agree that when classifying a lease of land and buildings, the lease should 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 building element is classified as an operating or finance lease by applying the conditions in paragraphs 3 to 10 of IAS 17.*

Response

Yes. However, we suggest adding to para 11B for reasons of clarity (as was done in para 11C) the words "In the case of a finance lease, the economic life of the buildings is regarded as the economic life of the entire leased asset.".

Q2. *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?*

Response

We agree with the proposal to require capitalisation of lessors' initial direct costs. The investment in a lease consists of the cost of acquiring the asset and the direct costs of arranging the lease, and it is arbitrary to attempt to distinguish these. Immediate expensing of initial direct costs can give rise to a reported loss in the period in which a lease is entered into, even when the lease is confidently expected to be profitable. However, we believe clarification by means of examples is needed of what exactly is understood by "incremental directly attributable (internal) costs".

IAS 21

Q1. *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?*

Response

Yes. We agree with the proposed improvements supported by the Basis for Conclusions. We would, however, point out that, despite the clarification in para 49 that references to functional currency in the case of a group shall be taken as references to the functional currency of the parent, the use of this shorthand (particularly when taken up by others outside the standard) seems likely to cause significant confusion over the way in which this standard works.

Q2. *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?*

Response

Yes, we see no reason why a reporting entity should not be permitted to present its financial statements in any currency, although we acknowledge that local law in some jurisdictions may require the use of the currency of the parent company. However there are often very good reasons to present financial statements in a different currency – for example, because the group is multinational with shareholders and other users located principally in a different country, or because the parent is located in a small country whose currency is not widely used internationally whilst its main competitors report in another currency (e.g. Euro or US dollar). However, we recommend adding a disclosure requirement under which the reasons for the selection of the reporting currency are summarised if that currency is not the functional currency of the parent.

Q3. *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)?*

Response

Yes. We support the improvements, which we believe increase comparability amongst entities and reliability of financial statements prepared under IFRS.

Q4. *Do you agree that the allowed alternative to capitalise certain exchange differences in paragraph 21 of IAS 21 should be removed?*

Response

Yes. We support the elimination of the option for the reasons given in the Basis for Conclusions.

Q5. *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 of the foreign operation and translated at the closing rate (see paragraph 45)?

Response

We agree with the proposed improvement: goodwill is generated as a result of the acquisition of an entity and therefore relates to the acquired entity. For the same reason, we concur with the improvement regarding fair value adjustments to assets and liabilities.

<u>Other comments</u>

1. Para 30 makes a distinction between the recognition of exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation in the separate financial statements (to be recognised as income or expense) and in the consolidated financial statements (to be recognised in equity). Intuitively, we would expect that the accounting policies for consolidated and separate financial statements are consistent. We recognise there can be justifiable reasons for different policies but believe those reasons should be made clear either in para 30 or in the Basis for Conclusions.

2. We do not see the reason for the treatment suggested in paragraph 31 when a monetary item is denominated in a currency other than the functional currency of either entity. For both entities any exchange differences do not represent or measure changes in actual cash flows, or prospective cash flows, and as such should not be reflected in the income statement of either entity; nor should they remain in the consolidated income statement.
3. We believe that the definition of 'foreign operation' in para 6 should be expressed in terms of functional currency, without making any reference to the country in which it is based. We suggest that the definition is changed to 'an entity that is a subsidiary, associate, joint venture or branch of the reporting entity, the functional currency of which is other than that of the parent.'

<u>IAS 24</u>

Q1. *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'.

<u>Response</u>

<u>No, we do not agree.</u>
We think that shareholders have the right to be informed of top management's remuneration (e.g. those managers for whom remuneration is determined by a remuneration committee of the Board). 'Management' in this context should at least include the Board of Directors in a single tier system, or the Board of Management in a two tier system. Compensation comprises salaries, bonuses and the value of share options, together with other parts of the benefits package (including pension benefits). Even if not exactly

quantifiable the contractual agreements regarding compensation between the company and the management should be disclosed.

Q2. *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?*

Response

No, we do not agree. We believe that this information will often be essential to understand the financial position and performance of an entity and should therefore be required for separate financial statements. We recommend a requirement to disclose the intra group amounts included in the balance sheets and income statements. We support the arguments of the six Board members who disagree with the new paragraph 3 as stated in the Appendix B (B4.-B6.).

