UK 36

Hans Nailor
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16 September 2002

Dear Sir

CONSULTATION PAPER ON IASB PROPOSALS TO AMEND CERTAIN INTERNATIONAL ACCOUNTING STANDARDS

We are pleased to have this opportunity to comment on the above Consultation Paper on the proposed amendments to IAS 1, 8, 17, 27, 28 and 40. We note that the IASB would like comments on certain specific matters in each standard. We also have some more general comments.

In general, we support the IASB's Improvements Project. However, we question the wisdom of revising standards now when further substantial changes are likely to be proposed within a matter of months as a result of other IASB projects, in particular that on performance reporting. New and revised standards arising from this project are likely to come into force only one year after changes arising from the improvements project. We are not convinced that the credibility of standards is enhanced by such frequent changes. The standards within the scope of this consultation paper that are most affected by this would appear to be IAS 1 and IAS 8. Therefore from a UK point of view we thoroughly agree with the ASB's intention not to convert these proposals to FRS at this point.

Our major concerns on these proposals are that:

- The concept of "undue cost or effort" should be clearly and consistently explained wherever it occurs, for example in IAS 1, IAS 8 and ED 1.
- We consider that the issue of materiality, which was thrown into confusion by the late deletion of the paragraph in the Preface, must be made clear. We note that the rubric on the exposure drafts continues to say the IAS are not applicable to immaterial items, but refers to the paragraph in the Preface which does not now exist.

We respond in detail to the questions raised in the Consultation Paper in the appendix. If you would like us to amplify our comments, please contact Robert Carroll on 0870 991 2210.

Yours faithfully

Grant Thornton

APPENDIX

IAS 1 PRESENTATION OF FINANCIAL STATEMENTS

1 Do you agree with the proposed approach regarding departure from a requirement of an International Reporting Standard or an Interpretation of an International Financial Reporting Standard to achieve a fair presentation?

In general, we are comfortable with the broad thrust of the proposals. We have the following comments:

- The parenthesis in paragraph 10 seems to raise the status of the Framework above that of the set of IFRS and Interpretations. From a practical point of view, it would be more helpful and understandable to put the words in the parentheses as explanation of "present fairly" in a subsequent paragraph, perhaps before, in or after paragraph 12.

- The phrase "true and fair view" is often used as an alternative to "fairly presents". It would improve comprehensibility if the relationship between the phrases were made clear here.

- Paragraph 15 describes the response when fair presentation requires a deviation from IFRS but local law prohibits that deviation. Whilst accepting that this may occur rarely, we consider that the proposals of paragraph 15 are badly wrong. In essence, they allow local law to override what should be done to give a fair presentation, by permitting explanatory disclosure only. In our view, such a result weakens the whole basis of IFRS being strong, and the whole principle of paragraphs 10 and 11. If the highest objective is fair presentation, then local interference with that should result in the financial statements no longer earning the tag of compliance with IFRS. If there is a practical problem here, that paragraph 15 is trying to deal with, possibly the solution is to require, in theses circumstances only, that the compliance statement from paragraph 11 be qualified.

- We consider that the existing paragraph 12 in IAS 1, pointing out that disclosure cannot rectify poor accounting treatment, is a powerful and helpful paragraph, and should be retained. (It occurs to us that its proposed demise may have been the result of the facilitation of the mechanism in paragraph 15 with which we have disagreed above)

2 Do you agree with prohibiting the presentation of items of income and expense as "extraordinary items" in the income statement and the notes?

We see no reason to object to this proposal. We consider that this is a matter of mandating a treatment to reduce differences in accounting for items, increase comparability and prevent abuse of standards. Therefore, as there is the ability to describe items as exceptional and so highlight them, prohibiting extraordinary items would not inhibit the amount of information given to the users of financial statements.

3 **Do you agree that a long term liability due to be settled within twelve months of the balance sheet date should be classified as a current liability, even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue?**

Yes.

4 **Do you agree that:**

(a) a long term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date, even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach?

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

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

(ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be?

Yes.

5 **Do you agree that an entity should disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements?**

This proposal is not explicit enough in what it is seeking to require. As such, it could become a charter for unwarranted criticism, which will not help the reputation of reliable accounting standards. Therefore, we suggest that the IASB re-expose this concept, with more examples of the type of judgements and the extent of disclosure that is envisaged. The

IASB has not been shy of providing examples in the rest of IAS 1, and there seems to be no reason to be so here.

