UK 04

Dear Sir

The attached file contains the comments of the Co-operative Accounting Standards Committee (CASC), who are responsible for the recommendations of best practice for accounting and financial reporting standards, as a committee of the Co-operative Union Limited. The Co-operative Union is a trade association which represents the Co-operative Consumer Movement and also a large portion of the worker co-operatives in the UK.

(See attached file: FRED28 NP.doc)

Yours faithfully
Phil Holmes FCCA

Secretary - Co-operative Accounting Standards Committee

Exposure draft: Improvements to International Accounting Standards

The key changes proposed by the International Accounting Board's Improvements Project were highlighted in KPMG's paper to the CASC on 10 July.

This paper addresses the questions included within the exposure draft.

IAS 1 - Presentation of financial statements

Question 1

We generally agree with the proposal but with some reservations. The true and fair override should operate where compliance with International Financial Reporting Standards would not present a fair presentation of the results. The true and fair override should not be conditioned upon the regulatory environment of each country and therefore alternative treatments should not be permitted.

The revised wording should acknowledge the sentiment of the original standard that the true and fair override should only be used in the circumstances where the application of a standard will be misleading and clearly inappropriate. The proposed revised wording may encourage more frequent use of the override provisions.

The previous standard also contained the wording " . . inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used or by explanatory notes to the accounts. This wording also discouraged inappropriate use of the true and fair override.

Question 2

Yes, We agree. The presentation of income and expenses as extraordinary items should be prohibited. Further consideration should also be given to limiting the discretion given to presenting items as exceptional or unusual as this can broaden the practice to present items as arising from outside the ordinary activities of an entity.

Question 3

Yes, We agree. Refinancing or rescheduling payments after the year is a non-adjusting post balance sheet event. All assets and liabilities should be stated as at the balance sheet date unless they are subject to adjusting post balance sheet events.

However a disclosure in note form of any significant post balance sheet events should be made.

Question 4 (a)

Yes, We agree. See answer to question 3.

Question 4 (b)

As stated in the answer to question 3, the liability should be stated at the balance sheet date, unless an adjusting post balance sheet event occurs.

However, IAS 10 (Events After the Balance Sheet Date) could be amended to include rectification of breaches of loan agreement conditions within the period of grace (which is before the financial statement are approved) as an adjusting post balance sheet event. Rectification of Loan breaches as described in this scenario could be an acceptable post balance sheet event as this event provides '....additional evidence to conditions existing at the balance sheet date...'. This would avoid creating confusion about what is and is not an adjusting event under IAS 10.

The reader's key concern regarding loans at year end is to understand whether any events have occurred to change the repayment terms (from a long-term liability to a current liability). If breaches to the conditions of the loan have been corrected before the financial statements have been approved, it would be incorrect to state this loan as a current liability as it will not be repayable within 12 months of the balance sheet date, because the conditions of the loan continue to be satisfied.

Question 5

No, We do not agree. The usefulness of such information may be questionable and limited. The requirement to provide information on the judgements made by management in applying accounting policies could lead to non-specific, standard and meaningless disclosures.

However, it would be useful to know where and bow key judgements and estimates have been made. Disclosure should be encourage for significant balances which would aid the reader of the financial statement's understanding.

Question 6

Yes, We agree. Key assumptions about the future and sources of measurement uncertainty would be useful to the reader of the financial statements.

It would be particularly useful to specify what is expected in the disclosure rather than what should be included (avoid being over prescriptive). Examples of the required disclosure would be helpful.

IAS 2 - Inventories

Question 1

Yes. We generally agree, particularly as tax regimes of certain counties, for example UK do not permit the use of LIFO for tax purposes and the elimination of options in accounting standards improves comparability.

However, there are certain circumstances where the LIFO basis gives a better profit and loss measurement eg. where there is requirement to match current costs with current revenues so that the profit and loss excludes the effects of holding gains.

The impact of the LIFO convention is also understood clearly and disclosures are required to highlight the impact of using the LWO basis compared with the F1FO basis. This allows comparability between the LW 0 and FIFO bases.

In conclusion, whilst it is preferable to remove the LIFO option, there are benefits of retaining the current arrangements.

Question 2

Yes, We agree. If the circumstances of the original write-down no longer exist, the write down should be reversed. This would be consistent with the objective that stock should be stated at the lower of cost and net realisation value.

