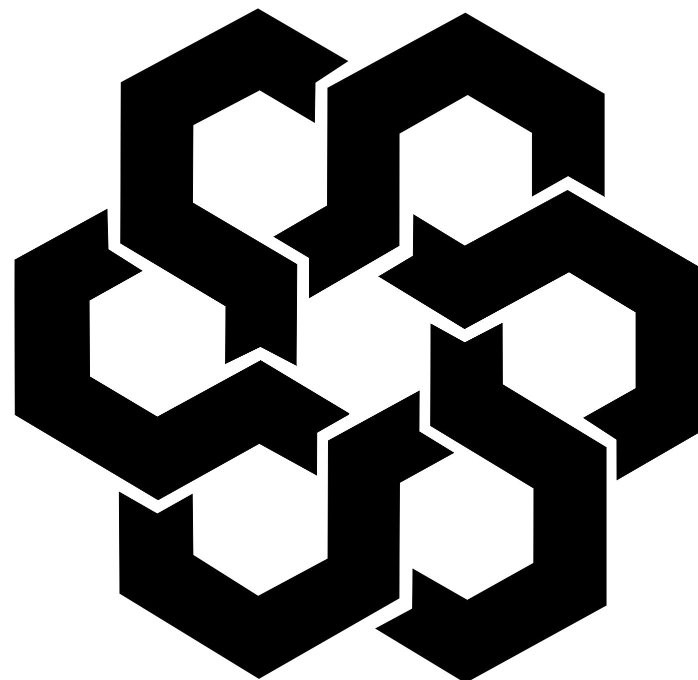
JULY 1990

Statement of Intent

Comparability of Financial Statements



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and the International Coordinating Committee of Financial Analysts' Associations.

The approved text of the Statement of Intent is that published by the International Accounting Standards Committee in the English language. The Statement of Intent was approved in June 1990 for publication in July 1990.

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2. Issues on which the Board has agreed to make substantive changes to the proposals in E32, comparability of Financial Statements.

3. Issues on which the Board has deferred consideration pending further work.

Comparability of Financial Statements

Introduction

1. This Statement of Intent sets out the Board's decisions following its review of the comments received on Exposure Draft 32, Comparability of Financial Statements (E32). It describes how the decisions will be implemented and the further efforts of the Board in seeking the improvement and harmonisation of accounting standards and other requirements relating to the presentation of financial statements. The Statement of Intent does not alter the status of existing International Accounting Standards; the changes will take effect after further work on existing Standards, which is described in paragraphs 12 and 13, has been carried out.

E32, Comparability of Financial Statements

2. E32 was published on 1st January 1989. It dealt with twenty nine accounting issues where the choice of alternative accounting treatments permitted by International Accounting Standards may have a material effect on the definition, recognition, measurement and display of income, expenses, assets, liabilities and equity in the financial statements of an enterprise.

3. The objectives of the proposals in E32 were to:

(a) eliminate all but one accounting treatment where the alternative treatments represent a free choice for like transactions and events; and

(b) ensure that the appropriate treatment is used where the alternatives represent different treatments which should be applied in different circumstances.

4. In some cases, E32 proposed the retention of two accounting treatments for like transactions and events particularly when the application of the different criteria in paragraph 5 below supports the use of different treatments. In these circumstances, E32 identified one treatment as the preferred treatment and the other as an allowed alternative. E32 proposed that an enterprise that presents financial statements which use allowed alternative treatments and which purport to conform with International Accounting Standards should reconcile its reported net income and shareholders' interests to those amounts determined using the preferred treatments.

5. In E32, the Board used the following criteria in deciding which alternative treatments should be required, preferred or eliminated:

(a) current worldwide practice and trends in national accounting standards, law and generally accepted accounting principles;

(b) conformity with the Framework for the Preparation and Presentation of Financial Statements (which was in Exposure Draft form at the time E32 was issued);

(c) the views of regulators and their representative organisations, such as the International Organisation of Securities Commissions (IOSCO); and

(d) consistency within an International Accounting Standard and with other International Accounting Standards.

Comments on E32

6. IASC received over 160 comment letters on the proposals in E32. Many of these comment letters were the result of extensive consultation within national standard setting bodies, accountancy bodies, international accounting firms and other organisations. In addition, representatives of IASC discussed the proposals with standard setting bodies, representatives of preparers and users of financial statements, the accountancy profession, stock exchanges and securities regulators in over twenty countries.