6 Do you agree that an entity should disclose the key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year?

We do not agree with this proposal as a general proposition. While we have sympathy with attempts to make financial statements more useful in predicting the future, we consider it could be onerous, costly and commercially sensitive. It is similar to the proposal in question (v) but it is posing questions about the future. It could create difficulties in drawing lines between a profit forecast and financial statements.

In a similar way to paragraph 108, the lack of precision of the requirements of paragraph 110 carries the dangers of unwarranted criticism of IFRS and their application. We think that more detail and more examples might help to show where the boundaries of these requirements are.

Other issues

"Undue cost or effort"

We note that, in common with other recent proposals by the IASB, the term "undue cost or effort" is used in place of "impracticable". In the revised IAS 1, there is material in paragraphs 35 to 39 explaining this idea, relating specifically to comparative figures. We have concerns about the use of this phrase, as, at face value, it appears to be a weaker requirement than the concept of impracticability that it replaces. We recognise the need for some concept of this type, but recommend strongly that its meaning and intent be explained consistently and clearly in the standards affected to minimise the potential for abuse. For example, some companies may regard almost any cost or effort as "undue". We believe that there is a strong case for a definition to be included in the IASB's Glossary of Terms.

The IASB should also ensure that the "undue cost or effort" exemptions are consistent as between IAS 1, IAS 8, and ED 1 on first-time application of IFRS. IAS 1 paragraph 35 and IAS 8 paragraph 13 make general allowance for undue cost or effort when changing accounting policies – however ED 1 only explicitly makes exemptions in the case of a limited number of specified items. It would be helpful to include the general exemption explicitly in ED 1, if that is intended to be available, and also to make reference to (the IFRS resulting from) ED 1 in IAS 1, paragraph 39.

IAS 8 NET PROFIT OR LOSS FOR THE PERIOD, FUNDAMENTAL ERRORS AND CHANGES IN ACCOUNTING POLICY

1 Do you agree that the allowed alternative treatment should be eliminated for voluntary changes in accounting policies and corrections of errors, meaning that those changes and corrections should be accounted for retrospectively as if the new accounting policy had always been in use or the error had never occurred (see paragraphs 20, 21, 32 and 33)?

Yes.

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

Yes. However, we note that the text of the draft revised standard itself does not refer to materiality in this context. We recommend that the word "material" be incorporated either into the definition of an error or into paragraph 32.

Other issues

Developing accounting policies

Paragraphs 5 and 6 of the draft standard set out factors to consider in developing an accounting policy for a matter that is not addressed by a standard. We suggest that the IASB consider extending the scope of the factors in paragraph 5 to include the development and application of accounting policies and estimation techniques in general. The highest quality financial reporting is most likely to be achieved where there is not merely a requirement to comply with standards where they exist and with more general principles where there is no specific standard, but where entities are required to select and apply accounting policies and estimation techniques in the manner most appropriate to the entity's particular circumstances, in addition to complying with standards. This may be of particular relevance where a choice of treatment is permitted or where significant judgement is required. It may also be useful to give more emphasis to the importance of comparability with other entities in the same industry or business sector when selecting and applying accounting policies and techniques. Such an approach would converge International Financial Reporting Standards with the approach set out in the UK ASB's standard FRS 18 'Accounting Policies'.

Proposed disclosure requirements

We have concerns about the proposed disclosure requirements relating to future adoption of a standard in issue but not in force, as set out in paragraph 19, in particular the numerical disclosure in sub-paragraph (d)(i). We consider this proposed disclosure to be unduly burdensome and likely to be difficult or impracticable to comply with, especially where a new standard is issued shortly before the accounts are finalised or where a new standard makes significant changes to recognition or measurement requirements. We acknowledge that sub-paragraph (d)(ii) grants relief on the grounds of undue cost or effort but consider that such an exemption is likely to be invoked so frequently when a major new standard is issued as to undermine the disclosure requirement itself.

