



August 31, 2010

Mr. Wayne Upton
Director of International Activities
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Wayne:

Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (the Mexican Financial Reporting Standards Board, or CINIF), the accounting standards setting body in Mexico, has performed a thorough analysis of the differences between International Financial Reporting Standards (IFRS) and Normas de Información Financiera (Mexican Financial Reporting Standards, or MFRS). That study resulted in the publication of a book that includes all differences identified to date between IFRS and MFRS, except those related to financial instruments. The reason for not including the topic of financial instruments is due to the fact that we are aware of the IASB's ongoing project to revise and reissue all standards related to financial instruments. CINIF is closely following those developments, and once the project is complete CINIF will consider amending existing MFRS as part of its goal of full convergence with IFRS.

It should be noted that our study was performed in 2009 and is in the process of being updated. As you know, the Mexican Stock Exchange will require all issuers to file financial statements prepared in accordance with IFRS beginning in 2012. As a result, all affected issuers are in the process of adopting IFRS and will apply IFRS 1, *First-time Adoption of International Financial Reporting Standards*, no later than 2012. In connection with the adoption of IFRS, we anticipate that some additional differences will surface and have to be addressed in our overall convergence effort. This may result in a follow-up letter to address any such differences.

We remain committed to achieving full convergence of MFRS with IFRS by the end of 2012.

Our publication mentioned above is divided into the following sections:

- Section A – Includes those identified differences that CINIF is considering eliminating in its convergence process through a revision of existing MFRS.
- Section B – Includes those identified differences supported by the Conceptual Framework (CF) of MFRS that to achieve convergence would require either modification of the CF of MFRS (and the related standard) or modification of the corresponding standard of IFRS.

- Section C – Includes those areas of accounting where existing MFRS coincides with one of the alternatives in IFRS but does not allow the other alternative(s). Accordingly, following MFRS in these cases does not represent a difference between MFRS and IFRS. On the other hand, if a reporting entity applies the IFRS alternative that is not accepted by MFRS, a difference would exist.
- Section D – Includes a series of clarifications of MFRS to avoid the conclusion that a difference between IFRS and MFRS exists when none was intended. CINIF will consider these clarifications in its annual improvements to MFRS.
- Section E – Includes those issues addressed in MFRS but not in IFRS. Paragraphs 10 to 12 of IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, state that in the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgment in developing and applying an accounting policy that results in relevant and reliable information. In making such judgment, IAS 8 indicates that management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with other IFRS of the Conceptual Framework. Accordingly, CINIF believes that MFRS may be considered to supplement IFRS especially in those cases where MFRS addresses a transaction, other event or condition typical to the Mexican environment. It should be noted that existing MFRS requires the use of IFRS in the absence of a standard in MFRS that specifically applies to a transaction, other event or condition.

This letter specifically addresses the differences identified in Section B of our publication, wherein CINIF believes that convergence can and should be achieved by the IASB reconsidering its position and considering the revision of some of its standards.

We have also investigated the accounting for each of the items in Section B pursuant to the accounting standards generally accepted in the United States of America (US GAAP). In those cases where US GAAP conforms to IFRS, no mention of US GAAP is made in our discussion of the difference. On the other hand, in those cases where US GAAP conforms to MFRS and not IFRS, we have mentioned US GAAP to strengthen our argument for MFRS.

1. Business Acquisition Accounting

a. Recognition of a Gain on Acquisition

Under paragraphs 34 and 36 of IFRS 3, *Business Combinations*, occasionally the fair value of the net assets acquired and liabilities assumed, pursuant to such standard, can exceed the consideration paid, resulting in a bargain purchase. In this case, if such excess remains after a thorough review of the valuation of the net assets acquired, pursuant to IFRS 3 the acquiring entity recognizes a gain in the results of operations at the acquisition date. Similarly, paragraph 23 of IAS 28, *Investments in Associates*, requires recognition of a gain on the acquisition of an associate when the fair value of the proportion of the assets and liabilities acquired is greater than the consideration paid.

Under paragraphs 76 to 78 of NIF B-7, *Business Acquisitions*, the excess in a business combination mentioned above, which is calculated in the same manner as IFRS 3, must first be applied to reduce the values assigned to long-term nonmonetary assets, beginning with intangible assets. If after reducing such assets to zero an excess still remains, such excess is recognized as a gain by the acquiring entity in the results of operations of the

period. Similarly, paragraph 13 of NIF C-7, *Investments in Associates and Other Permanent Investments*, establishes that when the fair value of the consideration paid is less than the fair value of the proportion of the acquired net assets of the associate, the latter must be adjusted to the fair value of the consideration paid.

In both cases, the fair value of the consideration paid is considered to be the fair value of the purchase transaction and, accordingly, is the value at which the net assets of the business acquired and the investment in the associate should be recorded. To recognize the net assets or the investment at an amount greater than the consideration paid results in recognizing an estimated value that is not the fair value at which the transaction was carried out.

We believe that to recognize a gain on acquisition, when in many cases such gain arises from the recognition of intangible assets in a business combination, violates the CF of MFRS, which indicates that a gain is recognized when realized in a transaction and a reliable fair value is determined, fundamentally, in a transaction between informed interested parties in a free market, as opposed to values determined by valuation experts. In this regard, the CF of MFRS establishes that upon initial recognition, the most objective economic value is the original exchange value at the time of the economic events. Additionally, the secondary characteristics of reliability, specifically veracity, faithful representation and objectivity, are affected, since a gain is recognized upon the acquisition of an asset and not when such asset generates an economic benefit through its use or disposition.

