BRITISH AMERICAN TOBACCO

CELEBRATING A CENTURY OF EXCELLENCE

13 September 2002

The Technical Director
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London WC1X 8AL

Globe House
4 Temple Place
London WC2R 2PG

Dear Sir

International Standards Board's Improvements Project

We have reviewed the exposure drafts, FRED23 to FRED29, and the consultation paper which were issued in May this year by the ASB with regard to the above project being undertaken by the IASB.

We have attached as separate appendices our responses to the questions for which comments were requested as well as other issues on each of these eight documents. In the main you will see that we are broadly in agreement with the changes being proposed so far to incorporate international standards into UK GAAP. However we are concerned about the approach that the Board is taking over the timing of the introduction of these changes. We would suggest that a better strategy would be to introduce all the necessary changes at the same time.

Whilst we believe that the Board should continue to publish the necessary exposure drafts for comment in an orderly fashion, we would recommend that the resultant UK standards should all state that their effective date of implementation is 1 January 2005. In addition the Board should consider suspending its current policy of encouraging early adoption of standards to avoid the confusion referred to below.

As interested parties all seem to agree, the 2005 deadline is a tight deadline. It is our opinion that, from a practical viewpoint, requiring reporting entities to change accounting policies every year up to 2005 is not the best option. Some of the current proposals admit that certain aspects of the relevant international standards may change before 2005, leading to further changes in the UK standards. In addition there are changes required in UK Company Law before certain international requirements can be adopted.

We believe that three years of change in published accounts towards what is still a moving target will be confusing for both preparers and all users. It would be more useful and productive to report 2002, 2003 and 2004 on a consistent basis, while companies work towards one change in 2005.

Other considerations include the question of whether transitional arrangements are necessary. Given that the IASB has recently issued an exposure draft specifically dealing with first-time application of IFRSs, deferral of the implementation of the new UK standards will presumably avoid the Board having to address this question. The transition can then be dealt with in 2005 on the basis of the standard resulting from the current IASB exposure draft.

In addition to this concern over the Board's strategy, there are a number of issues pertaining to the individual documents published by the Board which we wish to highlight. These are set out below with reference to the relevant exposure draft.

FRED23 If our view on the approach to the adoption of international standards into UK GAAP is accepted, then we see no need for a standard on hedge accounting at this time. FRED3O has already been published for comment and the resultant standards will cover this accounting area.

FRED24 The Board has apparently ignored UITF9's alternative approaches, in particular the use of a stable currency as the functional currency, in proposing the adoption of IAS29 unchanged as well as the revised IAS21. We believe it is misguided to assume that there is one right and precise answer in the various and volatile environments that are present in high inflationary economies around the world. We believe that the Board should discuss with the TASB the possibility of revising IAS21 and IAS29 before the 2005 deadline.

FRED26 In proposing to replace FRS 14 with the revised IAS33, we note that it will no longer be possible to show additional per share amounts on the face of the profit and loss account; We are most concerned at what we regard to be a retrograde step for users as well as preparers and would ask that the Board discuss with the IASB incorporating FRS 14's approach of allowing such additional amounts into the revised IAS33.

In summary, whilst we fully support the Board's intention to pursue its programme of convergence with IFRSs, we would ask that serious consideration be given to delaying the implementation date of the necessary new UK standards to 1 January 2005. As we have said above, we would not want this to delay the programme of exposing and agreeing these standards as we believe that preparers in the UK should be given as much time as possible to make the necessary changes to be able to produce their financial statements in accordance with IFRSs in 2005.

We hope that you find our comments useful and thank you for giving us the opportunity to comment on the Board's proposals.

Yours faithfully

D C POTTER
Head of Finance and Accounting

Earnings per share (FRED 26)

The ASB would welcome comments in particular on the following:

ASB (i) Do you agree with the proposal to issue a new UK standard on earnings per share to replace FRS 14, as soon as the new IAS 33 is approved by the IASB?

We do not agree with the proposal. We would prefer that changes to the existing standard (FRS14) should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.

ASB (ii) Do you believe that ASB should consider any other transitional arrangements?

If the Board agrees to defer implementation of the proposals, the question of transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

ASB (iii) Are there any aspects of the draft standard that the ASB should request the **IASB to** review when finalising the revised IAS 33?