7. The comment letters were virtually unanimous in supporting the objective of greater comparability of financial statements and the Exposure Draft as a whole. Inevitably, however, many respondents disagreed with one or more of the detailed proposals in E32.

Revised Proposals

8. The Board has reconsidered the proposals in E32 in the light of the comment letters and its discussions around the world. It has decided that it should continue with the Comparability project in substantially the same form as envisaged in E32 although certain changes will be made on some accounting issues, to the terminology used when a free choice is retained and to the reconciliation requirement.

9. The Board has decided that:

(a) twenty one of the twenty nine proposals in E32 should be incorporated in revised International Accounting Standards without substantive change (see appendix 1);

(b) three of the proposals in E32 require substantive change and should be reexposed (see appendix 2); and

(c) reconsideration of five of the proposals should be deferred pending further work (see appendix 3).

10. The Board has concluded that it should use the term "benchmark" instead of the proposed term "preferred" in those few cases where it continues to allow a choice of accounting treatment for like transactions and events. The term "benchmark" more closely reflects the Board's intention of identifying a point of reference when making its choice between alternatives.

11. A substantial number of comment letters indicated disagreement with the proposed reconciliation requirement in E32 for those enterprises that present financial statements which use allowed alternative treatments and which purport to conform with International Accounting Standards (see paragraph 4 above). The Board has been convinced by the commentators' arguments and does not intend to require the reconciliation requirement proposed in E32. However, it will encourage enterprises to publish such a reconciliation as part of their financial statements. Furthermore, individual Standards may, as at present, require disclosure of the effects of using accounting treatments which are different from the benchmark treatments.

Implementation of the Changes

12. Drafts of revised Standards 8, 11, 16, 18, 19, 21, 22 and 25 will be exposed for comment; the exposure drafts will indicate that the Board does not intend to reconsider the issues described in Appendix 1 which were exposed for comment in E32 and subsequently approved by the Board without substantive change. Drafts of revised Standards 2, 9 and 23 will be exposed for comment and, because the Board has changed its position concerning the issues described in Appendix 2, the Board will reconsider these issues in light of comments received. The Board has deferred consideration of the issues listed in Appendix 3 but once the necessary work on these issues is complete, the Board intends to reexpose and reconsider

subsequently only those issues on which it has changed its position from that exposed in E32.

13. Before the Board implements the agreed changes, it will make other improvements to existing International Accounting Standards. The purpose of this Improvements project is to ensure that International Accounting Standards are sufficiently detailed and complete and contain adequate disclosure requirements to meet the needs of capital markets and the international business community.

14. As more information becomes available on the likely progress on the revised Standards, the Board will publish further details of its implementation programme. It is intended, however, that the implementation work on existing International Accounting Standards will be completed by the beginning of 1993.

15. The revisions to existing International Accounting Standards will not take effect until the Board has approved and issued the revised Standards.

16. The Board will also develop new Standards where it is necessary to fill the gaps in the existing set of International Accounting Standards in order to meet the needs of capital markets and the international business community. Current projects include Joint Ventures, Financial Instruments, Cash Flow Statements, Long Term Intangible Assets and Earnings per Share.

Further Consultations and Improvements

17. The Board recognises that it is both impracticable and inappropriate to remove some of the remaining alternative accounting treatments permitted by International Accounting Standards in the foreseeable future - for example, the choice between historical cost and revaluation based carrying amounts for property, plant and equipment and some investments. The Board also recognises that future developments in accounting and the business environment may result in a requirement for a treatment other than that presently identified as the benchmark.

18. The Board will continue to consult national standard setting bodies, accountancy bodies and others who are interested in the improvement and harmonisation of financial reporting practices. The purpose of such consultations will be to seek ways of eliminating the remaining free choices in International Accounting Standards and encouraging national standard setting bodies to adopt the required treatments and the benchmark treatments in the revised International Accounting Standards.