Accordingly, we recommend that IFRS 3 be revised to establish that the consideration paid must be used as the basis for the accounting recognition of the net assets acquired.

b. Valuation of Previous Holdings

Paragraph 42 of IFRS 3, *Business Combinations*, establishes that in a step acquisition of a business, upon the acquirer obtaining control of the acquired entity, the previous holdings in the acquired entity, which were valued at fair value at each respective acquisition date, are revalued to fair value at the date control is obtained, with the acquirer recognizing a gain or loss in the results of the period.

Under paragraphs 83 and 84 of NIF B-7, upon obtaining control of the acquired entity, the previous holdings are not required to be revalued to fair value, and as a result, a gain or loss is not recognized in the results of operations of the acquirer. Accordingly, the value of the consideration for holdings acquired in each step is comprised of the previously paid consideration, adjusted for the depreciation and amortization of the assets identified in each acquisition, any impairment of goodwill, and the adjustments derived from the application of the equity method of accounting to the investment held prior to obtaining control of the acquired entity.

Paragraph IN18 of NIF B-7 further indicates that to revalue such investment to fair value at the time of the business acquisition is incongruous, since such investment was already recognized at its fair value at the time each consideration was paid, thereafter adjusted for the participation in the results subsequent to each step of the acquisition. Accordingly, to try to determine a fair value of these items would be equivalent to trying to determine the value of a previously paid consideration at values different from those actually exchanged. This approach results in the recognition of additional goodwill without the payment of any consideration, offset by the recognition of a gain in the results of operations of the acquirer.

Finally and consistent with our arguments presented in the previous item, the secondary characteristics of reliability, specifically veracity, faithful representation and objectivity, are

affected, since such investment is revalued to fair value as if such value had been negotiated at the moment control was obtained, and a gain is recognized on an asset prior to such asset generating an economic benefit through its use or disposition.

Accordingly, we recommend that IFRS 3 be revised to establish that any previous holdings not be revalued to fair value but be maintained at their recorded values at the time control is obtained.

c. Recognition of Contingent Liabilities

Included in the assumed liabilities to be recognized pursuant to paragraph 23 of IFRS 3, *Business Combinations*, when valuing assumed liabilities in a business combination, are liabilities for contingencies that relate to a present obligation that arises from past events and whose fair value can be reliably measured, even when an outflow of economic resources is not considered probable. In this regard, IFRS 3 indicates that recognition of a liability in the absence of the probability of an outflow of economic resources contradicts the guidance for the recognition of contingent liabilities found in paragraph 22 of IAS 37, *Provisions and Contingent Assets and Liabilities*.

The guidance found in paragraph 39 of NIF B-7 does not allow the recognition of a provision for contingent liabilities in a business combination since, by definition, this type of obligation does not represent a probable future outflow of economic resources.

We believe that to recognize a contingent liability at the business acquisition date even though the materialization of such liability is not probable is contrary to the CF of MFRS, which states that a liability is an identifiable present obligation that is virtually unavoidable and represents a future reduction of economic benefits. It is also contrary to the CF of MFRS to recognize a liability that does not yet exist, thereby increasing goodwill by creating provisions that will be reversed into earnings since their materialization is unlikely. In fact, the recognition of such liabilities could be considered to represent the creation of hidden reserves.

Additionally, the recognition of such liabilities is contrary to the fundamental requirement for their recognition pursuant to Bulletin C-9, *Liabilities, Provisions, Contingent Assets and Liabilities and Commitments*, which indicates that contingent liabilities will be subject to continuous evaluation to determine whether their materialization has become probable. If the outflow of resources related to a contingent liability is considered probable, the corresponding provision must be recognized in the financial statements of the period in which the increase in probability of materialization occurs.

It should be noted that the recognition conditions for assets and liabilities in a business combination found in ASC 805-20-25-2 of US GAAP state "To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*, at the acquisition date." Paragraph 35 of FASB Concepts Statement No. 6 states "Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events." Accordingly, US GAAP conforms to MFRS and also differs from IFRS in this regard.

Accordingly, we recommend that IFRS 3 be revised to establish that only liabilities that represent a probable future outflow of economic resources be recognized in a business combination.

2. Deferred Income Taxes

a. *Goodwill*

Paragraph 21 of IAS 12, *Income Taxes*, does not allow recognition of deferred income taxes for the initial recognition of goodwill where the reduction of goodwill is not deductible against taxable income of the entity, even though it is recognized that a taxable temporary difference exists, either as a result of the impairment of goodwill or when the goodwill is canceled upon the sale of the businesses from which it arose. The prohibition is established because goodwill is determined as a residual, and the recognition of a deferred tax liability would increase the book value of the goodwill and such increase would also need to be tax-effected. Some have argued that recognition of the tax effects of recovering goodwill would not provide information that is particularly relevant, and the calculation often is very complex.

In Mexico and as explained in paragraphs C10 and C16 of NIF D-4, *Income Taxes*, the goodwill that arises in a business acquisition through the purchase of the shares of a subsidiary is identified with the acquisition cost of the shares. Consequently, such goodwill forms part of the tax basis of the shares of subsidiaries and, based on current Mexican tax legislation, is deductible for tax purposes since such cost will likely impact the results of operations at the time of sale of the shares. Accordingly, although no temporary difference exists at the date of acquisition, deferred income taxes are recognized in such cases under both IFRS and MFRS subsequent to the recognition of any goodwill impairment recorded for accounting purposes.

However, in Mexico when the goodwill is generated by a business acquisition via a merger, there is no shareholding that supports a tax basis in the goodwill and which might be tax deductible upon the sale of the shares, in which case a taxable temporary difference arises. Nevertheless, according to NIF D-4 no exception is provided and a corresponding deferred tax liability must be recognized. We do not believe the arguments of irrelevance and complexity are sufficient to override the CF of MFRS.