We are most concerned that the IASB's proposals do not allow for the presentation of additional per share amounts on the face of the profit and loss account, especially as such measures may be what management and users focus on. We would suggest that the IASB should consider adopting FRS14's approach of allowing such additional amounts, having regard to their relevant prominence.

The IASB has asked commentators to respond to the following question on the proposed changes to IAS 33:

IASB (i) Do you agree that contracts that may be settled either in ordinary shares or in cash, at the issuer's option, should be included as potential ordinary shares in the calculation of diluted earnings per share based on a rebuttable presumption that the contracts will be settled in shares?

We agree with these proposals.

IASB (ii) Do you agree with the following approach to the year-to-date calculation of diluted earnings per share (as illustrated in Appendix B, examples 7 and 12)?

- The number of potential ordinary shares is a year-to-date weighted average of the number of potential ordinary shares included in each interim diluted earnings per share calculation, rather than a year-to-date weighted average of the number of potential ordinary shares weighted for the period they were outstanding (ie without regard for the diluted earnings per share information reported during the interim periods).

- The number of potential ordinary shares is computed using the average market price during the interim periods reported upon, rather than using the average market price during the year-to-date period.

- Contingently issuable shares are weighted for the interim periods in which they were included in the computation of diluted earnings per share, rather than being included in the computation of diluted earnings per share (if the conditions are satisfied) from the beginning of the year-to-date reporting period (or from the date of the contingent share agreement, if later).

We do not agree with the above approach in that we would prefer to compute the number of potential ordinary shares using the average market price during the year-to date period.

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Whilst we believe that the Board should continue to publish the necessary exposure drafts for comment in an orderly fashion, we would recommend that the resultant UK standards should all state that their effective date of implementation is 1 January 2005. In addition the Board should consider suspending its current policy of encouraging early adoption of standards to avoid the confusion referred to below.

As interested parties all seem to agree, the 2005 deadline is a tight deadline. It is our opinion that, from a practical viewpoint, requiring reporting entities to change accounting policies every year up to 2005 is not the best option. Some of the current proposals admit that certain aspects of the relevant international standards may change before 2005, leading to further changes in the UK standards. In addition there are changes required in UK Company Law before certain international requirements can be adopted.

We believe that three years of change in published accounts towards what is still a moving target will be confusing for both preparers and all users. It would be more useful and productive to report 2002, 2003 and 2004 on a consistent basis, while companies work towards one change in 2005.

Other considerations include the question of whether transitional arrangements are necessary. Given that the IASB has recently issued an exposure draft specifically dealing with first-time application of IFRSs, deferral of the implementation of the new UK standards will presumably avoid the Board having to address this question. The transition can then be dealt with in 2005 on the basis of the standard resulting from the current IASB exposure draft.

In addition to this concern over the Board's strategy, there are a number of issues pertaining to the individual documents published by the Board which we wish to highlight. These are set out below with reference to the relevant exposure draft.

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FRED24 The Board has apparently ignored UITF9's alternative approaches, in particular the use of a stable currency as the functional currency, in proposing the adoption of IAS29 unchanged as well as the revised IAS21. We believe it is misguided to assume that there is one right and precise answer in the various and volatile environments that are present in high inflationary economies around the world. We believe that the Board should discuss with the IASB the possibility of revising IAS2 1 and IAS29 before the 2005 deadline.

FRED26 In proposing to replace FRS 14 with the revised IAS33 we note that it will no longer be possible to show additional per share amounts on the face of the profit and loss account. We are most concerned at what we regard to be a retrograde step for users as well as preparers and would ask that the Board discuss with the IASB incorporating FRS 14's approach of allowing such additional amounts into the revised IAS33.

In summary, whilst we fully support the Board's intention to pursue its programme of convergence with IFRSs, we would ask that serious consideration be given to delaying the implementation date of the necessary new UK standards to 1 January 2005. As we have said above, we would not want this to delay the programme of exposing and agreeing these standards as we believe that preparers in the UK should be given as much time as possible to make the necessary changes to be able to produce their financial statements in accordance with IFRSs in 2005.

We hope that you find our comments useful and thank you for giving us the opportunity to comment on the Board's proposals.