IAS 17 LEASES

1 Do you agree that when classifying a lease of land and buildings, the lease should be split into two elements—a lease of land and a lease of buildings? The land element is generally classified as an operating lease under paragraph 11 of IAS 17, Leases, and the buildings element is classified as an operating or finance lease by applying the conditions in paragraphs 3-10 of IAS 17.

We agree in principle with this proposal. However, we consider that there may be considerable practical difficulties in distinguishing between the land element and the buildings element, especially in fully developed areas where values for the land element may be difficult to determine by reference to market transactions.

2 Do you agree that when a lessor incurs initial direct costs in negotiating a lease, those costs should be capitalised and allocated over the lease term? Do you agree that only incremental costs that are directly attributable to the lease transaction should be capitalised in this way and that they should include those internal costs that are incremental and directly attributable?

We support the IASB's proposal to eliminate the choice currently in IAS 17. Although we see merit in the argument that initial direct costs are in the nature of selling costs and should be expensed, we support the IASB's proposed treatment on the grounds of international convergence.

IAS 27 CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING FOR INVESTMENTS IN SUBSIDIARIES

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

We agree, although we are not convinced that unanimous consent of any minority interest should be required. A requirement for unanimous consent is simple but may lead to group accounts being required in circumstances where the costs outweigh the benefits, for example if there is a dissident or uncontactable minority shareholder. We suggest that the IASB consider the approach currently embodied in UK companies legislation. In the UK, the parent of the company seeking exemption from preparing consolidated accounts must hold more than 50% of the company's shares and group accounts must not have been requested by the holders of more than half of the remaining shares or the holders of 5% of the total shares of the company. Alternatively, the IASB may wish to consider amending the requirement for unanimous consent of the minority to one of no objections from the minority to not preparing group accounts.

2 **Do you agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity (see paragraph 26)?**

Yes.

3 **Do you agree that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, in the investor's separate financial statements (paragraph 29)?**

Do you agree that if investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments should be accounted for in the same way in the investor's separate financial statements (paragraph 30)?

In response to the first part of this question, we accept that the IASB's proposals will reduce the scope for choice by eliminating the option of using the equity method for such investments in the investor's separate financial statements. However, given that a choice will remain between cost and fair value under IAS 39, we see little merit in removing one option whilst still permitting the other two. In addition, the use of the equity method in the parent's separate financial statements has the attraction of aligning shareholders' equity between the parent and group accounts. We favour either retaining the current alternatives or permitting only one treatment. Our preferred treatment would be to carry such investments at cost as we consider that obtaining fair values in accordance with IAS 39 may be unduly burdensome and not provide useful information to users of the financial statements.

We agree with the second part of the question.

Other comments

Disclosure of significant subsidiaries

The IASB has not explained its proposal to delete the disclosure requirement currently set out in paragraph 32(a) of IAS 27. This currently requires disclosure of a listing of significant subsidiaries including name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held. In our view, readers of the accounts may find this information valuable and we therefore suggest that this disclosure be retained. We note that the IASB has included in the draft revised IAS 24 (paragraph 12) a more general requirement to disclose relationships between parents and subsidiaries, but our preference is for the more specific requirement of IAS 27 to be retained.

Publishing consolidated financial statements

Paragraph 8(d) refers to the parent "publishing" consolidated financial statements. It would be helpful to give an indication of what "publish" involves eg a member of the public can access them. (The previous disclosure requirement for the registered office of the parent has been deleted – and we do not disagree with this).

Separate financial statements

The description of "separate financial statements" is tortuous and hard to follow, encompassing paragraphs 4, 8 and 9. Several comments:

The purpose of paragraph 9 is not clear. Is it telling the parent not to prepare any other accounts?

Paragraph 4 refers to preparing financial statements in accordance with IAS 28 or 31. But financial statements are not prepared in accordance with a single IAS, but in accordance with all IFRS.

Quite apart from that, it is unclear what is intended by "separate financial statements". It seems to encompass parent company accounts produced in addition to consolidated accounts (from para 4) and non-consolidated financial statements of a parent exempt under para 8. But what is "in addition to financial statements prepared in accordance with" IAS 28, or IAS 31? If a company with an associate prepared financial statements, IAS 28 would require it to use the equity method irrespective of whether the financial statements were consolidated or company only – what additional financial statements might it produce? More clarity is required.