19. The International Organisation of Securities Commissions (IOSCO) has emphasised the need for mutually acceptable accounting standards for use in multinational securities offerings and other foreign issues of equity and debt securities. The Board believes that the Comparability project is an important first step towards meeting this need. The Board will continue to support the efforts of IOSCO which are to encourage individual securities regulators to allow or require each foreign issuer to present:

(a) a reconciliation of its financial statements prepared in conformity with its domestic requirements to the required treatments and, where a choice remains, the benchmark treatments in International Accounting Standards. Such a reconciliation would replace the reconciliation to the required treatments in national accounting requirements in each country in which the issuer's securities are traded; or

(b) financial statements prepared in conformity with the required treatments and, where a choice remains, the benchmark treatments in International Accounting Standards.

20. As a longer term objective, the Board will seek to encourage all issuers of securities to present their financial statements in conformity with the required treatments and benchmark treatments in International Accounting Standards.

Appendix 1

Issues on which the Board has agreed to incorporate the proposals in E32, Comparability of Financial Statements, in revised International Accounting Standards without substantive change

IAS 8, Unusual and Prior Period Items and Changes in Accounting Policies

Correction of fundamental errors and omissions, and adjustments resulting from accounting policy changes

Benchmark treatment - subject to the exception below, prior period items and the amount of any adjustments resulting from changes in accounting policies should be reported by adjusting opening retained earnings. The comparative information in respect of prior years which is included in the financial statements should be amended unless it is impracticable to do so and that fact is disclosed. As an exception to this general requirement, the revised Standard will require that adjustments resulting from changes in accounting policies should be applied prospectively in the limited situations where the amount of any adjustment to opening retained earnings is not reasonably determinable or where prospective application is required by a national accounting standard or an International Accounting Standard.

Allowed alternative treatment - prior period items and the amount of any adjustments resulting from changes in accounting policies should be included in net income for the current period. Comparative information in respect of prior years should be presented on a pro forma basis unless it is impracticable to do so and that fact is disclosed.

The revised Standard will also require:

(a) the disclosure of the nature and amount of prior period items and the amount of any adjustments resulting from changes in accounting policies; and

(b) that the amount of any adjustments resulting from changes in accounting policies resulting from the implementation of a requirement in an International Accounting Standard should be accounted for in accordance with any specific transitional provisions in that Standard.

IAS 11, Accounting for Construction Contracts

Recognition of revenue and net income on construction contracts

Required treatment - revenue and net income should be recognised using the percentage of completion method. The revised Standard will make clear that the percentage of completion method requires the following:

(a) when the outcome of the contract can be reliably estimated, revenue should be recognised by reference to the stage of completion of the contract activity at the end of each accounting period. The conditions that must be satisfied before such a degree of reliability can be obtained are set out in existing paragraph 43 of IAS 11;

(b) when the outcome of the contract cannot be reliably estimated, revenue should be recognised only to the extent of costs incurred that are recoverable; and

(c) when the outcome of the contract and the recoverability of the costs already incurred cannot be reliably estimated, revenue should not be recognised.

IAS 16, Accounting for Property, Plant and Equipment

Measurement of property, plant and equipment

Benchmark treatment - the gross carrying amount of an asset included in property, plant and equipment should be its historical cost.

Allowed alternative treatment - the gross carrying amount of an asset included in property, plant and equipment should be determined by reference to revaluations.

Measurement of property, plant and equipment acquired in exchange for another asset

Required treatment - when an item of property, plant and equipment is acquired in exchange or in part exchange for a dissimilar asset, the cost of the asset acquired should be measured at fair value. When the item is acquired in

exchange for a similar asset which has a similar use in the same line of business and which has a similar fair value, the cost of the asset acquired should be measured at the net carrying amount of the asset given up, adjusted for any balancing payment or receipt of cash or other consideration.

The revised Standard will include guidance on the identification of similar and dissimilar assets.

Recognition of a revaluation increase relating to a revaluation decrease previously charged to income

Required treatment - an increase in net carrying amount arising on the revaluation of property, plant and equipment should be credited to income to the extent that the increase is related to and not greater than a decrease arising on revaluation previously recorded as a charge to income.

IAS 18, Revenue Recognition

Recognition of revenue on transactions involving the rendering of services

Required treatment - revenue should be recognised using the percentage of completion method.

The revised Standard will make clear that the percentage of completion method requires the following:

(a) when no significant uncertainty exists regarding the consideration that will be derived from rendering the service and the associated costs incurred or to be incurred in rendering the service, revenue should be recognised by reference to the work accomplished at the end of each accounting period;

(b) when the outcome of the contract cannot be reliably estimated, revenue should be recognised only to the extent of costs incurred that are recoverable; and

(c) when the outcome of the contract and the recoverability of the costs already incurred cannot be reliably estimated, revenue should not be recognised.