Accordingly, we recommend that IAS 12 be revised to establish that the tax effect of all temporary differences, including goodwill, be recorded even when the reduction of goodwill is not deductible.

b. *Tax Rate to Use*

For the calculation of deferred income tax assets and liabilities, paragraph 47 of IAS 12, *Income Taxes*, requires the use of the tax rates (and tax laws) that have been approved, or substantially approved, as of the date of the statement of financial position. The latter are those that the governments of some countries announce before their enactment, but which are considered to have a high probability of being enacted, based on the customs of such countries.

Existing Paragraph 4 of NIF D-4, *Income Taxes*, only allows the use of rates and laws that have been enacted as of the date of the financial statements.

It should be noted that existing MFRS conforms to ASC 740-10-30-8 of US GAAP, which also requires the use of enacted tax rates.

We are considering an improvement to NIF D-4 to require use of the substantially approved rate at the date of the financial statements, as long as such rate is enacted subsequent to the date of the financial statements but prior to issuance thereof, in which case the enactment represents an event subsequent to the date of the financial statements that provides evidence of a condition that existed at the end of the reporting period. As a result,

the substantially approved rate must be used pursuant to paragraph 8 of IAS 10, *Events After the Reporting Period*, and paragraph 6 of NIF B-13, *Events Subsequent to the Date of the Financial Statements*.

Accordingly, we recommend that IAS 12 be revised to establish that a tax rate that has only been substantially approved as of the date of the statement of financial position be used for the calculation of deferred income tax assets and liabilities, as long as such rate is enacted prior to the issuance of the financial statements. If enactment does not take place prior to issuance of the financial statements, the substantially approved rate should not be used, and the appropriate disclosures should be made.

3. Employee Benefits

a. Limit for Recognition of Projected Net Asset

Paragraph 58 of IAS 19, *Employee Benefits*, establishes a limit for the recognition of an asset when, upon determining the amount of the liability for defined benefits in accordance with such standard, a debit balance (an asset) results. Pension assets may not be recognized in excess of the net total of unrecognized past service cost and actuarial losses plus the present value of benefits available from refunds or reduction of future contributions to the plan.

NIF D-3, *Employee Benefits*, does not establish such a limitation since the legal and economic environment in Mexico in fact allows the withdrawal of plan assets. We believe that the procedure established in IAS 19 to limit the recognition of a projected net asset does not comply with the characteristic of faithful representation, which is associated with reliability, one of the primary characteristics of financial statements.

It should be noted that ASC 715 of US GAAP also places no limitation on the amount that can be recognized.

Accordingly, we recommend that IAS 19 be revised to eliminate a limit for the recognition of an asset, particularly considering the amendments proposed in ED/2010/3 on IAS 19.

b. Termination Benefits

Paragraphs 132 to 134 of IAS 19, *Employee Benefits*, establish that this standard treats termination benefits apart from other employee benefits, because the event that gives rise to such benefits is the termination of employment and not the services rendered by the employees during their employment. IAS 19 makes no distinction between special and other termination benefits.

According to IAS 19, the recognition of an expense and liability for termination benefits is made only when the entity can demonstrate that it is committed to either: a) terminate the employment with an employee or group of employees before the normal retirement date; or b) provide termination benefits as a result of having made an offer to motivate voluntary retirement. To demonstrate the entity's commitment to terminate employment, the entity must have a detailed formal plan that describes the characteristics of the termination, without any realistic possibility of being canceled.

Paragraph 33 of NIF D-3, *Employee Benefits*, establishes that termination benefits can arise in the following situations: a) termination of employment for reasons other than restructuring, and b) termination of employment due to restructuring. The requirements established by NIF D-3 for the recognition of a provision in the event of termination due to

restructuring are similar to those established in IAS 19, since, among others, it requires that the entity have a detailed formal plan to proceed with the restructuring.

However, in the case of termination of employment for reasons other than restructuring (which benefits could include, for example, statutory severance payments, bonuses or special compensation offered in exchange for voluntary retirement, seniority premiums due to death, disability, dismissal and voluntary separation before the retirement date, or substitute retirement, additional rewards and medical benefits), there is a difference from what is established in IAS 19. This occurs because NIF D-3 requires recognition of a provision for these benefits over the period of employment, including those benefits that employees expect to receive as a result of established business practices, despite not being required by Mexican law or by employment contracts. On the other hand, IAS 19 establishes that such provision is not recognized until the entity can demonstrate that it is committed to terminate employment or provide termination benefits as a result of having made an offer to motivate voluntary retirement.

The requirements of NIF D-3 for the recognition of termination benefits for reasons other than restructuring are based on NIF A-2, *Basic Principles*, with respect to:

- Accounting recognition – As these employee benefits do not assume the entity will receive any future economic benefits, the provision should be recognized as incurred, regardless of the date it is considered realized for accounting purposes.
- Matching costs and expenses with revenues – Requires the recognition of these expenses for employee benefits to achieve an adequate matching of revenues with these expenses, and in this case, the expense for these benefits contributes to the generation of revenues recognized during the period of employment, since, as indicated above, they will not generate any future economic benefits.

Additionally, paragraph 29 of NIF A-5, *Elements of Financial Statements*, requires the recognition of provisions as follows: a provision is a liability whose amount or date of occurrence are uncertain and must be recognized for accounting purposes, after considering all available evidence, when existence of the obligation is probable at the valuation date and the essential characteristics of a liability are met.

It should be noted that ASC 715-30-25-10 of US GAAP is comparable to MFRS with respect to termination benefits. US GAAP requires entities to recognize special (onetime) termination benefits generally when they are communicated to employees unless employees will render service beyond a 'minimum retention period', in which case the liability is recognized ratably over the future service period. It also requires entities to recognize contractual termination benefits when it is probable that employees will be entitled and the amount can be reasonably estimated. Finally, voluntary termination benefits are recognized when negotiated with the employee. In practice, this has resulted in the recognition of similar provisions for termination benefits under MFRS and US GAAP.