The write-down should be shown in the profit and loss account as it is appropriate to assume at the time of the write down, that the write down will not be reversible and therefore is a permanent loss.

IAS 8 **-** Accounting policies, changes in accounting estimates and errors

Question 1

Voluntary changes in accounting policies

Yes. We agree. Treatment of voluntary changes in accounting policies should be treated retrospectively as if the accounting policy had always been in place. This would aid comparability.

However, it should be emphasised that voluntary change in accounting policies should only be made where the change will result in a fairer presentation of the results (rather than changing accounting policies to show more favourable results).

Correction of errors

Yes , We agree. Again adjusting the previous year's results for errors would aid comparability. This is in preference to amending prior periods by a cumulative effect by adjusting opening retained earnings.

However, the an amendment of errors as a restatement of financial statements via opening retained earnings does have negative connotations. If errors are to be treated retrospectively we may see more restatements, as this will not be seen as being unusual and having the same negative implication to the financial statements. This may be addressed by way of additional disclosure of the current year's results recognising the full impact of the error.

There may also be instances where expenses are 'deliberately' missed from the profit and loss account to show better results, and then adjusted in the following year as an error. In this case these expenses would never to be shown in the current year's results.

Question 2

Yes, We agree. However, a distinction should be drawn between correction of an error and revision of estimates. It should also be emphasised that correction of an error is necessary only when previous financial statements have been misstated materially.

IAS 16 - Property, plant and equipment

Question 1 and2

No, We do not agree. Recognition of property, plant and equipment at fair value involves recognition of gains and losses (in addition to impairment losses). The issues regarding gain recognition for non-monetary transactions should be dealt with in conjunction with the Board’s new project on Revenue Recognition and should cover bartét transactions. Until the Revenue Recognition project is complete, the current position for exchange of assets should be maintained to avoid potentially multiple changes to major cIASses of assets.

Question 3

If an asset is permanently removed from active use it should be measured at the lower of cost and net realisable value. The asset should be subject to impairment tests at the time it ceases to be employed in the business. Depreciation is defined as “the systematic allocation of an asset over its usual life”. The useful life is the period of use. Where an asset is temporarily idle, depreciation should cease for that period, but the life of the asset should be revised to recognise the longer period over which the asset should be depreciated.

IAS 17— Leases

Question 1

No, We do not agree. Splitting leases between land and buildings would be difficult. The land element in particular would be difficult to value fairly on a separate basis. This information may not be readily available

The risks and benefits of the land lease should be identical to the building and therefore the land and buildings should be treated as one asset.

Question 2

Yes, We agree. This would aid comparability.

IAS 21 — The effect of changes in exchange rates

Question 1

Yes, We agree with the definition of functional currency.

Question 2

Yes, We agree the reporting entity should be able to report its results in any currency that it choses. Financial statements may need to be presented in a different currency from the parent for a number of reasons, for example

- There may be different users (local tax authority, fmancial lenders etc)

- The parent may be small and be located in country where the currency is not used internationally

However, disclosure of the reasons that a currency has been selected should be given if the currency of the parent has not been used.

Question 3

Yes, We agree The proposal could improve comparability and reliability of financial statements amongst entities.

Question 4

Yes, We agree with the proposal. Again, the elimination of options will improve comparability.

Question 5

Yes, We agree. Goodwill is generated as a result of the acquisition of a company and therefore relates to the acquired entity. The same reason applies to fair values.

IAS 24 - Related party disclosure

Question 1

No, We do not agree. There should be full transparency of compensation payments made to all key management (directors and employees have received compensation payments of say more than £50,000).

To avoid breanches of national privacy laws, compensation payments could be aggregated.

Compensation payments to directors are covered by corporate governance requirements in many countries, but disclosure requirements are inconsistent. Until this inconsistency is eliminated, related party disclosure of compensation payments should remain.

Question 2

No, We do not agree. Information about related party transactions and outstanding balances of the parent and the subsidiary's own financial statements is required to understand the financial position of an entity and therefore this disclosure requirement should be maintained for both the profit and loss account and the balance sheet.

IAS 27 - Consolidation and separate financial statements

Question 1

Yes, We agree, if the all the criteria are satisfied, consolidated financial statements should not be prepared.