IAS 19, Accounting for Retirement Benefits in the Financial Statements of Employers

Determination of the cost of retirement benefits

Benchmark treatment - in a defined benefit plan, the cost of retirement benefits should be determined using an accrued benefit valuation method.

Allowed alternative treatment - in a defined benefit plan, the cost of retirement benefits should be determined using a projected benefit valuation method.

The costs which would be involved in undertaking a second actuarial valuation may be substantial and may not be justified. E32 proposed that enterprises which use the allowed alternative treatment need only disclose the amounts based on the accrued benefit methods to the extent practicable. The Board intends to encourage securities regulators to adopt the same approach in any reconciliations which they may require.

Use of projected salaries in determining the cost of retirement benefits

Required treatment - an enterprise should use appropriate and compatible assumptions, including those regarding projected salary levels to date of retirement, in making an actuarial valuation.

Recognition of past service costs, experience adjustments and the effects of changes in actuarial assumptions

Required treatment - subject to the exception below, past service costs, experience adjustments and the effects of changes in actuarial assumptions on retirement benefit costs should be allocated to income systematically over a period approximating the average of the expected remaining working lives of the participating employees.

As an exception to the general requirement, the revised Standard will require the immediate write off or the use of shorter amortisation periods for certain

adjustments such as curtailments, settlements, some plan amendments and similar items.

IAS 21, Accounting for the Effects of Changes in Foreign Exchange Rates

Recognition of foreign exchange gains and losses on long-term monetary items

Required treatment - exchange differences arising on reporting long-term foreign currency monetary items at rates different from those at which they were recorded during the period or presented in the previous financial statements should be recognised in income for the period except for those differences:

(a) arising in the circumstances set out in the existing paragraph 29 of IAS 21 which should be dealt with in accordance with that paragraph; and

(b) relating to a hedged liability which should, to the extent of the hedge, be deferred until the liability is settled and the asset sold.

It is intended that the definition of a hedge will be dealt with in the Financial Instruments project.

Recognition of foreign exchange losses on the acquisition of an asset that result from a severe devaluation against which there is no practical means of hedging

Benchmark treatment - exchange differences arising on reporting long-term foreign currency monetary items at rates different from those at which they were recorded during the period or presented in the previous financial statements should be recognised in income for the period.
Allowed alternative treatment - exchange differences resulting from a severe devaluation or from depreciation of a currency against which there is no practical means of hedging and that affects liabilities arising directly on the recent acquisition of assets invoiced in a foreign currency should be included in the carrying amount of the related assets provided that the adjusted carrying amount does not exceed the lower of the replacement cost and the amount recoverable from the sale or use of the asset.

Exchange rate for use in translating income statement items of foreign entities and treatment of differences on income statement items translated at other than the closing rate

Required treatment - income statement items should be translated at the exchange rates at the dates of the transactions (or at a rate that approximates the actual rates). Differences resulting from the translation of income statement items at the dates of transactions and balance sheet items at the closing rate should be taken to shareholders' interests.

Subsidiaries operating in hyperinflationary economies

Required treatment - the financial statements of a subsidiary that reports in the currency of a hyperinflationary economy should be restated in accordance with International Accounting Standard 29, Financial Reporting in Hyperinflationary Economies, before they are translated into the reporting currency of the parent.

Procedures applied in translating the financial statements of a foreign operation that is integral to the operations of the parent

Benchmark treatment - exchange differences arising on the translation of the financial statements of a foreign operation that is integral to the operations of the parent should be included in income except that those differences relating to a hedged liability should, to the extent of the hedge, be deferred until the liability is settled and the asset sold.

Allowed alternative treatment - exchange differences resulting from a severe devaluation or from depreciation of a currency against which there is no practical means of hedging and that affects liabilities arising directly on the recent acquisition of assets invoiced in a foreign currency should be included in the carrying amount of the related assets provided that the adjusted carrying amount does not exceed the lower of the replacement cost and the amount recoverable from the sale or use of the asset.

It is intended that the definition of a hedge will be dealt with in the Financial Instruments project.

IAS 22, Accounting for Business Combinations

Acquisitions and mergers

Required treatment - an acquisition should be accounted for using the purchase method. A uniting of interests should be accounted for using the pooling of interests method.

