Organismo Italiano di Contabilità (OIC)
Italian Accounting Standard Setter

IASB – EXPOSURE DRAFT OF PROPOSED IMPROVEMENTS TO INTERNATIONAL ACCOUNTING STANDARDS

ORGANISMO ITALIANO DI CONTABILITA'

Professor Sir David Tweedie
Chairman Supervisory Board
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Fax: 0044 (0)20 7246 6411
Ph: 0044 (0)20 7246 6410
e-mail: CommentLetters@iasb.org.uk

October 17, 2002

Dear Sir Tweedie

I am pleased to submit you, on behalf of the Organismo Italiano di Contabilità the following comments to this important Exposure Draft.

IAS 1

Q1. 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 (see proposed paragraphs 13-16)?

A. Financial statements can be described as complying with IAS if they meet all the requirements of each applicable International Accounting Standards and related Interpretations. These requirements, include the overriding rule, which requires, (in extremely rare circumstances) to depart from a Standard in order to achieve a true and fair view. In our view, it shall not be allowed to apply the overriding rule if a domestic legislation does not allow any departure from IAS. The "overriding rule" purpose is to allow a true and fair view in the spirit of the IAS which are “principles based” and not “ruled based”. Therefore, this rule has a pervasive value that is always to be taken into consideration. To admit the domestic legislation to prevale on IAS in such an important circumstance could create further problems in the future, such as , a legal or regulatory interpretation of IAS.

In addition, the used wording used is misleading. In the circumstances in which domestic legislation prohibits a departure from IAS, the wording “perceived misleading aspect of compliance” is used. The term “perceived” is ambiguous. If the compliance is misleading, this is always misleading and not only when “perceived”. The term “perceived” is rightly not used in the case in which the domestic legislation does not prohibit the overriding rule (paragraph 13).

Moreover, the disclosure of the related effects can not substitute a proper accounting standard or limit the effects related to the adoption of a proper accounting standard. This is a pervasive and fundamental concept which can never be abandoned.

Q2. Do you agree with prohibiting the presentation of items of income and expense as “extraordinary items” in the income statement and the notes (see proposed paragraphs 78 and 79)?

A. We do not agree with the proposed prohibition, although we agree that a univocal definition of extraordinary items does not exist. We would welcome a more detailed guidance for defining, among items of a non-recurring nature, those that could qualify as extraordinary. We believe that an example of extraordinary items could be represented by corrections of errors (see our answer to Q 1 under IAS 8).

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

A. 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 a better understanding of the financial position of the entity. It would be useful to add a sentence to paragraph 60 indicating that in such circumstances paragraph 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 classification in IAS 10 would be helpful.

Q4. Do you agree that:

(a) 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 authorised for issue, not to demand payment as a consequence of the breach (see proposed paragraph 62)?

(b) If a lender was entitled to demand immediate repayment of a loan because the entity breached a condition of its loan agreement, but agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:

(i) The entity rectifies the breach within the period of grace; or

(ii) When the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified (see proposed paragraphs 63 and 64)?

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

Q5. 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 (see proposed paragraphs 108 and 109)?

A. We do not agree with such a generic requirement. Judgement is an essential part of the estimation process. Selecting those accounting policies most affected by judgement would imply the introduction of another judgement component.

On the contrary, we agree that specific standards (as the ones mentioned for instance in § 109) can require adeguate disclosures.

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 (see proposed paragraphs 110-115)?

A. We agree with the required disclosures.

Other comments

? We do not agree with moving to Ias 8 paragraphs dealing with the accounting policies selection and application. It concerns a fundamental basis to prepare financial statements and, consequently, should be part of IAS 1, which prescribes the basis for presentation of general purpose financial statements . We believe that it would be reductive to confine it in a standard dealing with the accounting accounting treatment of accounting changes.

? We do not agree with changing from “impracticability” to “undue cost and efforts” in order to exempt entities from restating comparative figures when the entity used a new classification during the current year. The term “undue cost and effort” is less specific and could permit spurious justifications. Impracticability is a more objective concept.

? We do not agree with eliminating the disclosure of the number of employees. It regards a fundamental disclosure for analysts and investors to calculate important ratios. On the contrary, we believe that the number of employees at the end of the period and the average number of employees during for period should be disclosed

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?