Question 2

Yes, We agree. The minority interests represents the remaining interest in net assets of a subsidiary within a group and meets the definition of equity. Therefore the minority interest should be shown as part of equity.

Question 3

Investments in subsidiaries should be at cost in an entity's own financial statements rather than permitting measurement as fair value under IAS 39. The elimination of options in accounting standards assists comparability.

If the focus of a separate company financial statements is on the legal entity alone, measurement at cost is more consistent with that focus, rather than mixing in valuation adjustments relating to other entities.

IAS 28 - Accounting for Investments in Associates

Question 1

Yes, We agree. For venture capital organisations, mutual funds etc IAS 28 and IAS 31 should not apply to investments that would otherwise be associates or joint ventures, if these investments are measured at fair value in accordance with IAS 39. The fair value measurement will provide the most relevant information when the asset is held for investment purposes rather than for use in the business.

Where the fair value basis is being used for valuation of associates and joint ventures, all investments should be valued on this basis rather than a mix of fair value or cost.

Question 2

We do no agree fully. Where a long-term receivable, in substance forms part of an entity's investment in associate, it should be measured in the same way as other elements of the investment.

However, where long term receivables have special conditions associated with repayment, therefore making the recovery of balance likely, it would be inappropriate to write down the receivable in line with the investment. This is particularly the case where collateral is in place to support the recovery of the balance due.

IAS 33 - Earnings per share

Question 1

Yes, We agree. The proposal is consistent with the definition of dilution.

Question 2

The proposed approach would achieve convergence with US GAAP. However the following points require some consideration.

a) The frequency of interim reporting may impact EPS

b) Issuable shares should only be taken into account from the time the conditions have been met or contingent events have occurred. This requires emphasis in the standard.

CO-OPERATWE ACCOUNTING STANDARDS COMMITTEE (CASC)

13th September 2002

FRED 25 RELATED PARTY DISCLOSURES

Question ASB (i)

We agree with the proposal to issue a new standard in the UK on related party disclosures once the new ISA24 is approved by the IASB. This is provided that the two standards should be consistent such that when preparers of the accounts in the UK have to comply with international accounting standards in 2005 there is no need for any further change in published accounts.

Question ASB (ii)

We do not believe there is any need for any transitional arrangements.

Question ASB (iii)

We agree that the disclosure of the name of a controlling party and, if different, that of the ultimate controlling party is appropriate.

Question ASB (iv)

We do not believe that the standard should generally require disclosure of the names of transacting parties. In the majority of circumstances, it is not the specific parties themselves which are important in respect of the impact on the business; it is the nature of the relationship with those parties that is important. The disclosure requirements of paragraph 14 should be adequate.

Question ASB (v)

Shadow directors and persons acting in concert can have precisely the same impact as other related parties. For this reason they should be included in the definition of related parties.

Question ASB (vi)

The consideration of materiality in FRS8 is somewhat unusual in that it refers not only to materiality in relation to a set of financial statements but also in relation to the other related party. There is no reference to materiality in Fred 25.

We consider that more guidance on materiality should be included within Fred 25. My view is that the disclosure of related party transactions should relate to those transactions that are material to the entity. If they are not material to the entity they are unlikely to influence significantly any decisions made by the users of the financial statements.

There are, however, other possible interpretations. If transactions are on completely normal terms they might not have a significant impact on the financial statements in the year in which the transaction is reported. It could, therefore, be considered that they do not require disclosure. However, similar transactions might take place in future years but on different terms. Those different terms might impact significantly on the profitability of the entity. Disclosure of the nature and scale of all related party transactions would warn a user of the accounts of this potential risk.

Question ASB (vii)

The requirement to disclose all related transactions other except where an entity is a wholly subsidiary is unnecessarily onerous. The exemption in FRS8 for subsidiaries that are 90% owned appears quite reasonable.

FRED 25 RELATED PARTY DISCLOSURES

IASB Questions

We agree with both of the IASB questions.

CO-OPERATIVE ACCOUNTING STANDARDS COMMITTEE (CASC)

13th September 2002

FRED 27
EVENTS AFTER THE BALANCE SHEET DATE

Question ASB (1)
In principle We agree with the proposal to issue a new UK standard on events after the balance sheet date, once the new IAS 10 is approved and once the law the amended to permit its application. However, a new UK standard should not be issued if its requirements are different than the new IIAS 10 such that companies will be required to make a change on the implementation of the UK standard and a further change in 2005 when international accounting standards apply.