E32 proposed that a uniting of interests should only arise when, among other things, an acquirer cannot be identified. The revised Standard will include guidance on when an acquirer cannot be identified.

Positive goodwill

Required treatment - the excess of the cost of acquisition over the fair values of the net identifiable assets acquired should be recognised as an asset as goodwill arising on acquisition. This goodwill should be amortised to income on a systematic basis over its useful life. The amortisation period should not exceed five years unless a longer useful life can be justified and is explained in the financial statements. The longer period chosen should not exceed twenty years.

Negative goodwill

Benchmark treatment - the amount by which the aggregate fair value of net identifiable assets exceeds the cost of acquisition should be allocated over individual non monetary assets acquired in proportion to their fair values. After making this allocation, in the rare circumstances in which any negative goodwill remains, it should be treated as deferred income and recognised in income on a systematic basis over a period that does not exceed five years unless a longer period can be justified and is explained in the financial statements and which, in any case, does not exceed twenty years.

Allowed alternative treatment - the amount by which the aggregate fair value of net identifiable assets exceeds the cost of acquisition should be treated as deferred income and recognised in income on a systematic basis over a period that does not exceed five years unless a longer period can be justified and is explained in the financial statements and which, in any case, does not exceed twenty years.

Measurement of minority interests arising on a business combination

Benchmark treatment - a minority interest that arises on a business combination should be stated at the appropriate proportion of the pre-acquisition carrying amounts of the net assets of the subsidiary.

Allowed alternative treatment - a minority interest that arises on a business combination should be stated at the appropriate proportion of the fair values of the net assets of the subsidiary.

IAS 25, Accounting for Investments

Measurement of investment properties

Benchmark treatment - investment properties should be carried at cost and depreciated in accordance with International Accounting Standard 4, Depreciation Accounting.

Allowed alternative treatment - investment properties should be carried in the balance sheet at revalued amounts.

Recognition of a realised gain previously recognised in revaluation surplus

Required treatment - on disposal of an investment which was previously revalued and on which an increase in carrying amount was transferred to revaluation surplus, any remaining revalued amount should be credited directly to retained earnings and disclosed.

Appendix 2

Issues on which the Board has agreed to make substantive changes to the proposals in E32, Comparability of Financial Statements; these issues will be reexposed and reconsidered in the light of comments received

IAS 2, Valuation and Presentation of Inventories in the Context of the Historical Cost System

Assignment of costs to inventories

Required treatment - inventories that are not ordinarily interchangeable or goods manufactured and segregated for specific projects should be accounted for using specific identification of their individual costs. The FIFO formula or a weighted average cost formula should be used for assigning costs to all other inventories.

Eliminated treatments - the Exposure Draft will propose that the use of the LIFO formula and the Base Stock method should not be permitted.

IAS 9, Accounting for Research and Development Activities

Recognition of development costs

Required treatment - development costs should be recognised as an asset when they meet the criteria in paragraph 17 of IAS 9 and it is probable that these costs will be recovered. Such costs should be allocated on a systematic basis to future periods in accordance with the existing paragraph 20 of IAS 9.

Eliminated treatment - the Exposure Draft will propose that development costs which meet the criteria in paragraph 17 of IAS 9 should not be charged as an expense in the period in which they are incurred.

IAS 23 - Capitalisation of Borrowing Costs

Recognition of borrowing costs

Required treatment - borrowing costs should be recognised as an asset when they meet certain criteria which will be developed as part of the Improvements project. The criteria will be based on the procedures set out in paragraphs 22 to 27 of IAS 23.

Eliminated treatment - the Exposure Draft will propose that borrowing costs which meet the criteria should not be charged as an expense in the period in which they are incurred.

Appendix 3

Issues on which the Board has deferred consideration pending further work

IAS 17 Accounting for Leases

Recognition of finance income on finance leases

The Board believes that further study is required on the recognition of finance income on those leases on which the lessor's net investment outstanding is materially affected by income tax factors. It plans to develop an internationally acceptable definition of such a lease and delete the use of the term "leveraged lease".

IAS 25, Accounting for Investments

Measurement of long-term investments

Measurement of marketable equity securities held as long-term investments

Measurement of current investments

Recognition of increases and decrease in market values of current investments

Consideration of all these issues has been deferred pending further work on the Financial Instruments project.

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