



# BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

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Sir David Tweedie  
International Accounting Standards Board  
30 Cannon Street,  
London EC4M 6XH

13 September 2002

**Re: Exposure Draft of proposed Improvements to International Accounting Standards**

Dear Sir David,

The Basel Committee on Banking Supervision welcomes the opportunity to comment on the Exposure Draft of proposed "Improvements to International Accounting Standards", published for comment in May 2002. The Committee has a strong interest in promoting transparent and high quality financial statements by banks and believes that the Exposure Draft includes many useful proposals.

Please find our detailed comments in the attached note. The note has been prepared by the Committee's Accounting Task Force, chaired by Prof Arnold Schilder, Executive Director of De Nederlandsche Bank.

If you have any questions regarding our comments, please feel free to contact Prof Schilder (+ 31 20 524 3360) or Bengt A Mettinger at the Basel Committee Secretariat (+ 41 61 280 9278).

Yours sincerely,

William McDonough

# Exposure Draft of Proposed Improvements to International Accounting Standards

## IAS 1 Presentation of Financial Statements

### Question 1

*Do you agree 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?*

We support retaining the override provision in the standard which requires both the directors and the auditors of a company to consider whether accounting standards have been applied so as to achieve a fair presentation.

In addition, we believe that two statements deleted in the exposure draft from the current standard convey an important message about the need for adherence to International Financial Reporting Standards (IFRSs) and recommend that they be retained in the standard. Specifically the statement in paragraph 12 that "Inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used or by notes or explanatory material," and the statement in 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".

### Question 2

*Do you agree with prohibiting the presentation of items of income and expense as 'extraordinary items' in the income statement and the notes?*

We do not agree with the proposal to eliminate "extraordinary items" at present. Furthermore, we note the tension between the last sentence in paragraph 76, which requires line items and subtotals to be added when that is relevant to an understanding of the entity's financial performance, and paragraph 78, which prohibits presenting any income or expense item as "extraordinary", not only in the income statement but also in the notes. The overall effect is likely to be that items currently described as 'extraordinary' would simply be re-named under a different additional caption. We recommend that the Board refer the issue of extraordinary items to the Presentation Project.

### Question 5

*Do you agree that an entity should disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements?*

We believe that this information is useful and agree in principle with the proposed disclosure. However, the requirement, as drafted, relates to "accounting policies that have the most significant effect on the amounts of **items** recognised in the financial statements". The term "item" seems to be undefined but is often used to mean the line items in the income statement and the balance sheet. Uncertainty about the meaning of this term is likely to result in differing interpretations of this disclosure requirement. We recommend that the Board further clarify the suggested requirement by specifically defining this term.

## Question 6

*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?*

Yes.

## Other comments

1. We believe that the requirement of management to "develop policies to ensure that the financial statements provide information that is reliable in that they reflect the economic substance of events and transactions and not merely the legal form" contained in the existing IAS 1 should be retained in the standard. While we recognise that this concept is also in the Framework, we do not regard its deletion from IAS 1 as an improvement.
2. The current IAS 1 states in paragraph 6 that "the board of directors and/or other governing body of an enterprise is responsible for the preparation and presentation of its financial statements." This statement is, however, eliminated in the ED. Insofar IFRSs are used in many different countries and by different types of organisations. We believe that the paragraph supports an important corporate governance aspect and recommend that it should be retained in the new IAS 1.
3. We also believe that the current encouragement to present a financial review outside the financial statements should be kept (old paragraph 8). The new paragraph 7 notes that many entities present a financial review by management but no longer expresses encouragement of this practice.
4. The ED includes several 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 further guidance should be provided on the meaning of "undue cost or effort" in order to avoid conflicting interpretations that could undermine the overall reliability and comparability of financial statements prepared in accordance with IFRSs. For example, some believe that the expression allows an entity to regard almost any cost as undue, whereas the previous test of impracticality was much more stringent.
5. In our view the deletion in the ED of paragraph 102 (d) requiring disclosure of the number of employees of a firm eliminates information considered important and useful by many users of financial statements.
6. Paragraph 105 provides a list of particular accounting policies that should be considered for disclosure in the financial statement. We suggest that recognition and derecognition should be added to the list.

## IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

### Question 1

*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?*

Yes.

### Question 2

*Do you agree with eliminating the distinction between fundamental errors and other material errors?*

Yes.

### Other comments

When an enterprise has not adopted a new standard that has been issued but has not yet taken effect, the ED elevates the encouragement in the current IAS 8 to a requirement in proposed paragraph 19 that the enterprise disclose the nature of the future change in accounting policy and an estimate of the effect of the change on its net profit or loss and financial position. We believe that, if the requirement is kept in the final standard, the ED should clarify whether the requirement pertains only to changes arising from entirely “new standards” or also includes changes in existing standards.