IAS 28 ACCOUNTING FOR INVESTMENTS IN ASSOCIATES

1 Do you agree that IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, should not apply to investments that otherwise would be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries (see paragraph 1)?

We agree, provided that the meaning of "venture capital organisation" and "well-established practice in those industries" are unambiguous. We suggest that the IASB consider including a definition of the former term in the revised standard. However, we would not support an extension of this exemption to cover similar investments that would otherwise be treated as subsidiaries.

2 **Do you agree that the amount to be reduced to nil when an associate incurs losses should include not only investments in the equity of the associate but also other interests such as long-term receivables (paragraph 22)?**

We agree, provided that such long-term receivables are not thereby stated at an amount below their recoverable amount.

Other comments

We note that the requirement to disclose an appropriate listing and description of significant associates in paragraph 27(a) of the current IAS 28 is proposed for deletion. In our view, this disclosure requirement provides valuable information and should be retained.

Paragraph 27(b) of the proposed revised standard introduces a requirement to disclose summarised financial information of associates. It is not clear from the draft text whether this applies to associates individually or in aggregate. We assume that it is the latter but it may be helpful to clarify the wording on this point.

Paragraph 24A requires an associate to be accounted for in the separate financial statements of the investor either at cost or fair value (under IAS 27). However, paragraph 8A requires that the equity method be used irrespective of whether the investor has subsidiaries, in which case it would not present consolidated financial statements, but only separate ones. Perhaps this issue is related to the confusing description of separate financial statements to which we refer in our comments on IAS 27. In any case, more clarity is required.

IAS 40 INVESTMENT PROPERTY

1 **Do you agree that the definition of investment property should be changed to permit the inclusion of a property interest held under an operating lease provided that:**

(a) **the rest of the definition of investment property is met; and**

(b) **the lessee uses the fair value model set out in IAS 40, paragraphs 27-49?**

Yes.

2 **Do you agree that a lessee that classifies a property interest held under an operating lease as investment property should account for the lease as if it were a finance lease?**

Yes.

3 Do you agree that the Board should not eliminate the choice between the cost model and the fair value model in the Improvements project, but should keep the matter under review with a view to reconsidering the option to use the cost model in due course?

We believe that the IASB should eventually standardise on a single approach to investment property, based on fair values. However, we agree that this cannot be achieved within the scope and timescale of the improvements project.

Our Ref FRED26/BRS
Your Ref FRED 26

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For the attention of The Technical Director

16 September 2002

Dear Sir

FRED 26 - EARNINGS PER SHARE (EPS)

We are pleased to comment on FRED 26. We also make some comments that we would like the ASB to pass on to the IASB with regard to the revised IAS 33.

GENERAL COMMENTS

Our overall view is that FRED 26 should not be converted to a UK FRS at this time, even if the IASB, having received comments on its revised IAS 33, issues that as a revised standard. We explain why in the following paragraphs.

The FRED contains a number of amendments to the IASB's text. Changes have been made to terminology and definitions to conform to that used in UK standards. An example is a change from 'discontinuing' to 'discontinued' in paragraph 38. Paragraph 4A gives definitions under UK GAAP, which are slightly different to those given in IAS 32. The FRED also includes some minor changes that have been made to reflect differences between FRS 4 and IFRS.

In our view, it would improve the convergence with IFRS if the UK terminology and definitions were altered to conform to those in IFRS. In our view, it would be extremely confusing if the wording in the UK standard were not identical to the international standard, apart from cross references. Implementation of the new reporting standard should be delayed until we are certain that there will be no further changes to the definitions and terminology in IFRS before 2005.

The ASB proposes implementation into a new UK standard in the first quarter of 2003, alongside the IASB's issue of the revised IAS 33. This appears likely to be in advance of the revised UK and international standards on performance reporting. Revised performance reporting will fundamentally change the face of the 'profit and loss account' which will in turn alter the presentation, disclosure and calculation aspects of IAS 33 (and so of FRED 26). In our view, implementation of FRED 26 into a new UK standard should be delayed until we are certain of no further changes to IAS 33, and until the ASB know the results of the consultation on performance reporting, and have a UK financial reporting standard in line with IFRS. In fact, because the FRS on EPS is primarily of interest to listed companies who will be using IFRS from 2005 anyway, and because it will take a considerable time to get the standard on reporting financial performance in place, there is a good argument for not progressing a UK amendment to FRS 14 at all, but simply adopting the eventual IAS 33 in time for 2005.