Yours faithfully

D C POTTER
Head of Finance and Accounting

Financial Instruments: Hedge Accounting (FRED 23)

Particular issues on which comments are invited:

Do you agree that a UK standard on hedge accounting is needed at this time to improve UK accounting and to prevent a gap appearing in UK accounting literature on hedges of net investments in foreign operations?

The "gap in UK accounting literature" presumably arises if SSAP2O is replaced by the proposals contained in FRED24. In our response to that exposure draft you will see that we do not agree with the implementation timetable proposed in FRED24 which is the only reason for the gap. Also while it may be necessary to improve accounting standards in this area, for the reasons noted in our covering letter we believe this should be part of the total change to IAS in 2005. This is preferable to undertaking a number of changes towards what is a moving target.

2 The ASB has taken the view that, in order to start the process of bringing UK practice on hedge accounting into line with the practice adopted internationally, the proposed UK standard's restrictions on the use of hedge accounting should be based on the main principle that underlies the hedge accounting restrictions in IAS 39: that hedge accounting should be permitted only if the hedging relationship is pre-designated and meets certain effectiveness criteria.

(a) Do you agree that the UK standard should be based on the principles underlying IAS 39 as set out in the FRED?

(b) Does the principle need to be supplemented by any other principles?

While it is logical to follow the international standard as part of convergence, we believe this area should be addressed as part of a subsequent consideration of the changes necessary for IAS32 and IAS39 once the IASB has finalised its review of these standards.

3 The ASB has taken the view that the UK standard should contain those detailed restrictions in IAS 39 that appear to it to be necessary to implement the aforementioned principle, but should not at this stage include any other restrictions on the use of hedge accounting.

(a) Do you agree that the FRED's proposed restrictions on the use of hedge accounting (see paragraphs 4, 6 and 8 of the FRED) are all necessary to implement the aforementioned principle?

(b) Do you believe that the FRED should not contain any other restrictions on the use of hedge accounting? If not, what should those other restrictions be?

As in Q2 above.

4 Do you agree with the material in the FRED on measuring hedge effectiveness (see paragraphs 9-15 of the FRED)? If you do not, what if any changes would you make to the material (bearing in mind that the material is drawn largely from IAS 39 and that one objective of the FRED is to bring about convergence of accounting practice)?

We would agree that any subsequent UK standard should include guidance on measuring hedge effectiveness that is consistent with that included in IAS39

5 The ASB has taken the view that, in the main, the proposed FRS should not prescribe how hedge accounting should be done. Do you agree with this approach?

Again as in Q2 above.

6 The ASB has nevertheless decided that the FRED should propose some minimum requirements on the hedge accounting techniques to be used. Do you agree with the FRED's proposals on:

(a) the treatment of hedges of net investments in foreign operations (see paragraph 16(a) of the FRED)?

(b) the treatment of the ineffective portion of a gain or loss on a hedge that is not a hedge of a net investment in a foreign operation (see paragraph 16(b) of the FRED)?

(c) the treatment of hedging instruments that cease to qualify for hedge accounting (see paragraphs 17 and 18 of the FRED)?

Again as in Q2 above.

7 The ASB is proposing that the standard should come into effect for reporting periods ending on or after a date in early 2003, although it is also proposing certain transitional arrangements (see paragraph 20 of the FRED). Do you agree with this approach?

As we have stated in our response to question 1 above, we do not believe that the proposed standard is necessary at this time. Our preference is
that the subject of hedge accounting should be included in a UK standard that brings the requirements of IAS39 into UK GAAP. This is the subject of FRED30 issued subsequently to FRED23, on which we will be commenting separately in due course.

The Effects of Changes in Foreign Exchange Rates

Financial Reporting in Hyperinflationary Economies (FRED 24)

The ASB would welcome comments in particular on the following:

ASB (i) Do you agree with the ASB's proposed timetable for the implementation in the UK of standards based on a revised IAS 21 and IAS 29?

We do not agree with the proposal. We would prefer that the changes to replace SSAP2O and UITF9 should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.

ASB (ii) Do you agree with the proposal not to include the IAS 21 provisions on the recycling of certain exchange gains and losses?

We would suggest that any decision on whether such translation differences should be recycled to the profit and loss account should await the result of the current project on reporting financial performance.