## IAS 16 Property, Plant and Equipment

### Question 1

*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?*

We disagree and recommend that the difference in the accounting for exchanges of similar and dissimilar assets should be retained. In the case of similar assets, the financial position of the entity is unchanged by an exchange, and so such exchanges should continue to be accounted for at cost. Furthermore, to allow or require fair value measurement for exchanges of similar assets may open up opportunities for cherry picking transactions entered into in order to record latent gains.

### Question 2

*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.*

We disagree, for the same reasons noted in the response to question 1 above.

Revised paragraph 7 sets forth two criteria for recognition of property, plant and equipment. The second criterion in part requires that the cost of the asset must be able to be measured reliably. This criterion is already contained in the existing standard. The exposure draft further requires that when the asset is carried at a revalued amount, the fair value must be able to be measured reliably. We support the application of the reliable measurement criterion to revalued amounts, but believe it would be more appropriate to include it in the section on Measurement Subsequent to Initial Recognition, as a condition for the use of the allowed alternative treatment.

## **IAS 17 Leases**

### **Question 1**

*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 buildings element is classified as an operating or finance lease [...]?*

Conceptually, the suggested approach is a good solution. However, it is often impracticable to reliably split the amounts between land and buildings. In such cases, the ED dictates that the entire lease be classified as a finance lease, unless it is clear that both elements (land and buildings) are operating leases. We are not convinced that such an assumption is helpful in achieving the correct accounting representation of these contracts.

### **Question 2**

*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?*

We mainly agree with the proposal to capitalise initial direct costs for finance leases. The solution means the same measurement for leases as, for example, for loans (see IAS 39.10,17 and 66). However, we recommend that it should be made clear that selling costs should not be capitalised.

## **IAS 21 Changes in Foreign Exchange Rates**

### **Question 1**

*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 paragraph 7–12 on how to determine what is an entity’s functional currency?*

Yes.

## Question 2

*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?*

We believe that the standard should allow the choice of the (main) presentation currency to be governed by national or regulatory requirements, where such requirements exist.

## Question 3

*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?*

Yes.

## Question 4

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

Yes.

## Question 5

*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?*

Yes.

## Other comments

1. Revised paragraph 1 includes a reference to “balances”, but this term does not appear in the current standard. As it may not be obvious to readers what is meant by that term, it would be useful to include a definition of the term in paragraph 6 of the standard.

2. Paragraph 6 includes a definition of “foreign operations” saying that it is an entity, the activities of which are based or conducted in a **country** or currency other than those of the reporting entity. Actually, given the way the ED is structured, the country is an irrelevant aspect. The entity concerned can be in the same country as the reporting entity but have a different functional currency, or it can be in a different country but have the same functional currency. We suggest that the word “country” be deleted.

3. The meaning of monetary and non-monetary items is illustrated with examples in paragraph 14. While the examples are helpful, they do not cover the more complex situations

of assets and liabilities that are equity and equity related instruments. We suggest that the paragraph states whether such instruments are monetary or non-monetary items.

4. Paragraph 19 requires foreign currency transactions to be recorded in the functional currency, which appears at variance with the guidance in paragraph 32 addressing the situation when an entity's books and records are kept in a currency other than the functional one.

## **IAS 24 Related Party Disclosures**

### **Question 1**

*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?[..]*

No, we believe that this information about such arrangements is relevant and necessary information for shareholders and others. In fact, transparency in this area has important corporate governance implications.

### **Question 2**

*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?*

No. We believe that related party disclosures are relevant to investors and counterparties in understanding an entity's financial position and performance.

## **IAS 27 Consolidated and Separate Financial Statements**

### **Question 2**

*Do you agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity?*

Yes.

### **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 [...] in the investor's separate financial statements?*

No. Currently, the standard allows three alternatives: cost, IAS 39 and the equity method. We do not believe that the elimination of the equity method in the ED is meaningful or helpful.

*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?*

Yes.

## **IAS 28**

### **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)?*

Yes.

### **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)?*

Yes.

## **IAS 40 Investment Property**

### **Question 1**

*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 [...]*

We do not agree. IAS 40 is a new standard and experience with its application to date has therefore been limited. The suggested change would allow for assets "held" under an operating lease agreement to be included in the scope of application of IAS 40 and measured at fair value. This is a potentially far-reaching proposal, which we believe requires thorough analysis and might appropriately be included with the leasing project currently on the IASB's agenda.

### **Question 2**

*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.*



We do not agree and suggest that this issue should also be dealt with in the leasing project.

### **Question 3**

*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?*

We agree that the Board should continue to allow for a choice between the cost model and the fair value model, and where the cost model is used, disclosure of fair value would be beneficial. We do, however, believe that the Board should carefully assess the application of the fair value model for investment property.