Question ASB (ii)
We do not believe that transitional arrangements are necessary.

Question ASS (iii)
We concur with the draft standard. There are no aspects that the ASB should request the ISAB to review when finalising the revised IAS 10.

CO-OPERATIVE ACCOUNTING STANDARDS COMMITTEE (CASC)

13th September 2002

FRED 29- PROPERTY, PLANT AND EQUIPMENT. BORROWING COSTS

Question ASB (i)

It is not appropriate for two new standards replacing the current FRS15 to be issued prior to 2005. This would create unnecessary work for the preparers of accounts and unnecessary difficulty for the readers of accounts. It therefore follows that a new standard should only be issued if it is fully in accordance with the expected international accounting standards that will be in existence in 2005. Therefore any UK standard on property, plant and equipment and borrowing costs should not be issued if there are any unresolved differences between that standard and IAS 16. If it is likely that IAS 16 will be changed by 2005, We do not believe it is worthwhile amending FRS 15 until such time. However concerns over the current IAS should be collated for incorporation into any future revision.

Question ASB (ii)

We disagree with the proposed international approach to residual values. It appears technically inconsistent to include what is, essentially, an element of re-evaluation in the residual value when the original cost is historic cost.

In extreme cases the use of the current estimate might lead to no depreciation charge on an asset. This would appear to be inconsistent with the principles of the consumption of benefits arising from the asset.

Question ASB (iii)

The fact that the ASB have asked respondents whether or not they believe that the FRED would permit renewals accounting indicates that the answer is not clear. This is an inadequate position regardless of the responses received because it leaves open the possibility that some preparers of accounts will treat renewals accounting as acceptable under the FRED whereas others will not.

Unfortunately We have little knowledge of businesses where this might be relevant and am unable to comment on the practice.

Question ASB (iv)

We concur with the approach set out in FRS15 with regard to the revaluation of properties to existing use values rather than fair values. Two examples illustrate why the IAS approach is inappropriate:

1. The revaluation of assets to open market value can lead to unnecessary or unfortunate results. It might, for example, require the write down of a property which, although not specialised, has being refurbished to a standard higher than other potential users would require. This could be a deliberate policy by the owner of a property in order to distinguish its properties (such as retail outlets) from competitors. It would be inappropriate to require the write down of such properties to open market value if the owner had no intention of selling.

2. Similarly, but conversely, although the open market value might be higher than the existing use value it would be inappropriate to revalue the property upwards when there is no intention for the property to be sold. Depreciation would be required on the higher amount and this would effectively result in a depreciation charge based on opportunity costs.

FRED 29- PROPERTY, PLANT AND EQUIPMENT. BORROWING COSTS

The detailed requirements for valuations set out in FRS 15 are useful and help increase consistency between different sets of accounts. Not including these guideline increases the risk of revaluations falling into some disrepute.

Question ASB (v)

The treatment of write downs on revalued assets set out on FRS 15 is difficult to understand. In particular it results in write downs of fixed assets appearing in different parts of the accounts even though it may be very difficult to identify the different circumstances applicable. Indeed, it is possible for one set of accounts to write down one asset partly in one place and partly in another. The treatment proposed by IAS 16 is much more straight forward and much more readily understandable to users of the accounts. We consider this treatment much preferable.

Question ASB (vi)

The recognition of revaluation gains and losses in the profit and loss account of insurance companies is wholly appropriate since the gain is part of the day to day operations. It should, therefore, be retained.

Question ASB (vii)

We do not consider that the transitional arrangements for the first time application of FRS15 should be included in a new standard because it has no technical justification. It had no technical justification in FRS15..

Question ASB (Viii)

We do not believe that the ASB should consider any other transitional arrangements.

Question ASB (ix)

There are no other aspects Qf the draft standard that the ASB should request the IASB to review.

Question ASB (x)

Since there is no international agreement on the capitalisation of borrowing costs, We concur that it should, at this stage, remain optional.