ASB (iii) Do you agree with the proposal not to include any transitional arrangements in these UK standards?

If the Board agrees to defer implementation of the proposals, the question of transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

In addition we would make the following comments:

In proposing to introduce UK standards based on IAS21 and IAS29 the Board has not given any explanation as to why it is considered that restatement of financial statements is now the only appropriate method of eliminating the distortions that arise in hyperinflationary economies. In our experience the use of a stable currency as the functional currency is a fairly common approach to the problem. We believe that this approach is often a practical solution, particularly where inflation indices tend to be unreliable or not readily available.

In the light of this, we were somewhat surprised that the IASB did not feel fit to deal with this in IAS21 and re-examine IAS29 as part of its improvements project. We would suggest that the Board should raise with the IASB the possibility of incorporating UITF9' s alternative approaches in IAS21 and IAS29. In our opinion, whilst restatement by indices is sometimes the correct approach, in practice there needs to be pragmatic alternative solutions.

Turning to IAS21, we note that whilst the proposed UK standard does not include IAS2I's requirement to classify certain exchange differences as a separate component of equity, it still retains the requirement for a reconciliation of the changes during the period. We would question the necessity for the reconciliation if separate identification is not to be required under UK GAAP.

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 21:

IASB (i) Do you agree with the proposed definition of functional currency as "the currency of the primary economic environment in which the entity operates" and the guidance proposed in paragraphs 7-12 on how to determine what is an entity's functional currency?

We disagree with the statement in paragraph 12 concerning the avoidance of restatement. The use of a hard currency to deal with a high inflationary environment is a fairly common approach to the problem. This has been recognized in the UK through UITF9, as we have referred to above. We believe that the approach being adopted internationally is misguided in assuming that there is one right and precise answer to deal with high inflationary economies and their varied and volatile environments. It is an unnecessary restriction which will cause problems and cost for preparers with no apparent justification.

IASB (ii) Do you agree that a reporting entity (whether a group or a stand-alone entity) should be permitted to present its financial statements in any currency (or currencies) that it chooses?

We also agree that a reporting entity should be permitted to present its financial statements in any currency that it chooses.

IASB (iii) Do you agree that all entities should translate their financial statements into the presentation currency (or currencies) using the same method as is required for translating a foreign operation for inclusion in the reporting entity's financial statements (see paragraphs 37 and 40)?

We agree with the above proposals regarding translation to the presentation currency.

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

We again agree that this allowed alternative should be removed.

IASB (v) Do you agree that

(a) goodwill and
(b) fair value adjustments to assets and liabilities

that arise on the acquisition of a foreign operation should be treated as assets and liabilities of the foreign operation and translated at the closing rate (see paragraph 45)?

We are also in agreement with the above proposal that such items are foreign assets and liabilities which should be translated at closing rate.

Related Party Disclosures (FRED 25)

The ASB would welcome comments in particular on the following:

ASB (i) Do you agree with the proposal to issue a new standard in the UK on related party disclosures, once the new IAS 24 is approved by the L&SB?

We do not agree with the proposal. We would prefer that changes to the existing standard (FRS8) should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.

ASB (ii) Do you believe that the ASB should consider any transitional arrangements?

If the Board agrees to defer implementation of the proposals, the question of transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

ASB (iii) Do you believe that an accounting standard should require disclosure of the name of a controlling party and, if different, that of the ultimate controlling party? If the new IAS 24 does not require disclosure, do you believe that a new UK standard should require this disclosure as set out in paragraphs l3A and 13B of the [draft] FRS?

We believe that the name of a controlling party and, if different, that of the ultimate controlling party should be disclosed. If the revised IAS24 does not require such disclosure, we would agree with this requirement being retained in the revised UK standard.

ASB (iv) Do you believe that an accounting standard should require disclosure of the names of transacting related parties?

Whilst such information is currently required by FRS8, we are not **concerned by its omission from FRED25. We would suggest that the proposals require sufficient information to be disclosed about transactions between related parties.**

ASB (v) Should the definition of related parties specifically refer to shadow directors? Should it also refer to persons acting in concert?

We believe that the definition of related parties included in FRED25 should be extended to specifically refer to both shadow directors and persons acting in concert.

ASB (vi) Do you believe that an accounting standard should specify that disclosure is required of *material* related party transactions arid give more guidance on materiality in the context of such transactions?