DILUTED EPS

The exposure draft does not give any guidance on how to estimate profit or loss from continuing operations. In particular there is no guidance on allocation of interest and tax. This guidance is a helpful part of FRS 14, and would usefully be included in the revised IAS 33, or cross-referred from IAS 35 if that is where the guidance is to be given.

DISCLOSURE

FRS 14 includes additional guidance in respect of the presentation of financial statistics in historical summaries, but there is no equivalent guidance in the exposure draft. This could lead to reduced comparability within a single annual report and between companies. We recommend that the ASB ask the IASB to include equivalent guidance in the revised IAS 33.

OTHER DIFFERENCES BETWEEN PROPOSED UK REQUIREMENTS AND PROPOSED IFRS

We recommend that implementation of the exposure draft be delayed until these differences have been resolved.

If you have any queries on our response, please contact Nick Jeffrey direct on 0870 991 2787, or by e-mail at nick.jeffrey@gtuk.com.

Yours faithfully

Grant Thornton

FRED 26 EARNINGS PER SHARE

We set out below our responses to specific questions raised by the ASB:

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?

No. In our view a new UK standard should only be issued once the new standard on performance reporting has been issued.

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

No. We support transitional arrangements in line with those of the revised IAS 33, but no further than that.

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?

Yes. See comments above on 'presentation and disclosure of EPS'; 'Diluted EPS'; and 'Differences between proposed UK requirements and proposed IFRS'.

It might be helpful to clarify paragraph 37 of the draft to the effect that potential ordinary shares are only dilutive where they decrease EPS or increase loss per share.

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 33. We set out below our responses to those questions:

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?

Yes. The rebuttable presumption that the contract will be settled in shares should be allowed only where there is past experience of settling similar contracts in shares or where there is a stated policy.

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).**

No. It should be the second option, without regard to diluted EPS information reported during the interim period(s). The performance statement is a report for a period, not a report for the sum of a number of constituent periods. In our view, the first option would hinder comparability, and would require the audit of figures in the 'interim' report. It would be ludicrous for two companies with identical performance and results to report different annual EPS because one of them had reported interim figures (or more interim figures than the other).

- **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.**

No. We support the second option, for the reasons given in our response above.

- **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).**

No. We support the second option, for the reasons given above.

ADDITIONAL COMMENT

It is not clear to us why the definition of contingently issuable ordinary shares should require that they will be issued for "little or no cash". Although this may be the norm, it is the future satisfaction of conditions that is the defining characteristic and principle. Including the phrase about the cash amount may incite financial engineers to develop instruments that bend round the rules.

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16 September 2002

Dear Sir

FRED 27 - EVENTS AFTER THE BALANCE SHEET DATE

We welcome the issue of this exposure draft (FRED 27), and the opportunity for us to comment on the proposals.

We draw your attention to our separate letter on the implementation of revisions to UK GAAP, in which we have set out our overall comments on the Board's proposals in FREDs 23-30. As stated therein, our view is that new UK standards should only be issued where they follow IFRS word for word (except for cross references), and where the IFRS will not itself be changed before 2005. We therefore disagree with the removal of guidance on going concern from the IFRS version.

However, we do not believe that the revised IAS 10 could be introduced into UK GAAP as it stands because of the conflict with FRS 18. In addition, the implementation may be subject to amendments in companies legislation, although this is debatable. Therefore, we advocate the retention of SSAP 17 until the above issues have been resolved.

We respond in detail to the questions raised in the FRED in the appendix. If you would like us to amplify our comments, please contact Brian Shearer on 0870 991 2723.

Yours faithfully

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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?

In principle, we support the ASB's proposal to converge UK standards with IFRS. However, if IASB standards are to be brought into UK GAAP, we believe that this should be done only if they can be incorporated verbatim (except for cross-references and a scope exclusion for the FRSSE).

We therefore do not agree with the removal of the paragraphs on going concern from the exposure draft as this would result in a standard different from the IFRS. In addition, if those paragraphs are removed in the UK, the remaining guidance on going concern will only be from FRS 18 (but this does not specifically address post balance sheet circumstances), unlike SSAP 17 that is being replaced, which already contains some guidance.