Accordingly, we recommend that IAS 19 be revised to establish that a liability for termination benefits be recognized over the period of employment, whether such liability is required by law or routinely paid as part of the existing business practice.

4. Translation of Financial Statements of Foreign Operations

- a. *Entity that Individually Prepares Financial Statements, and its Recording and Reporting Currencies are the Same, but Different from its Functional Currency*

Paragraph 17 of IAS 21, *The Effects of Changes in Foreign Exchange Rates*, establishes that when preparing financial statements, each entity must determine its functional currency; based on that determination, it will translate all foreign currency items to such functional currency. Subsequently, given the information needs of interested third parties, or including legal requirements, this standard allows the presentation of the financial statements in any reporting currency. However, if the reporting currency differs from the functional currency of the entity, its results and financial position must be translated from the functional currency to the reporting currency, in accordance with the procedures established in IAS 21.

Paragraph 18 of NIF B-15, *Translation of Foreign Currencies*, also establishes the requirement for each entity to identify its functional currency, as well as determine its reporting and recording currencies; the preparation of financial statements is also based on the functional currency.

Based on the above, NIF B-15 requires that first a translation from the recording to the functional currency be made, and from there translated to the reporting currency. Nevertheless, when the financial statements of the entity are neither subject to consolidation nor the basis for the valuation of investments under the equity method and its reporting and recording currencies are the same, NIF B-15 allows such entity, even though its functional currency differs from its recording and reporting currency, not to translate its financial statements from its recording to functional currency and then back to the reporting currency, resulting in the recording currency financial statements being those in which it reports. This exception represents a difference with IAS 21, which does not contemplate such exception.

For example, if the recording and reporting currencies of an entity, which is neither subject to consolidation nor the basis for the valuation of investments under the equity method, are the Mexican peso, and its functional currency is the U.S. dollar, when issuing its financial information with a Mexican peso reporting currency, under NIF B-15 the entity is not required to translate from the recording currency (the Mexican peso) to the functional currency (U.S. dollar), and subsequently translate from the functional currency (U.S. dollar) back to the reporting currency (Mexican peso), which is required by IAS 21.

The reasons for the exception in NIF B-15 are included in paragraphs BC18 and BC19 of the basis for conclusions of such standard as follows:

- During the exposure process of NIF B-15, different interested parties requested that the standard specify whether it is acceptable to present financial statements in the recording currency without going through the process of translating to the functional currency, when the latter differs from the recording currency, particularly where the local financial statements are prepared primarily for use by the local tax authorities.
- CINIF included a paragraph stating that in those cases where the functional currency differs from the recording currency, the financial statements must be translated in accordance with the standard. Nevertheless, in those cases where the entity is neither subject to consolidation nor valuation under the equity method and its reporting and recording currencies are the same, but different from its functional currency, the reporting currency may be the recording currency without going through the process of translating to the functional currency. This exception is allowed for practical purposes, but also because the recording currency is considered to include the effects of changes in the functional currency exchange rate.

The practicality mentioned above is based on the cost-benefit relationship discussed in paragraphs 42 and 43 of NIF A-4:

- Financial information is useful in the decision-making process, but at the same time its preparation involves the generation of costs.
- The benefits derived from the information should exceed the cost of its preparation. The evaluation of benefits and costs requires considerable professional judgment. The issuers of financial reporting standards, the preparers of financial statements, as well as general users, should be aware of such restriction.

The primary reason different interested parties requested the inclusion of such exception in the standard is the cost-benefit relationship, since in those cases consolidated financial statements are not prepared and they are not required to value an investment in the entity under the equity method, the financial statements of the entity prepared in Mexican pesos are used primarily for legal and tax purposes.

Accordingly, we recommend that IAS 21 be revised to include this exception.

b. Accounting for Changes in Accounting Derived from the Initial Application of IAS 21 and NIF B-15

Paragraph 6 of IAS 21, *The Effects of Changes in Foreign Exchange Rates*, establishes that with the exception of the guidance in its paragraph 47, any change resulting from the application of this standard will be accounted for in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, in other words, retrospectively. Paragraph 47 of IAS 21 refers to the accounting for the goodwill that arises in the acquisition of a foreign operation and the accounting for any adjustments to the fair value of the assets and liabilities obtained in the acquisition of such foreign operation, which are done prospectively.

On the other hand, paragraph 53 of NIF B-15, *Translation of Foreign Currencies*, which went into effect in 2008, establishes that, with the exception of a change in reporting currency, any accounting changes derived from its application must be accounted for prospectively. This prospective treatment was established partially due to the simultaneous effective date of NIF B-10, *The Effects of Inflation*, which discontinued the recognition of the effects of inflation in Mexico on a prospective basis.

During the exposure process of NIF B-15, comments were received generally indicating that retrospective application of the new standard was impractical, particularly when certain entities routinely present comparative financial statements for various periods. Considering the cost-benefit relationship, one of the restrictions of qualitative characteristics of financial information according to NIF A-4, *Qualitative Characteristics of Financial Statements*, CINIF established that the accounting changes resulting from the initial application of a standard such as NIF B-15 must be recognized on a prospective basis.

Accordingly, CINIF believes that foreign operations that, in accordance with MFRS, restated their financial statements for the effects of inflation through December 2007, to prepare their 2008 financial statements the most appropriate approach is to:

- a) Determine the opening balances of 2008 in the functional currency, by converting the accounting balances in the recording currency using the exchange rate in effect at the end of December 2007.
- b) Determine the ending balances of 2008 in the functional currency by applying the methodology for the translation from the recording to the functional currency established in NIF B-15. For nonmonetary items originating in December 2007 or

earlier, the historical exchange rate is the rate as of December 31, 2007, the initial translation date pursuant to NIF B-15.