We agree that disclosure should only be required of material related party transactions. In addition we also believe that for this particular standard it would be useful for the standard to give guidance on materiality.

ASB (vii) Are there any other aspects of the draft standard that the ASB should request the IASB to review when finalising the revised IAS 24?

We would suggest that the wording of paragraph 12 be replaced by the deleted paragraph 32(a) of IAS27. We believe that this would provide a clearer understanding of the information that should be given with regard to subsidiaries.

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 24:

IASB (i) Do you agree that the Standard should not require disclosure of management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations (see paragraph 2)?

'Management' and 'compensation' would need to be defined, and measurement requirements for management compensation would need to be developed, if disclosure of these items were to be required. If commentators disagree with the Board's proposal, the Board would welcome suggestions on how to define 'management' and 'compensation'.

We agree that disclosure of these items should not be required by the standard.

IASB (ii) Do you agree that the Standard should not require disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or a wholly-owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs (see paragraph 3)?

Again we agree that such disclosures should not be required.

Earnings per share (FRED 26)

The ASB would welcome comments in particular on the following:

ASB (i) Do you agree with the proposal to issue a new UK standard on earnings per share to replace FRS 14, as soon as the new IAS 33 is approved by the IASB?

We do not agree with the proposal. We would prefer that changes to the existing standard (FRS14) should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.

ASB (ii) Do you believe that ASB should consider any other transitional arrangements?

If the Board agrees to defer implementation of the proposals, the question of transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

ASB (iii) Are there any aspects of the draft standard that the ASB should request the IASB to review when finalising the revised IAS 33?

We are most concerned that the IASB's proposals do not allow for the presentation of additional per share amounts on the face of the profit and loss account, especially as such measures may be what management and users focus on. We would suggest that the IASB should consider adopting FRS14's approach of allowing such additional amounts, having regard to their relevant prominence.

The IASB has asked commentators to respond to the following question on the proposed changes to IAS 33:

IASB (i) Do you agree that contracts that may be settled either in ordinary shares or in cash, at the issuer's option, should be included as potential ordinary shares in the calculation of diluted earnings per share based on a rebuttable presumption that the contracts will be settled in shares?

We agree with these proposals.

IASB (ii) Do you agree with the following approach to the year-to-date calculation of diluted earnings per share (as illustrated in Appendix B, examples 7 and 12)?

- The number of potential ordinary shares is a year-to-date weighted average of the number of potential ordinary shares included in each interim diluted earnings per share calculation, rather than a year-to-date weighted average of the number of potential ordinary shares weighted for the period they were outstanding (ie without regard for the diluted earnings per share information reported during the interim periods).

- The number of potential ordinary shares is computed using the average market price during the interim periods reported upon, rather than using the average market price during the year-to-date period.

- Contingently issuable shares are weighted for the interim periods in which they were included in the computation of diluted earnings per share, rather than being included in the computation of diluted earnings per share (if the conditions are satisfied) from the beginning of the year-to-date reporting period (or from the date of the contingent share agreement, if later).

We do not agree with the above approach in that we would prefer to compute the number of potential ordinary shares using the average market price during the year-to date period.

Events after the balance sheet date (FRED 27)

The ASB would welcome comments in particular on the following:

ASB (i) Do you agree with the proposal to issue a new UK standard on events after the balance sheet date, once the new IAS 10 is approved by the IASB and once the law is amended to permit its application?

We do not agree with the proposal. We would prefer that changes to the existing standard (SSAP17) should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its **programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.**

ASB (ii) Do you believe that ASB should consider any other transitional arrangements?

If the Board agrees to defer implementation of the proposals, the question of transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

ASB (iii) Are there any aspects of the draft standard that ASB should request IASB to review when finalising the revised IAS 10?

No

Inventories; Construction and service contracts (FRED 28)

The ASB would welcome comments in particular on the following:

ASB (i) Do you agree with the proposal to issue new UK standards on inventories and construction contracts to replace SSAP 9, once the revised IAS 2 is approved by the IASB?

We do not agree with the proposal. We would prefer that the changes to replace the existing standard should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.

ASB (ii) Do you agree with the proposal to incorporate part of IAS 18 in the standard on construction contracts, so that it may also apply to other contracts for services?