Other comments

1. To ensure that preparers disclose all significant related party transactions we suggest adding to the first sentence of the definition of a related party the words “at any time during the financial period”.

2. When the reporting entity is controlled by another party, we believe there should be disclosure of the related party relationship and the name of that party and, if different, that of the ultimate controlling party. If the controlling party or ultimate controlling party of the reporting entity is not known that fact should be disclosed. This information should be disclosed irrespective of whether any transactions have taken place between the controlling parties and the reporting entity. We recommend including this disclosure requirement in the standard.

3. We believe that “the nature of the related party relationship” and “any other elements of the transaction necessary for an understanding of the financial statements” should be added to the list in the second sentence of para 14 to ensure sufficient disclosure. The introductory sentence would need to be amended accordingly.

4. It is our understanding that the new para 12 covers the requirements of the deleted para 32 (a) of IAS 27 to disclose in the consolidated financial statements significant subsidiaries, including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held However we believe that the wording of the deleted para was much clearer as to what information must be disclosed and we therefore recommend reinstatement of this wording in the new para 12.

IAS 27

Q1. *Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?*

Response

Yes. We agree for the reasons explained in the Basis for Conclusions. However, we would point out that in our opinion para 8 (d) should include the words "an intermediate" in order to permit the exemption from consolidation when a higher level parent (either at an intermediate level or the ultimate parent) prepares group accounts. The present wording does not provide exemption where the group accounts are prepared by an intermediate parent.

Q2. *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

Yes. We concur with the Board's conclusion that a minority interest represents the residual interest in the net assets of those subsidiaries held by some of the shareholders of the subsidiaries within the group, and therefore meets the Framework's definition (paragraph 49(c)) of equity.

Q3. *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

Whilst we generally favour deletion of unnecessary options, in this case two options are retained and only the third is deleted. That option – to carry these investments under the equity method – is in some ways the most relevant because it usually allows the equity in the separate financial statements of the investor and in the group consolidated financial statements to be the same – which logically they should be.

In this case therefore we favour retaining all three existing options – cost, equity method and fair value – as the basis for accounting for subsidiaries, jointly controlled companies and associates in the financial statements of the investor.

We do 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.

<u>Other comments</u>

1. We understand that the dispositions of SIC 33 are now incorporated in paragraphs 12B and 15A. However, we note that only the consensus has been included in IAS 27 and we suggest also including the Basis for Conclusions and the appendices that existed in SIC 33, taking into account that derecognition matters are within the scope of IAS 39.

2. The title of the standard has been amended so that it now deals with consolidated and <u>separate</u> financial statements. Whilst the term consolidated financial statements is defined in para 6 there is no corresponding definition of separate financial statements. Para 4 does attempt to explain the meaning but in such broad terms that it is unclear whether the meaning extends only to single entities or goes beyond that to sub groups, for example. We believe the term should be defined in para 6.

3. We draw attention to an inconsistency between IAS 27 and IAS 28. Para 3 of IAS 27 states that IAS 27 should be applied when accounting for investments in subsidiaries, jointly controlled entities and associates in the separate financial statements of a parent venturer or investor. Para 29 of IAS 27 states 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. However para 8A of IAS 28 states that an investor accounts for an investment in an associate using the equity method irrespective of whether the investor has also investments in subsidiaries or whether it describes its financial statements as consolidated financial statements. Based on the above paragraphs, we do not understand how an investment in an associate should be accounted for in the separate financial statements of an investor: at cost, in accordance with IAS 39 or using the equity method? Clarification of the scope of IAS 27 and 28 is needed.

IAS 28

Q1. *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

Yes we agree that for venture capital organisations, mutual funds, unit trusts and similar entities IAS 28 and 31 should not apply to investments that otherwise would be associates or joint ventures if these investments are measured at fair value in accordance with IAS 39. The fair value measurement will provide the most relevant and useful information. To ensure consistent application we believe it is necessary to include a definition of "venture capital organisations" in the standard. Provided that a workable definition of venture capital organisations can be found, we believe that the new para 13A of IAS 27 should be amended to allow the same exemption for investments that would otherwise qualify as subsidiaries requiring consolidation. Such an exemption could be combined with further disclosure requirements regarding the subsidiaries measured at fair value in accordance with IAS 39.