However, bringing these paragraphs into UK GAAP would result in inconsistency with FRS 18 in respect of management intent (to liquidate or to cease trading). This raises the issue of inconsistency between FRS 18 and IAS 1, which needs to be addressed as part of the international convergence process. We believe that in this specific instance, the financial information given under IFRS could be more useful, even if the decision leading to loss of going concern status is technically after the balance sheet date. Therefore, unless the ASB believes that FRS 18 concepts will become part of IAS, and notwithstanding the recent issue of FRS 18, our view is that the paragraphs on going concern should be adopted verbatim in the draft standard.

In addition, we note the comments regarding the incompatibility of the presentation of dividends with the legislation, ie. paragraph 3(7) of Schedule 4 to the Companies Act 1985. Although we support making this amendment to further assist in implementing the standard, some may consider that this may not be strictly required as the existing paragraph, which requires the dividends paid and proposed to be shown, could be interpreted such that a memorandum disclosure would suffice.

The change in the way dividends are treated represent a significant change to current practice. To assist with its implementation, we think the timing of its adoption could be made in conjunction with other related projects, particularly on the revision of the performance statement.

In conclusion, although we support convergence with IFRS, we do not believe that the draft standard is ready to be adopted in the UK until these matters have been resolved.

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

We believe that there are no major practical difficulties in implementing the proposed standard in full, other than possible misunderstanding or misinterpretation of the resulting numbers particularly in respect of dividends. However, these could be subdued by the

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entity's good reporting practice, supported by requirements of FRS 18, by providing supplemental disclosure.

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

In terms of the structure of the draft standard, we feel that the presentation of examples (of adjusting and non-adjusting events) could be better organised. In SSAP 17, this has been neatly presented in the Appendix. However, the draft standard at present lists examples of adjusting events within 'Recognition and Measurement' (paragraph 8), but gives examples of non-adjusting events in both 'Recognition and Measurement' (paragraph 10) and 'Disclosure' (paragra

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16 September 2002

Dear Sir

FRED 29 - PROPERTY, PLANT AND EQUIPMENT; BORROWING COSTS

We welcome the opportunity to comment on the proposals set out in FRED 29.

In principle, we support the ASB's proposals to converge UK standards with IFRS. However, we draw your attention to our separate letter on the implementation of revisions to UK GAAP, in which we have set out our overall comments on the Board's proposals in FREDs 23-30. As stated therein, our view is that new UK standards should be issued only where they follow IFRS word for word, and where the IFRS will not itself be changed before 2005. We do not support the early introduction of FRED 29 into UK GAAP because the IASB is currently carrying out a project on valuation that may lead to significant revisions to IAS 16 prior to 2005.

As set out in detail in the appendix, we disagree with the IASB's proposals regarding residual values and we support the retention of the existing approach in FRS 15 and IAS 16. We support the ASB's value to the business approach to valuation and we believe the ASB should argue for its adoption internationally. We agree that capitalisation of borrowing costs should remain optional at present.

We respond in detail to the questions raised in the FRED in the appendix. If you would like us to amplify our comments, please contact Robert Carroll on 0870 991 2210.

Yours faithfully

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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?

In principle, we support the ASB's proposal to converge UK standards with IFRS. However, given that the IASB is at present carrying out a project on valuation, we believe that there is a significant possibility that IAS 16 will change further prior to 2005. Therefore, we do not support the early introduction of the proposals in FRED 29 into UK GAAP. If IASB standards are to be brought into UK GAAP, we believe that this should be done only if they can be incorporated verbatim (except for cross-references and a scope exclusion for the FRSSE).

Our comments in response to the remaining questions focus on points related to the proposed international text that we believe the ASB should put forward to the IASB.

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?

We disagree with the IASB's proposals. We note that the IASB has not provided adequate explanation in their draft to justify this proposed change. The proposed method of determining residual values raises wider conceptual issues about depreciation and valuation. We believe that the proposed approach will lead to the indirect recognition of holding gains by effectively netting such gains off against the depreciation charge. We do not see how the proposed approach fits in with historical cost principles. We support the approach in FRS 15 and the current version of IAS 16 of basing residual values on prices at the date of acquisition or subsequent revaluation.