We agree with the proposal to incorporate the additional text to deal with contracts for services.

ASB (iii) Do you believe that the ASB should consider any transitional arrangements?

If the Board agrees to defer implementation of the proposals, the question of transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

ASB (iv) Are there any aspects of the draft standard on inventories that the ASB should request the IASB to review when finalising the revised IAS 2?

We are not aware of any such aspects.

ASB (v) Are there any aspects of the standard on construction contracts that the ASB should request the IASB to review in due course?

Again we are not aware of any such aspects.

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 2:

IASB (i) Do you agree with eliminating the allowed alternative of using the IAS-in first-out (LIFO) method for determining the cost of inventories under paragraphs 23 and 24 of IAS 2?

We agree that the allowed alternative of using the IAS-in first-out (LIFO) method for determining the cost of inventories should be eliminated.

IASB (ii) IAS 2 requires reversals of write-downs of inventories when the circumstances that previously caused inventories to be written down below cost no longer exist (paragraph 30). IAS 2 also requires the amount of any reversal of any write-down of inventories to be recognised in profit or loss (paragraph 31).

Do you agree with retaining those requirements?

We are in agreement with retaining both of these requirements.

Property, plant and equipment; Borrowing costs (FRED 29)

The ASB would welcome comments, by 16 September 2002, in particular on the following:

ASB (i) Do you agree with the proposal to issue new UK standards on property, plant and equipment and borrowing costs when the IASB issues the revised IAS 16, unless it becomes clear that further changes to IAS 16 are likely by 2005 as a result of the revaluation project?

We do not agree with the proposal. We would prefer that the changes to replace the existing standard should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.

ASB (ii) The international exposure draft on property, plant and equipment proposes that residual values used in the calculation of depreciable amount should be reviewed at each balance sheet date and revised to reflect current estimates. FRS 15 generally requires prices at the date of acquisition or latest valuation to be used; hence, depreciation expense on a historical cost basis is not reduced by inflation in residual values. Do you agree or disagree with the proposed international approach?

It would seem more logical to adopt the FRS15 approach to avoid the depreciation expense on a historical cost basis being reduced by inflation in residual values. However we wonder whether this concern over residual values is likely to cause significant problems in practice.

ASB (iii) IAS 16 does not address the use of renewals accounting in respect of certain infrastructure assets. Do you believe that the absence of the guidance in FRS 15 would prevent entities from using renewals accounting as a method of estimating depreciation? Should UK entities be permitted to continue to use renewals accounting?

Renewals accounting was presumably included in FRS15 to allow certain industries a pragmatic solution to estimating depreciation on certain infrastructure assets. On the assumption that similar industries outside the UK are likely have the same concerns over infrastructure assets, it would appear that the IASB should be requested to look at the question of including similar provisions re renewals accounting in the revised IAS16.

ASB (iv) What are your views on the differences between the requirements of FRS 15 and IAS 16 concerning revaluations (as described in paragraphs 10 to 17 of the Preface to the FRED)?

Given the differences that exist between FRS15 and IAS16, we believe that there is a strong case for not introducing IAS16 into the UK at the present time. As there is a joint project looking at a convergence model for revaluations, we would suggest that there is no need to amend FRS15 until there is international agreement on this subject.

ASB (v) Are there any other aspects of the differences between the proposed standards and current UK accounting requirements that you wish to comment on?

We note that, in revising paragraph 60, the statement that comparative information is not required for the reconciliation of the carrying amount at the beginning and end of the period has been deleted. We see no reason for this deletion and would question the need for such comparative information.

With regard to the examples given in paragraph 17 of costs that are not a component of the cost of property, plant and equipment, we would question whether such costs should always be excluded. For example, training costs or relocation expenses could qualify for capitalisation in circumstances where they are necessary to bring the asset into operation or extend its useful life, production capacity or residual value.

ASB (vi) Do you agree with the ASB's proposal, as a transitional measure (see paragraph 18 above), that the present exemption in FRS 15 in respect of insurance companies should be retained in a new UK standard based on IAS 16 revised pending the outcome of the IASB's projects on insurance and reporting financial performance?

We agree that the present exemption in FRS15 in respect of insurance companies should be retained as a transitional measure.