A. We agree with eliminating the LIFO method. We think that it is also necessary to propose this elimination with reference to IAS 34, Interim financial reporting.

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?

A. We do agree. This requirement is consistent with the general principle stating that inventories should be measured at the lower of cost and net realisable value. Not reversing a write down would imply an evaluation lower than cost. The reversal shall be recognised in the income statement according to general principles for the recognition for cost and income

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 errors had never occurred (see paragraphs 20, 21, 32 and 33)?

A. We do not agree with eliminating the allowed treatment for corrections of errors. If it was decided that only one alternative should be maintained we would prefer that this alternative be the charge or credit of the effect as extraordinary item in the profit and loss account of the year of the correction. Appropriate disclosure should be provided as to the nature and amount of the error corrected.

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

A. We agree with eliminating the distinction between fundamental and material errors. This distinction, often, is a semantics problem rather than an accounting one.

Other comments(p.19)

We believe that the requirement to estimate the effects on the entity's financial position of a new accounting standard not yet come into effective is too onerous. In practice, entities will always refer the "undue cost and effort" thus eluding this requirement.
Therefore it would be better to eliminate this requirement.

IAS 10

The proposed changes relating to IAS 10 are extremely limited and concern, above all, paragraphs 10 and 11.
It is specified in a clearer way that dividends proposed or declared after the balance sheet date shall not be recorded at the same date in financial statements as liability, given that there is no "present obligation", as it is defined in IAS 37 at that date.
We agree with the proposed changes.

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)?

A. Yes , we do agree.

The main reasons are the following :

? The elimination of the distinction between sim ilar and non similar assets and the measurement of the new asset at fair value, in both cases, when the fair value is reliably measurable, represents a choice of consistency in the accounting treatment of the different financial statements items.
? The recognition of all exchanges at fair value is in line with the general approach at fair value of IASB accounting model.
? To maintain the distinction between items acquired in exchange for similar assets (to be recorded at the carrying amount of the asset given up) and non similar assets(to be measured at fair value of the asset received) is, above all, badly comprehensible and sometimes impracticable.

Q2. Do you agree that all exchanges of should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably? (See the amendments in paragraphs 34-34B of IAS 38, Intangible Assets, proposed as a consequence of the proposal described in Question 1.)
(Note that the Board has decided not to amend, at this time, the prohibition in IAS 18, Revenue, on recognising revenue from exchanges or swaps of goods or services of a similar nature and value. The Board will review that policy later in the context of a future project on the Recognition of Revenue.)

A. We agree with this proposal for the same reasons exposed in the comments to the previous question.

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 fom active use and held for disposal (see paragraph 59)?

A. No. We do not agree.

The main reasons are the following:

? To depreciate an asset which, for specific reasons, has not taken part in the production process can be misleading, for instance, in the determination of the operating cost to use in the inventory valuation . This is the case, for instance, of a specific machinery retired from the production process and replaced by another machinery which has made the same production of the machinery replaced . In this case, both the depreciation of the new machinery and of that replaced have to be accounted for as production cost.

? Perhaps, it could be useful to distinguish between assets temporarily idle but which are replaced by other assets in their original production (in this case the depreciation could not cease), and assets retired from the operating process and replaced by other new assets (depreciation shall not be calculated for the retired assets)

? In our view the retired assets should no longer be depreciated and should written down to their recoverable amount.

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 buildings element is classified as an operating or finance lease by applying the conditions in paragraphs 3-10 of IAS 17.

A. No. We do not agree.

? The distinction is, in most cases , impracticable.

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?

A. Yes, we agree.

? Except for selling costs, which shall be recognised directly in the income statement, the other incremental costs shall be capitalised and allocated over the lease contract term. We do not believe opportune to give the option to choose whether to capitalise or to recognise these costs in the income statement as it was in the previous IAS 17.

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?*

A. Yes, we agree.

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?*

A. No, we do not agree.
We believe that the currency used in preparing financial statements shall be the currency of the country where the entity has registered office or its functional currency.

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)?*

A. Yes, we agree.

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

A. Yes, we agree.

The possibility to capitalise exchange losses as assets realised after severe currency devaluations would have caused different solutions from entity to entity and would have impaired financial statements comparability. The decision to maintain only the alternative to allocate these losses to the current period is also more appropriate because exchange losses do not meet the definition of assets.

