

10 December 2001

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B-1040 BRUSSELS

Mr. Karel Van Hulle  
European Commission  
DG Internal Market  
C107 03/10  
rue de la Loi 200  
B - 1049 BRUSSELS

Dear Karel,

**Re: Modernisation of the Accounting Directives**

We are pleased to respond to your request inviting us to provide comments on whether the modernised 4<sup>th</sup> and 7<sup>th</sup> Directives remove all inconsistencies between the Accounting Directives and existing International Accounting Standards and the SIC interpretations.

As agreed with you our work was carried out drawing on our experience and by considering of the following documents:

- Commission/Contact Committee Examination of the Conformity between IAS 1 to 41 and the European Accounting Directives
- Commission/Contact Committee Examination: examination of the conformity between SIC 1 to SIC 25 and the European Accounting Directives
- FEE Study Comparison of the EC Accounting Directives and IASs
- FEE Study *"To what extent options in International Accounting Standards can be used for consolidated accounts under the EC Accounting Directives"*
- FEE Discussion Paper on Modernisation of the Accounting Directives (April 2001)

As a result of our work we concluded that there are no actual inconsistencies between IAS 1 to 41 (and related SIC) and the 4<sup>th</sup> and 7<sup>th</sup> Directives but we do recommend clarification of the Directives in three areas as follows:

IAS 8 Fundamental Errors and Changes in Accounting Policy

IAS 8 provides for two possible treatments of correction of fundamental errors and changes in accounting policy (see para 37, 40 and 46). Under one of those treatments the effects are dealt with retroactively so that the comparative figures are amended and an adjustment is made to the opening retained earnings.

It has been suggested that Article 31(f), which requires that the opening balance sheet for each financial year must correspond to the closing balance sheet for the preceding financial year, might prevent retroactive adjustment.

EFRAG believes that is not the case and that there is no conflict between IAS and the Directives in this regard but, as some uncertainty exists, it would be useful to clarify the meaning of Article 31(f).

## IAS 19 Use of the Corridor Approach in relation to Employee Benefits

Whilst recognising that the 4<sup>th</sup> Directive does not directly deal with accounting for pension costs, it has been suggested that use of the Corridor Approach for the deferral of actuarial losses is incompatible with the 4<sup>th</sup> Directive which requires that all losses be provided for.

EFRAG concluded that there is no incompatibility because both require the provision of losses. The IAS however recognises that the actuarial estimate is not an exact number and that the corridor represents a margin 10% either side of the central point and within the normal range of actuarial estimates. As such IAS 19 does require full provision for losses but acknowledges that the amount of the loss will be based within a range determined by the corridor.

Again it would be useful to clarify this.

## IAS 22 Reverse Acquisitions

IAS 22 paragraph 12 refers to accounting for reverse acquisitions whereby a business combination occurs and the shareholders of the legally acquired company become the majority shareholders of the combined group. IAS 22 recognises that legally the enterprise issuing the shares may be regarded as the parent or continuing enterprise, the enterprise whose shareholders now control the combined enterprise is the acquirer enjoying the voting power. The enterprise issuing the shares is deemed to have been acquired by the other enterprise and the latter is deemed to be the acquirer who must apply the purchase method to the assets and liabilities of the enterprise issuing the shares.

Reverse acquisitions were not in contemplation when the 7<sup>th</sup> Directive was prepared and it therefore does not discuss the accounting for such transactions. Nevertheless, it may be thought to require that the legal parent is treated as the acquirer and for that reason clarification is needed. We believe that, even if that is the effect of the wording of the 7<sup>th</sup> Directive, this is an example of those rare situations where the true and fair override can and should legitimately be applied so that there is no incompatibility between the IAS and the Directive. However, as the FEE comparison points out, if pooling is to be abolished, reverse acquisitions may become more common. Accordingly, it would be useful to clarify the 7<sup>th</sup> Directive requirements, perhaps by inserting in Article 19 a new paragraph 3 saying:

"3. Where under the terms of an acquisition the former shareholders of one of the undertakings acquired are put in a position where they hold a majority of the shares in the combined undertaking or otherwise dominate the general meetings or Board of Directors of the combined undertaking, the set-off referred to in paragraph 1 above shall be performed as though that acquired undertaking were the parent undertaking and all the other undertakings included in the consolidation were its subsidiary undertakings. This paragraph shall not, however, alter the identity of the undertaking determined under Article 1 to be the parent undertaking."

In our review we worked on the presumption that the Directives should permit all options permitted under IAS and that it should be assumed that where there are Member State options the comparability should be assessed for the option most favourable to the application of IAS. In practice we are aware that some Member States have implemented Member State options which are probably in conflict with IAS.

We are aware that a number of standards are in the process of being changed and these could result in conflicts with the Directives. In particular we have in mind that a new standard on business combinations may well adopt the new US practice in relation to goodwill where it may no longer be amortised (and may not be written off immediately to reserves) but would be subject to an impairment test which would result in write downs being charged to income from time to

time where necessary. You may wish to consider whether modifications to the Directives should be made in anticipation of changes to IAS, which would otherwise give rise to future conflicts.

Finally, we must warn that the limited review we have performed cannot provide any guarantee that there are no further conflicts but we hope this analysis will have proved useful to you.

Yours sincerely,

Johan van Helleman  
Chairman EFRAG Technical Expert Group