ASB (vii) The transitional arrangements for the first-time application of FRS 15 allowed an entity that does not adopt a policy of revaluation to retain carrying amounts reflecting previous revaluations instead of restating the carrying amounts to historical cost (see paragraph 19 above). Do you believe that a transitional arrangement should be included in a new UK standard to allow entities that adopted FRS 15's transitional arrangement to continue to recognise the carrying amounts under that arrangement?

We believe that entities which adopted FRS15's transitional arrangement should be allowed to continue to recognize the carrying amounts under that arrangement. We understand that the IASB's proposals for first-time application of IFRSs does allow for this type of situation.

ASB (viii) Do you believe that ASH should consider any other transitional arrangements?

If the Board agrees to defer implementation of the proposals, the question of any other transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

ASB (ix) Are there any other aspects of the draft standard on property, plant and equipment that the ASB should request the JASB to review when finalising the revised IAS 16?

Apart from the two points mentioned above in our response to ASB (v) and the specific points on the ASB questions below, we would also mention paragraph 46. The requirement for an annual review of material residual values imposes an unreasonable burden and we would suggest that such a review should only be necessary where there are indications of impairment.

ASB (x) Do you agree that the capitalisation of borrowing costs should remain optional? if you had to choose between mandatory capitalisation and prohibition of capitalisation, which would you support and why?

We agree that the capitalisation of borrowing costs should remain optional. Whilst we agree that conceptually directly attributable finance costs should be capitalised, such a concept also leads to capitalising notional interest as well as creating practical problems in allocating finance costs. Thus, on balance, if we had to make a choice, we would opt for prohibition of capitalisation.

ASB (xi) Do you agree that paragraph 5(e) of IAS 23, which allows certain exchange differences to be capitalised, should be deleted in the draft standard on borrowing costs?

As the IASB is not proposing to revise IAS23, we are surprised that the ASB is proposing to make this amendment and thus create a difference between UK GAAP and IFRSs. This would seem to be at odds with the policy of convergence.

ASB (xii) What are your views on the difference between IAS 23 and FRS 15 referred to in paragraph 24 of the Preface to the FRED concerning borrowing costs eligible for capitalisation?

Whilst we feel that FRS15's approach is probably preferable in this respect, we believe that, in many cases, the approach in IAS23 is not likely to make a significant difference in practice.

ASB (xiii) Do you have any comments on IAS 23 that you wish the ASB to bring to the IASB's attention?

We do not have any such comments other than as noted above.

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 16:

IASB (i) Do you agree that all exchanges of items of *property, plant and equipment* should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably (see paragraphs 21 and 21A of the [draft] FRS on property, plant and equipment)?

We do not agree with the changes that are proposed in this respect. We would prefer to keep the wording as set out in the current IAS16. For exchanges of similar assets, the cost of the new asset is the carrying amount of the asset given up.

IASB (ii) Do you agree that all exchanges of *intangible assets* should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably?

We would make a similar comment here to that shown above, i.e. for exchanges of similar assets, the cost of the new asset should be the carrying amount of the asset given up.

IASB (iii) Do you agree that depreciation of an item of property, plant and equipment should not cease when it becomes temporarily idle or is retired from active use and held for disposal (see paragraph *59* of the [draft] FRS on property, plant and equipment)?

We do not agree. It may be the case that, in becoming temporarily idle, the useful life is extended and thus the depreciation charge may be lower or possibly even zero. Where an item is being held for disposal , is it right to assume that its service potential is still being consumed? In addition should depreciation continue to be charged if this results in the asset being carried at a value below the expected realizable value?

IASB proposals to amend certain international accounting standards

Presentation of financial statements (IAS1)

Q1 We agree with the proposed approach regarding departure from an IFRS or interpretation thereof to achieve a fair presentation with the proviso that:

(a) the requirement in paragraph 14 (d) is revised to remove the reference to "on each item". Surely it is only necessary to give the key elements of the financial impact of the departure?

(b) The wording in paragraph 15 (b) is brought into line with that in paragraph 14 (d) as amended above.

Q2 We agree with the prohibition of presenting items of income and expenses as "extraordinary items".

Q3 We agree with the wording in paragraph 60 regarding the classification of a long-term financial liability due to be settled within twelve months of the balance sheet date.