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)?

A. Yes, we agree.

Allowing two different recognition alternatives was unacceptable ; the proposed solution is conceptually the most correct and operationally is the most adequate solution. In practice, the higher assets value and the goodwill arising on a consolidation are not parent's values but acquired subsidiary's value. For this, it is correct that these values are translated in the consolidated financial statements at the closing rate

IAS 24

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".

A. No, we do not agree, because the shareholders are entitled to be informed on the management compensation. "Management means the Board of Directors members and other governing body in a "two tier system". The "compensation" includes : salaries, bonuses, stock options and pension benefits.

The following considerations have to be taken in account as a further support of the above responses:

- The proposal in the revised paragraph 2 involves the difficulty to identify which compensation has to be considered as "paid in the ordinary course of an entity's operations" and which ones, on the contrary, shall be disclosed because they are extraordinary;

- The proposed possibility set out in paragraph 18 to provide disclosure on items of similar nature in aggregate can help overcome concerns about confidentiality and privacy.

With reference to paragraph 17 we would like to underline the following points:

- Related parties transactions can be referred to as “arms length” only if this caratheristic can be demonstrated.
- Whilst we consider this statement obvious ,instead it would be advisable to indicate what disclosure are required when it is not possible to demonstrate the “arm’s length” in relation to these operations or it seems to be clear that these transactions are not undertaken under market conditions.

  In this latter case, in addition the effect on the reliability of the financial statements should be clarified.

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?*

A. No, we do not agree because it is a very important information.

The lack of information, which can be meaningful for an individual entity, could create a not justified disparity in disclosure for any minority interests..

IAS 27

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

A. Yes, we agree.

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)?*

A. Yes, we agree for several reasons:

- ? The minority interests' share does not meet the criteria required by IASC's Framework to be considered a liability while it satisfies the criteria set out in paragraph 49 c) of the Framework;
- ? The proposed modification is more consistent with the group concept as a separate "entity", typical of the "entity theory";
- ? The previous choice created an hybrid financial statements item. This item could not be considered as equity or liability; this solution encourages the financial statements understandability

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)?

A. First question. No, we do not agree.

As far as the first issue is concerned, the current structure of IAS 27, paragraph 29, allows three options: at cost, equity method or the accounting basis provided by IAS 39, Financial instruments, with reference to financial assets available for sale.

The elimination of equity method does not seem to be justified; instead it is more appropriate to maintain this method in a parent's separate financial statements, given that it produces the same effects of the integral consolidation. Doing so, it would be possible to have a consistent approach both in consolidated and separated financial statements.

The reasons provided in the "Basis for conclusion" (par.A13) in favour of cost and fair value methods do not appear to be persuading.

Second question. Yes, we agree.

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)?*

A. The response has to be positive both for consistency among the applicable different Standards (IAS 27, 28, 31 and 39) and because, when there is no control relationship and the investments are owned by the types of investors indicated above, the fair value provides the best possible information to the financial statements users. In this circumstance, it is necessary to apply the requirements set out in IAS 39 instead of those included in IAS 28 and 31.

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)?*

A. No, the proposed modification does not seem to be appropriate.

To include in the computation of a write-down for losses on long-term receivables or payables (except for the trade ones), which in substance are an extension or a reduction in the associate investment, does not seem to be a good idea. This solution could lead to a confusion among balance sheet items having different nature. The justification exposed in the paragraph A9 and A10 is not persuading at all.

Furthermore, it is to be observed that long-term loans and borrowings to associates can not be linked to collaterals by third parties able to warrant their partial or integral recover.

Therefore , the loss incurred by the associate does not necessarily imply that the receivables, besides the investment, have to be reduced to nil as well.

IAS 33

Q1. Do you agree that contracts that my 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?

A. Yes, we agree.

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

(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.

(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).

A. Yes, we agree.

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?

A. 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?

A. *Yes, we agree.*

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, bus should keep the matter under review with a view to reconsidering the option to use the cost model in due course?

A. *Yes, we agree.*

However, we observe that the types of “capitalisable” operating leases is subordinate to the possibility that a contract is ceased (not if there is a sub-lease) and to the existence of a “fair value” for the same contract.