For presentation purposes, the financial statements for periods prior to January 2008 must be presented as originally issued, in accordance with the MFRS in effect on the corresponding dates, without any modifications or adjustments and with the appropriate disclosures.

We observe that the impracticality of retrospective application of IAS 21 is recognized in IFRS 1, *First-time Adoption of International Financial Reporting Standards*, in both Appendix C2, *Exemptions for Business Combinations*; and Appendix D13, *Exemptions from Other IFRS*.

It should be noted that the transitional guidance in FAS 52 of US GAAP allowed, but did not require, retrospective application of such standard to prior periods. If the prior year was restated, disclosure of the nature of the restatement and its effects was required. If the prior year was not restated, disclosure of income before extraordinary items and net income for the prior year computed on a pro forma basis was permitted.

Accordingly, we recommend that IAS 21 be revised to allow for its initial application on a prospective basis.

c. Presentation of Consolidated Financial Statements of Prior Periods for Comparative Purposes

For the presentation of comparative financial statements of prior periods, paragraph 34 of IAS 21, *The Effects of Changes in Foreign Exchange Rates*, establishes that first the financial statements of a foreign operation in a hyperinflationary economy are restated for the effects of inflation using a general price index that reflects the changes in purchasing power of the functional currency of the foreign operation, and subsequently they are translated to the reporting currency of the parent company, which differs from its functional currency, using the closing exchange rate as of the date of the latest statement of financial position presented.

According to paragraph 50 of NIF B-15, the comparative financial statements must be presented in units of purchasing power as of the date of the latest statement of financial position presented, considering the price index of the economic environment of the reporting entity (the parent company), in other words, not considering the price index of the economic environment of the foreign operation.

The approach for the presentation of consolidated financial statements presented for comparative purposes differs, since IAS 21 considers the perspective of the individual foreign operation, unless the economic environment of the reporting entity is non-hyperinflationary, in which case comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial statements. In other words, under both MFRS and IFRS, if the economic environment of the reporting entity is not subject to inflation accounting, the amounts included for the foreign operation in the comparative consolidated financial statements are not restated for the effects of inflation regardless of the level of inflation in the economy of the foreign operation.

On the other hand, NIF B-15 gives preeminence to the consolidated reporting entity and its economic environment, whether it is inflationary or not.

As a result, there is a difference in the presentation of comparative consolidated financial statements of prior periods when: a) the economic environment of the parent company is

hyperinflationary (inflationary under NIF B-10, *Effects of Inflation*) and that of its foreign operation is non-hyperinflationary, and b) the economic environments of the parent company and its foreign operation are both hyperinflationary.

The difference in case a):

Based on paragraphs 34 and 42(b) of IAS 21, the comparative amounts of prior periods of the foreign operation are those that were previously presented as current amounts. Based on NIF B-15, such prior period amounts must be restated as part of the consolidated financial statements using the inflation of the reporting entity.

The difference in case b):

Based on paragraphs 34, 42(a) and 43 of IAS 21, the comparative amounts of prior periods of the foreign operation must be restated for inflation in accordance with IAS 29, *Financial Reporting in Hyperinflationary Economies*, before translation using the rate of inflation of the economy of the foreign operation. Based on NIF B-15, such prior period amounts must be restated as part of the consolidated financial statements recognizing the inflation of the reporting entity.

Based on the basic economic entity principle of NIF A-2, *Basic Principles*, CINIF believes that the approach to be used for the presentation of consolidated financial statements of prior periods presented for comparative purposes should give preeminence to the financial information of the consolidated reporting entity, and, in the event its economic environment is inflationary, recognize its effect on the comparative financial statements using the price index of the economic environment of the reporting entity. By not considering the perspective of the individual foreign operation, the previously recognized translation of the financial statements of the foreign operation is updated, and the previously issued information is maintained.

It should be noted that while US GAAP does not specifically address this issue, the Securities and Exchange Commission (SEC) has interpreted US GAAP to conform to current MFRS. Appendix A to the SEC guidance on *International Financial Reporting and Disclosure Issues in the Division of Corporation Finance* addresses country specific issues and states that the methodology prescribed by IFRS requiring companies to report the assets and operations of consolidated foreign operations by price-level adjusting the accounts based on the inflation rate in the foreign country, then translating into the reporting currency using the year-end exchange rate, including comparative periods, is not consistent with (1) a comprehensive basis of price-level adjusted accounting, and (2) the requirement of Rule 3-20(e) of SEC Regulation S-X to present financial statements for all periods in the same reporting currency.

Accordingly, we recommend that IAS 21 be revised to establish that comparative financial statements be presented in units of purchasing power as of the date of the latest statement of financial position presented, considering the price index of the economic environment of the reporting entity only.

5. Valuation of Residual Interests

Valuation of Residual Interest in a Subsidiary or Associate Upon the Loss of Control or Significant Influence and Recognition of a Gain or Loss

Under paragraph 34 of IAS 27, *Consolidated and Separate Financial Statements*, upon loss of control of a subsidiary, the residual interest is valued at fair value at the date of loss of control. Similarly, in accordance with paragraph 18 of IAS 28, *Investments in Associates*,

upon the loss of significant influence in an associate, the residual interest is valued at fair value on the date of loss of significant influence, unless the associate becomes a subsidiary or a joint venture. The effect of such valuation is recognized in the holding company's results of operations of the period as a gain or loss. Neither IAS 27 nor IAS 28 contemplate the concept of other permanent investments similar to that established in NIF C-7, *Investments in Associates and Other Permanent Investments*, as explained below.