Q4 We also agree with the classification requirements set out in paragraphs 62 to 64 with regard to long-term financial liabilities that become payable on demand.

Q5 Whilst the examples given in paragraph 109 would seem to make the requirement more reasonable (provided that these examples are indicative ones), the requirement as set out in paragraph 108 appears, on its own, to be onerous and too open ended (see also Q6).

Q6 We are concerned that the requirements in paragraphs 110 to 115 are much too general. We would suggest that such assumptions should be specifically identified and specified in individual accounting standards, as was done for the assumptions referred to in paragraph 115.

In addition we would refer to the revised paragraph 76, which deals with information to be presented on the face of the income statement. The reference to the inclusion of the results of associates and joint ventures now requires share of "after-tax profit or loss" rather than "profits and losses" to be given before the disclosure of tax expense. We would prefer disclosure to be consistent with FRS9, but if "after-tax profit or loss" is to be disclosed, surely it should be shown after tax expense.

Accounting policies, changes in accounting estimates and errors (IAS8)

Q1 We agree that voluntary changes in accounting policies and corrections of errors should be accounted for retrospectively with no allowed alternative.

Q2 We also agree with the elimination of the distinction between fundamental and other errors, providing that there is no change in the interpretation of material. We would be concerned if the concept was extended to cover smaller items which, from a practical viewpoint, could not be seen as influencing the economic decisions of users of financial statements.

In addition we would question the wording of paragraph 19. Our preference would be to retain the existing paragraph 48 but, if this is not possible, then we would strongly object to the inclusion of paragraph (d) regarding a requirement to disclose the financial effect of adoption of a new standard.

Leases (IAS17)

Q1 Theoretically, we agree that when classifying a lease of land and buildings, the lease should be split into two elements - a lease of land and a lease of buildings. However we are concerned that in practice it will often be the case that a reasonable division cannot be achieved.

Q2 We also agree that initial direct costs incurred in negotiating a lease should be capitalised, provided that such costs are incremental and directly attributable to the lease.

Consolidated and separate financial statements (IAS27)

Q3 We agree that a parent need not prepare consolidated financial statements if all the criteria set out in paragraph 8 are met.

Q2 We also agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity.

Q3 With regard to! investments in subsidiaries, jointly controlled entities and associates, we are in agreement with the proposals set out in paragraph 29 and 30.

In addition we would make the following comments:

Paragraph 13 has been reworded to replace "in the near future" with "within twelve months from acquisition". In practice it can be the case that the sale of a subsidiary can take more than twelve months, particularly when regulatory approvals have to be obtained. We would therefore prefer that the phrase "in the near future" is reinstated.

We are concerned about the wording of paragraph 27, in that we would suggest that the relevance should be over whether the Group, rather than the minority, is obliged to make good the losses that may not be recoverable. Therefore it is the minority that has the residual interest in the subsidiary's net assets or liabilities, except to the extent that the Group has an obligation which would determine a different allocation.

The additional disclosure introduced in paragraph 32 (b) appears to us to be unjustified, given that this would apply to subsidiaries that are in the course of disposal and thus carried in the consolidated balance sheet at net realizable value rather than at net asset value.

Accounting for investments in associates (IAS28)

Q1 We agree with the scope exclusions set out in paragraph 1 and that they should also apply to IAS31.

Q2 We also agree with the proposals in paragraph 22 regarding investments in loss-making associates.

In addition we would make the following comments:

As mentioned above with regard to IAS27 we are concerned that the phrase “in the near future” is to be replaced with “within twelve months from acquisition” in paragraph 8.

Paragraph 18A allows for a difference of up to three months in the reporting date of the financial statements of an associate. From a practical point of view we would suggest that a difference of up to six months should be allowed.

The wording of paragraph 28B does not seem to make clear what disclosures are required in accordance with IAS37. We would suggest that it is reworded to clarify the necessary disclosures.

Investment property (IAS4O)

Q1 We agree with the inclusion of a property interest held under an operating lease providing the criteria set out in paragraph 4 are met.

Q2 We also agree that where a property interest held under an operating lease is classified as investment property, it should be accounted for as if it were a finance lease.

Q3 We agree that both the cost and fair value models should remain for the time being pending a further review.