Whilst the IASB's assertion in paragraph 46 of their proposed revised standard that residual values will often not be material is undoubtedly true for many assets, residual values may be material in a significant number of cases, for example scrap values of major plant or vessels. Therefore, on a practical level, we consider that the need to reassess residual values annually in line with current price levels will be unnecessarily burdensome for many businesses. For this reason also, we favour retaining the approach in FRS 15 and the current version of IAS 16.

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?

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We do not consider renewals accounting to be a sufficiently major area to warrant special treatment under IAS 16, in particular as we understand that the method is not widely used internationally. Nor do we believe that the UK should take a stand on this issue, and have an accounting standard different from the IASB.

However, there may be practical problems in this approach for UK companies currently using renewals accounting. Under the proposals for first-time application of IFRS, such companies could use a one-off fair value measurement as their IFRS starting point. An equivalent provision would seem to be appropriate in a UK FRS, although the companies affected would probably prefer to have a transitional provision allowing them to start with their current net book value as deemed cost.

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)?

IAS 16's fair value approach has the apparent attraction of being more straightforward and well understood but there is the hidden danger that simply accepting this approach will be interpreted as supporting exit values as appropriate values for all valuation needs, which may have unforeseen or undesirable consequences. Therefore, we support the value to the business model and believe that the ASB should argue for its adoption internationally. As the valuation debate internationally is still alive, this is a major reason why we would encourage ASB not to proceed to a FRS at this time, unless and until it becomes clear that the IAS will not change again before 2005.

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?

At present, FRS 15 contains specific provisions relating to non-depreciation of assets other than freehold land (FRS 15, paras 90-91). There is no equivalent material in either the current or proposed revised IAS 16. In view of the significance of this issue to particular industries in the UK, we believe that the ASB should press the IASB to clarify their position regarding non-depreciation on the grounds that the uncharged depreciation would be immaterial in aggregate. The use of the word "normally" in paragraph 42 of the draft revised IAS 16 does appear to leave open the possibility of non-depreciation but we believe that further clarification would be helpful to users, especially during the transition to IFRS.

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?

As stated above, we believe that international standards should only be brought into UK GAAP word-for-word. However, the major unresolved issues regarding insurance accounting at the international level suggest that there should be no change to the current UK position until the international position is clarified.

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?

As stated above, we believe that international standards should only be brought into UK GAAP word-for-word. The proposed IFRS on first-time application of International Financial Reporting Standards appears to be compatible with the ASB's proposal, and would effectively treat such amounts as deemed cost as at the date of valuation. (Care will need to be taken with the disposition of the revaluation reserve.) For the purpose of UK GAAP we propose that the transitional provisions mirror those in IFRS as far as possible in their wording.

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

No.

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

No.

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 support the IASB's position that the option should be retained at present. In the longer term, we believe that it would be desirable for the IASB to eliminate the choice currently contained in IAS 23. However, we do not consider that a compelling case has yet been made for either mandatory capitalisation or the prohibition of capitalisation. We do not consider that this should be a high-priority area for the IASB at present.

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?

We disagree with this proposal. We believe that the exchange differences covered by this part of IAS 23 are usually economically similar to interest costs, and so should be included. However, the IASB should be prevailed upon to provide more guidance on what is meant by "akin to interest". We also disagree with the concept of introducing differences between UK GAAP and IFRS, as the ASB are proposing here.

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?

In principle, we prefer the ASB's approach, but we consider the IASB's approach to be acceptable.

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

No.

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)?

Yes. It will be important to present the gain appropriately, a matter to be dealt with in the project on reporting financial performance. Although there may be some conceptual merit in treating exchanges of similar items differently from other exchanges, making such a distinction will inevitably involve drawing bright lines, which, in our view, the IASB should be seeking to avoid.

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?

Yes. See our answer to (i) above.

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 disagree with the IASB's proposal, which appears to go against the definition of depreciation in paragraph 41, as the asset is not being used up. In particular this would be true of assets whose primary indicator of consumption is units of output, rather than effluxion of time. In addition, the IASB has provided no explanation for the change. We believe that it would make more sense to mandate impairment reviews of idle assets, if it is felt that something is needed in this area.