Paragraph 49 of NIF B-8, *Consolidated or Combined Financial Statements*, and paragraph 42 of NIF C-7 establish that upon the loss of control of a subsidiary or significant influence in an associate, respectively, the residual interest must be analyzed to identify its new characteristics and be valued in accordance with the standard applicable to the new type of investment. If based on such analysis it is concluded that the residual interest is an investment in an associate or qualifies as other permanent investments, NIF C-7 must be applied, which in the first instance would require use of the equity method and in the second the cost method.

Accordingly, the initial measurement in these two possible cases of a new permanent investment upon loss of control of the subsidiary or significant influence in the associate, is based on the equity method; in other words, it is the same amount at which the residual interest was valued when it formed part of the investment in the former subsidiary or associate. In neither case would the results of operations of the holding company be impacted by changes in the fair value of the residual interest. This represents a difference from both IAS 27 and IAS 28, as explained above.

On the other hand, if based on the analysis mentioned above it is concluded that the residual interest represents a financial instrument available for sale or held for trading, Bulletin C-2, *Financial Instruments*, must be applied.

In both cases, the new permanent investment for the residual interest is valued at fair value, but the effect of such valuation is recognized in other comprehensive income in the case of an available for sale financial instrument, and in the case of a held for trading financial instrument is recognized in earnings. Upon sale of the available for sale financial instrument, the effect recognized in other comprehensive income is reclassified to earnings of the corresponding period. As a result, in the case of an available for sale financial instrument, there is a difference from both IAS 27 and IAS 28.

The recognition of a gain or loss for the valuation of the residual interest in a subsidiary over which control has been lost or associate in which significant influence has been lost does not comply with the CF of MFRS, which indicates that a gain or loss is recognized when it is earned upon the occurrence of a transaction, and in this case there has been no transaction associated with the residual interest.

Additionally, CINIF believes it is inappropriate, when there is no intent to dispose of the residual interest, to value such interest at fair value and recognize a resulting gain or loss, since fair value, by definition, is a negotiated value.

If the original intent to retain the residual interest is changed to a plan to dispose of the investment, the investment qualifies as a financial instrument available for sale or held for trading to be valued at fair value in accordance with Bulletin C-2.

Accordingly, we recommend that IAS 27 and IAS 28 be revised to establish that upon the loss of control of a subsidiary or significant influence in an associate, any residual interest not automatically be valued at fair value but rather be analyzed to identify its new characteristics and be valued in accordance with the standard applicable to the new type of investment.

6. Capitalization of Financing Costs

Elements to Capitalize

In accordance with paragraph 12 of IAS 23, *Borrowing Costs*, the interest earned on funds borrowed under specific loans that are invested before being used for the acquisition of a qualifying asset, is deducted from the interest incurred on such specific loans and the net amount is capitalized.

Under paragraph 9 of NIF D-6, *Capitalization of Comprehensive Financing Result*, the capitalizable amount does not include interest incurred on borrowings not applied to the qualifying asset and, accordingly, is not reduced by any earned interest on unused borrowings. Only the interest incurred on borrowings applied to the qualifying asset are capitalized.

Further, paragraph 9 of NIF D-6 requires capitalization of the comprehensive financing result, which in the case of borrowings in foreign currency includes foreign exchange gains and losses, and in the case of entities operating in inflationary environments, the related gain on monetary position. Additionally, the capitalization of net financing income is considered, in the event the foreign exchange (and monetary position, if applicable) gain exceeds the interest expense on the foreign currency borrowing.

Paragraph 6 of IAS 23 recognizes that borrowing costs can include exchange gains and losses of foreign borrowings to the extent they are considered an adjustment of the effective interest rate. Further, although not specifically addressed in IAS 23, we believe that any gain on monetary position recorded, when an entity operates in a hyperinflationary environment and consequently applies IAS 29, *Financial Reporting in Hyperinflationary Economies*, should be deducted from capitalizable interest, resulting in capitalization of the real, not nominal, interest rate. Finally, IAS 23 does not contemplate the capitalization of net financing income.

NIF D-6 does not allow offsetting interest earned on unused borrowings with the interest incurred on direct financing, because such interest earned represents a recovery of interest incurred on unused borrowings. Such interest income should be properly recognized in the results of operations, since both the interest earned and the interest incurred on unused borrowings are not yet associated with the acquisition of the qualifying asset. This conforms to NIF A-2, *Basic Principles*, which indicates that the costs and expenses of an entity must be matched with the income they generate in the same period. Additionally, to do otherwise would be inconsistent since the capitalizable comprehensive financing result would be a function of the borrowing and not the investment, as proposed by NIF D-6.

Accordingly, the same accounting treatment must be applied to both specific and general financing, as similar transactions, in accordance with the basic principle of consistency established in NIF A-2. Consequently, NIF D-6 establishes that interest earned on investments derived from borrowings not used for the acquisition of a qualifying asset is not part of capitalized comprehensive financing result.

The treatment of these items under ASC 835-20-30 of US GAAP is as follows:

- Interest incurred on borrowings not applied to the qualifying asset – Such interest is not capitalizable. This conforms to MFRS.

- Interest earned on unused borrowings – The offsetting of interest income against interest cost is not appropriate except in very limited circumstances. This conforms to MFRS.
- Foreign exchange gains and losses on foreign debt – The capitalization of this item is not contemplated. This differs from both IFRS and MFRS.
- Net financing income – Consistent with IFRS, this is not contemplated.

Accordingly, we recommend that IAS 23 be revised to establish that the capitalizable interest not include interest incurred on borrowings not applied to the qualifying asset and, as a result, not be reduced by any earned interest on unused borrowings.