If the optional requirement is not a possibility We believe that capitalisation should be mandatory. This is because interest costs are a cost of constructing assets. If an asset is purchased by a reporting entity, interest costs, would, effectively, be included in the purchase price. Capitalising interest costs on assets constructed by the reporting entity would allow a fairer comparison with companies who purchase such assets.

Question ASB (xi)

Where foreign currency borrowings are used specifically to fund a project, exchange differences arising on those borrowing should be capitalised. This is because the exchange difference is a cost that can be directly attributed to the cost of the project in the same way as the interest cost can be directly attributed.

Question ASB (xii)

We concur with the treatment of borrowing costs for captilisation set out in IAS23 Where a loan is obtained specifically to fund a project it will rarely be possible to thaw down the loan at exactly the time the expenditure is incurred on the project. Therefore the costs of acquiring funds to fund the project is equal to the total interest charge on the loan raised less the interest received on any surplus funds invested.

Question ASB (xiii)

We have no comments on IAS23 that We wish the ASB to bring to the IASB's attention.

IASB questions

We agree with all the IASB questions.

CO-OPERATIVE ACCOUNTING STANDARDS COMMITTEE (CASC) 13th September 2002

FRED 28 – INVENTORIES. CONSTUCTION AND SERVICE CONTRACTS

General Comments
The changes in accounting for inventories proposed by FRED 28 appear relatively limited.

The changes in accounting for construction and service contracts are more significant in that they require recognition of revenue and costs from the date work begins on contract rather than when the results of a contract can be reasonably determined. This will more closely reflect the work performed as revenue in the period in which it is performed. The adverse consequence is that the early periods are profitable contract will show no margin whereas the later periods will show a very high margin. Where there are a large number of contracts, one would expect the margins to average out because the contracts will be at different stages. Overall, therefore, We concur with the approach of the draft standard.

Question ASB (i)
It is not appropriate for two new standards replacing the current SSAP 9 to be issued prior to 2005. This would create unnecessary work for the preparers of accounts and unnecessary difficulty for the readers of accounts. It therefore follows that a new standard should only be issued if it is fully in accordance with the expected international accounting standards that will be in existence in 2005. Therefore any UK standard on inventories, construction and service contracts should not be issued if there are any unresolved differences between that standard and IASs.

Question ASB (ii)
We agree with the proposal to incorporate ISA18 in the standard on construction contracts, so that it may also apply to other contracts or services.

Question ASB(iii)
We do not believe any transitional arrangements are required.

Question ASB (iv)
We disagree with disclosure requirements set out in paragraph 34(c), 34(d) and 35(d). The disclosure of the amount of any write down or the amount of any reversal of a write down would not add any value to the accounts unless it was on such materiality or so unusual in nature that the information was required to provide a true and fair view. In such circumstances this information would need to be disclosed anyway. If the information was not so significant its disclosure would simply add unnecessary information to the accounts.

Question ASB (v)
Paragraph 21 refers to costs which are incurred in securing contracts. This paragraph appears less rigid than UITF34. UITF 34 requires that costs must be recognised as an expense up to the point at which the contract is virtually certain to be awarded. The implication of paragraph 21 of the FRED is that costs can be recognised at an earlier date (ie. when it is probable that the contract will obtained) and that any costs incurred in the accounting period in which the contract is awarded (including those costs incurred before it was probable that the contract would be obtained) may be treated as construction costs. Having only just issued the UITF 34 it is strange that the ASB appears to be changing its opinion of this matter.

Question IASB (i)
We agree with the elimination of the last in first out method for determining the cost of inventories.

Question IASB (ii)

We agree with the requirements of paragraphs 30 and 31 that write down should reversed when the circumstances that caused inventories to be written down below costs no longer exist and that the reversal should be recognised in the profit and loss account.

Inventories of agricultural and forest products and minerals

We consider it inappropriate that the standard does not cover agricultural and forest products and minerals. The standard does not make it clear whether or not agricultural products prior to harvesting should be valued in accordance with the standard. It is also simply inappropriate that there is no standard for the valuation of such products and the reference in paragraph 1(c) to “well established practices in certain entities” is too vague. There have been many well established practices for accounting for many items that have been criticised in the past. The lack of clarity leaves the standard open to abuse.

CO-OPERATIVE ACCOUNTING STANDARDS COMMITTEE (CASC)

13th September 2002