Q2. *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 do *not agree* with the proposed approach since this might lead to the inappropriate write-down of, for example, long-term receivables when good collateral is in place.

Other comments

1. In order to prevent the release of restricted, price-sensitive information we suggest adding to para 18A the following sentence "If the inclusion of the associate's financial statements would release restricted, price-sensitive information the difference in reporting date of the associate can be greater than three months."

2. The old para 27(a) has been deleted without any reasoning being given in the Basis for Conclusions. We believe this deletion is not an improvement and therefore should be reversed.

IAS 33

Q1. *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?*

Response

Yes. The proposed approach is consistent with the definition of dilution and based on an appropriate assessment of the likelihood of actual dilution.

Q2. *Do you agree with the following approach to the year-to-date calculation of diluted earnings per share (as illustrated in Appendix B, examples 7 and 12)?*

(i) 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 (ie without regard for the diluted earnings per share information reported during the interim periods).

Response

A difference between the year-to-date weighted average of the number of potential ordinary shares included in each interim diluted earnings per share calculation compared to a year-to-date weighted average of the number of potential ordinary shares weighted for the period they were outstanding (i.e. without regard to the information reported during the interim periods) will only occur when the weighted average for the interim period is calculated differently compared to the calculation method for the period the potential ordinary shares were outstanding. In examples 7 and 12 of Appendix B we noted a difference in the following cases:

- **Retail site contingency**: the year-to-date weighted average of the interim information results in 6,250 while the year-to-date weighted average for the period they were outstanding is actually 5,000. The difference is caused by the fact that under the diluted calculation the contingently issuable shares are included from the beginning of the interim period in which the conditions to issue are satisfied (i.e. opening of a retail store). We do *not agree* with this approach since the necessary conditions were not satisfied at the beginning of the interim period. The described approach results in the disclosure of diluted earnings per share including contingently issuable ordinary shares for which all necessary conditions have not been satisfied, which is incompatible with the new paragraph 45. Consequently, we believe the weighted average shares used to calculate the basic earnings per share (i.e. take the number of issuable shares into account as from the moment the contingent event has occurred, not earlier) should be used.

- **Earnings contingency**: under the example of earnings contingency, the number of contingently issuable shares depends on the net profit in excess of 2,000,000 for the year ended 31 December 20X1. Since the information on the number of potentially issuable shares is most accurate at the end of each period and the contingency becomes an obligation at 31 December 20X1, we do *not agree* with the illustrated approach and recommend taking the actual information (900,000) into account in calculating the full year diluted earnings per share. This method best reflects the actual performance during the past year.

(ii) *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.*

Response

We do *not agree* with the described approach unless the result of using the average market price during the interim periods reported upon approximates the result that would be obtained when using the average market price during the year-to-date period. If not, we believe the method using the average market price during the year-to-date period should be used.

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

Response

In our view this question is only relevant to the two cases discussed in the first point above to which we refer for our comments.

Other comments

1. Overall, we notice that important amendments have been made through the worked examples in Appendix B without (sufficient) disclosure of the reasons for the changes (e.g. calculation method for the year-to-date diluted earnings per share). We believe this undermines the understandability of the standard and that all significant changes should be highlighted when making improvements.

2. Para 43 does not take into account the time value of the warrant and option. We suggest the Board includes the concept of time value in para 43.

IAS 40

Q1. *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 IAS 40, paragraphs 27-49?*

Response

Yes, we agree.

Q2. *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?*

Response

Yes, we agree for the reasons set out in the Basis for Conclusions. However we believe it would be helpful to include the arguments in A6 of the Basis for Conclusions in the standard itself. We note, moreover, that the proposed approach will result in a mixed measurement of the finance lease: the asset is measured at fair value while the liability is measured at cost. We believe the Board should consider the need for further guidance when the lease price is subsequently revised.

Q3. *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?*

Response

Yes, we agree.
For reasons of practicality we support the suggestion that the option not be eliminated in the Improvements project. We agree that this issue should be kept under review with a view to eliminating the option at a later stage.