7. Unconsolidated Financial Statements

a. Situations in which the Preparation of Consolidated Financial Statements is Not Required

Both paragraph 10 of IAS 27, *Consolidated and Separate Financial Statements*, and paragraph 52 of NIF B-8, *Consolidated or Combined Financial Statements*, allow a holding company, which in turn is a subsidiary (a subholding company), subject to certain conditions, to not present consolidated financial statements. However, one of the conditions is different, since IAS 27 requires that the ultimate holding company of the group or another intermediate holding company of the subholding company in question, prepare consolidated financial statements under IFRS that are available for public use. NIF B-8, on the other hand, requires that the subholding company not issue external use financial statements for economic decision making purposes.

CINIF believes that to require the ultimate holding company of the group or another intermediate holding company of the subholding company to prepare consolidated financial statements under MFRS would impact the cost-benefit relationship, which is one of the restrictions of the qualitative characteristics of financial statements according to NIF A-4. In accordance with this relationship, the benefits derived from the information should exceed the cost of its preparation. The evaluation of benefits and costs requires considerable professional judgment.

In Mexico, there are certain holding companies (subholding companies) that, in turn, are subsidiaries of foreign entities that do not issue financial statements under MFRS or IFRS, but rather under the financial reporting standards of the country in which they are located. In this case, such subholding companies would not meet the IAS 27 condition that their holding company issue financial statements under MFRS or IFRS and could not elect to present unconsolidated financial statements. As a result and considering that these subholding companies are not the economic decision makers within the economic entity, and which frequently issue financial statements only for legal purposes, NIF B-8 is different from IFRS with respect to the conditions for presenting unconsolidated financial statements.

CINIF considers the preceding arguments to be valid, not only because the possibility of not consolidating permits more practical issuance of financial information by subsidiaries of foreign entities, but also because, in reality, an intermediate holding company does not have sole control of the economic entity that must be consolidated.

The above position is supported by the cost-benefit relationship:

- Financial information is useful in the decision-making process, but at the same time its preparation involves the generation of costs.
- The benefits derived from the information should exceed the cost of its preparation. The evaluation of benefits and costs requires considerable professional judgment. The issuers of financial reporting standards, the preparers of financial statements, as well as general users, should be aware of such restriction.

ASC 810 of US GAAP does not provide any exemption from the requirement to prepare consolidated financial statements.

Accordingly, we recommend that with respect to the conditions for not presenting consolidated financial statements IAS 27 be revised to eliminate the requirement that the ultimate holding company of the group or another intermediate holding company of the subholding company in question, prepare consolidated financial statements under IFRS that are available for public use, and that instead it require that the subholding company not issue external use financial statements for economic decision making purposes.

b. Valuation of Investments in Associates and Unconsolidated Subsidiaries in Unconsolidated Financial Statements of a Holding Company

Paragraph 38 of IAS 27, *Consolidated and Separate Financial Statements*, establishes that the valuation of investments in subsidiaries, associates and joint ventures in the unconsolidated financial statements of a holding company are valued either at cost or in accordance with IAS 39, *Financial Instruments: Recognition and Measurement*, at fair value. Further, paragraph 35 of IAS 28, *Investments in Associates*, and paragraph 46 of IAS 31, *Interests in Joint Ventures*, both refer to the guidance in IAS 27 when dealing with separate unconsolidated financial statements and therefore also require valuation of such investments at either at cost or in accordance with IAS 39 in separate unconsolidated financial statements.

Paragraph 55 of NIF B-8, *Consolidated or Combined Financial Statements*, establishes that the valuation of investments in subsidiaries in unconsolidated financial statements is done using the equity method. Further, paragraph 17 of NIF C-7, *Investments in Associates and Other Permanent Investments*, establishes that in general investments in associates must be recognized using the equity method.

CINIF believes that to not present investments in subsidiaries, associates and joint ventures with the effects derived from the use of the equity method causes the financial information to be unreliable as a result of not complying with the characteristic of faithful representation established in NIF A-4, *Qualitative Characteristics of Financial Statements*, since such information could, for example, fail to reflect significant income and expenses and changes in equity of the subsidiaries and associates. Additionally, the separate unconsolidated financial statements serve as the basis for the declaration and approval of dividends, as well as the minimum capital requirement, and therefore must reflect the results of all investments in subsidiaries, jointly controlled entities and associates. Accordingly, this creates a difference between NIF B-8 and IAS 27, as well as between NIF C-7 and IAS 28.

It should be noted that ASC 323-10-05-4 & 5 of US GAAP state that the equity method of accounting more closely meets the objectives of accrual accounting than does the cost method because the investor recognizes its share of the earnings and losses of the investee in the periods in which they are reflected in the accounts of the investee in those cases where an investment enables the investor to influence the operating or financial decisions of the investee. The investor then has a degree of responsibility for the return on

its investment, and it is appropriate to include its share of the earnings or losses of the investee in the results of operations of the investor. This supports MFRS.

Accordingly, we recommend that IAS 27 be revised to allow use of the equity method in separate unconsolidated financial statements.

8. Other Permanent Investments

Valuation

IAS 28, *Investments in Associates*, does not include a classification of “other permanent investments” as does paragraph 3 of NIF C-7, *Investments in Associates and Other Permanent Investments*, which are defined as those investments held by a holding company in entities over which it does not exercise control, joint control or significant influence; these are valued at acquisition cost. In accordance with IAS 39, *Financial Instruments: Recognition and Measurement*, these investments are recognized as available for sale financial instruments and valued at fair value; in only certain circumstances are they valued at acquisition cost, as in the case of equity instruments with no observable market price because they are not traded in an active market and whose fair value cannot be reliably determined.

CINIF believes that these types of investments are not held with the intent to sell but rather hold them indefinitely, as a result of which it would be inappropriate to value them at fair value, which is a negotiated price. Accordingly, paragraphs 53 and 54 of NIF C-7 establish that other permanent investments should be classified in one of the other investment categories, be valued at acquisition cost, and, as appropriate, when impairment indicators exist, apply the standard that addresses the impairment of long-lived assets.

The valuation of these investments at fair value impacts the reliability of financial information (a qualitative characteristic of financial information) in one of its secondary characteristics, faithful representation, which indicates that for the faithful representation of financial information, there must be agreement between its content and the underlying transactions, internal transformations and events that have economically impacted the entity, since there would be recognition of the results of valuation of other permanent investments at fair value, when the intent is to hold them indefinitely.

Accordingly, we recommend that IAS 28 be revised to address the accounting for other permanent investments and require their valuation at acquisition cost, and, as appropriate, when impairment indicators exist, require application of the standard that addresses impairment.

9. Inflation

Recognition of its Effects in Financial Statements

In accordance with IAS 29, *Financial Reporting in Hyperinflationary Economies*, the effects of inflation on financial information must be recognized in the financial statements of an entity whose functional currency is that of a hyperinflationary economy, which is identified by various characteristics of the economic environment of the country.

Of the various characteristics presented in paragraph 3 of IAS 29, the most objective parameter for the classification of an economy as hyperinflationary is when the cumulative inflation rate over the prior three years is approaching or exceeds 100%.

Under paragraph 3 of NIF B-10, *The Effects of Inflation*, the effects of inflation in financial information must be recognized once an economy is classified as inflationary, that is, when the cumulative inflation during the prior three years equals or exceeds 26%. Accordingly, the effects of inflation on financial information are recognized at lower levels of inflation than under IAS 29.

The CF of MFRS establishes that the effects of inflation, not just hyperinflation, that impact the entity must be recognized. Consequently, NIF B-10 requires recognition of the effects of inflation in financial information when such effects are considered to be significant, which occurs when the cumulative inflation equals or exceeds 26% in the prior three years. This complies with the characteristic of faithful representation established in NIF A-4, *Qualitative Characteristics of Financial Statements*, which indicates that for the faithful representation of financial information, there must be agreement between its content and the underlying transactions, internal transformations and events that have economically impacted the entity.

The basis for the percentage used in NIF B-10 is explained in the following extract of the basis for conclusions of that standard:

- For the purpose of adequately establishing the percentage of inflation to classify each economic environment, CINIF carried out a study of entities in different industries. Such study consisted of analyzing the impact of different levels of inflation on the more significant financial indicators of the entities, such as: profitability, efficiency, operating and financial leverage, as well as return on investment, among others; these financial indicators were selected because they involve those accounts and balances most significantly impacted by inflation.
- The results of the study indicated that with the recognition of the effects of annual inflation of approximately 8%, the financial indicators of the entities can deviate up to 35% over the information without such recognition.

Accordingly, we recommend that IAS 29 be revised to establish that the comprehensive effects of inflation be recognized in financial information when an economy is deemed to be inflationary, not just hyperinflationary.

10. Non-application of a Particular Standard of IFRS

Management Exception

Paragraph 19 of IAS 1, *Presentation of Financial Statements*, provides the requirements to be met for the extremely rare case in which the management of the reporting entity deviates from compliance with some standard of IFRS when such management believes the requirements of such standard conflict with the objective of the financial statements according to the CF of the IASB. Even though this disposition is only for exceptional situations, MFRS does not allow any exceptions to compliance with existing standards.

The CF of the IASB is intended, among other things, to assist preparers of financial statements with the application of IFRS and deal with topics that have not yet been the subject of any specific standard of IFRS. The CF of the IASB does not address any specific measurement or disclosure matters. The IASC recognizes that, in a limited number of cases, conflicts between the CF of the IASB and some standard or interpretation of IFRS may arise.

The CF of MFRS consists of eight standards in Series A, which represent the theoretical foundation that provides rational support for MFRS. Upon publication of the CF of MFRS

that went into effect in 2006, its mandatory and authoritative character since that date was confirmed.

Accordingly, since MFRS is a set of principles and not rules, they must be understood together with the authoritative CF, as indicated in each standard of MFRS. To allow management to elect noncompliance with a particular standard of MFRS, even in extremely rare cases, would represent a situation not supported by MFRS.

It should be noted that ASC 105-10-05-6 of US GAAP only provides for deviation from the provisions of the Codification of US GAAP for immaterial items and, like MFRS, does not contemplate the management exception of IFRS.

Accordingly, we recommend that the management exception contemplated in IAS 1 be eliminated.

Summary

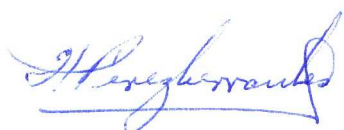
As mentioned at the beginning of this letter, the goal of CINIF is full convergence of MFRS with IFRS and we recognize that this will require revising some of the current standards of MFRS. On the other hand, we believe the differences presented in this letter include those supported by the CF of MFRS for which CINIF believes that convergence can and should be achieved by the IASB reconsidering its position and revising of some of its standards.

It should be noted that US GAAP supports the position of MFRS in 50% of the differences presented above. While we do not believe the support of the FASB is required to defend our point of view, we nevertheless believe it is relevant and worth consideration.

We believe it is appropriate to address this letter directly to you, Wayne, since we have previously discussed several of these items with you in the past. In fact, you have commented to us that we are not alone with respect to our opinion on some of the items discussed herein. Accordingly, we consider it most efficient to go directly to you with our concerns.

Should you require additional information on our comments listed above, please contact William A. Biese at (52) 55 5596 5633 ext. 113 or me at (52) 55 5596 5633 ext. 103 or by e-mail at wbiese@cinif.org.mx or fperezcervantes@cinif.org.mx, respectively.

Sincerely,



C.P.C. Felipe Perez Cervantes
President of the Mexican Financial Reporting Standards Board
Consejo Mexicano para la Investigación y Desarrollo
de Normas de Información Financiera (CINIF)

cc: Sir David Tweedie
Jan Engström
Amaro Gomes