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11 September2002

Dear Sirs

ASB FINANCIAL REPORTING EXPOSURE DRAFTS 23 TO 29

The Accounting Standards Committee has considered the above Exposure Drafts and I am pleased to set out its comments below.

Timing of Convergence Process

We are concerned at aspects of the timing of the ASB's proposed process of convergence in the UK. The proposed process would seem to involve the publication in the first quarter of 2003 of a number of new accounting standards based on, but not entirely replicating, the equivalent International Financial Reporting Standards ("IFRSs"). Presumably, under this process, there will also be further exposure drafts during the course of 2002 to 2004. If these first standards come into effect during 2003, and subsequent ones come into effect on a phased basis thereafter, the financial statements of each and every UK company over the next few years will contain a number of changes in accounting policy and corresponding prior year adjustments. For listed groups, this will be compounded in 2005, when the IASs/IFRSs replace the UK standards. It will be further compounded if the IASB changes those standards on which the ASB has already based its own new standards, thus requiring further changes to the UK standards.

We have a number of concerns on the effect of this phased process.

- Firstly, the changes required by the new standards will involve a great deal of planning and preparation by companies. Some changes may involve the introduction of new accounting processes and systems, and even different ways of doing business (eg hedging). Requiring changes every year for a number of years would be significantly more onerous for companies than a single "Big Bang" move to IASs/IFRSs for listed companies in 2005. This is particularly true in relation to a subject as pervasive as financial instruments.

- Some aspects of the FREDs retain UK-specific differences that will disappear for listed companies in 2005 but will apparently remain for those entities not subject to the EU regulation. This is likely to cause some confusion. In particular, although this might not be too significant for note disclosures, it could cause problems in relation to differences in recognition, measurement and presentation.

- Furthermore, it does not seem sensible to converge UK accounting standards on IASs when convergence at this early stage is not essential and when it is not clear to what extent these IASs may themselves change in the near future. Listed groups could be left to move across to IASs/IFRSs wholly in 2005. Subject to the current consultation by the DTI, other entities (individual companies, and unlisted groups, and other non-company entities) could also move across to IASs/IFRSs, or a version of UK standards based on those IASs/IFRSs, in 2005 or shortly thereafter.

- The number of changes in accounting policy and prior year adjustments which will arise from a phased implementation over the next few years may bring discredit on accounting and the accounting profession. Users of accounts are likely to mistrust these changes and fail to understand why it is necessary to make such prior year adjustments to accounts which previously claimed to give a true and fair view, and why these changes in policies are necessary to improve future accounts. In the post-Enron business environment, this may be regarded with extreme scepticism.

- The adoption of IAS-based standards in the UK, at the same time as current UK standards, will also inevitably result in inconsistencies between terms and definitions, which could have a detrimental effect on the application of those standards. It may also affect the perception of users of accounts and undermine the confidence which they have in the accounting framework. For example, differences in the definition of "control" and "significant influence" between a new standard on related party disclosures and existing FRSs 2, 5 and 9 may give rise to difficulties. There are also differences in terminology which would be even more confusing to users of accounts, for example the synonymous use of "income statement" and "profit and loss account".

- There are also educational needs to be considered for preparers, auditors and accounting students, but also for users of accounts. The current situation of having two evolving sets of accounting standards – the developing IAS/IFRSs and the ASB standards which are trying to converge with the IASB's moving target - makes this very difficult.

For these reasons we prefer a "Big Bang" application of the new standards wholly in 2005, but with a phased consultation and publication timetable.

Changes to International Accounting Standards

We note that the IASB discussion and justification for changes is not included fully in the ASB exposure drafts for consideration by UK consultees. This means that UK consultees are not necessarily made aware of the issues being addressed by the IASB. In some instances this discussion may be critical to consideration of the FRED, eg in considering whether the disclosure of management compensation should be required, in FRED 25.

In future, it would be helpful, if the IASB's rationale for its proposed changes were routinely incorporated in the ASB's FRED.

One further observation which we would make is that by the ASB issuing their own FREDs and consultation paper, UK commentators may focus on the FRED's and not give sufficient attention to the IASB's document. For example, the ASB's consultation paper on IASB proposals (issued at the same time as these FREDs) does not even mention the fact that the IASB's own exposure draft has over 50 pages dealing with consequential amendments to other IASs.

Recommended Approach

We would like to emphasise the importance of providing a reasonable lead time between the new requirements becoming clear and the implementation of those requirements. As indicated above, we would prefer a phased consultation, to allow interested parties to consider the proposed changes in the necessary detail. On balance, we recommend that the ASB develops and publishes its UK standards on a phased basis, but defers implementation until 2005. A phased period of development would allow the necessary consultation of interested parties, and would allow any changes in the IASB's approach to be reflected in the UK standards before they are implemented. Publication in advance would also allow the necessary education processes to occur.

Accordingly we recommend that all standards to be implemented in 2005 need to be finalised by mid-2003. Any subsequent (ASB and IASB) standards issued after mid-2003 should not be mandatory until after 2005.

This would result in a "Big Bang" approach to the adoption of extant IASs/IFRSs by listed companies in 2005, and to the adoption of revised ASB standards by other UK entities around the same time.

Materiality

We note that each draft revised IAS contains an opening paragraph in italics which, *inter alia*, states that "International Accounting Standards are not intended to apply to immaterial items" and refers to paragraph 12 of the Preface. However, as a result of the changes to the IASB Preface, the authority for standards not needing to be applied to immaterial items has been removed. We presume that the IASB intends to include such authority in each standard but no longer in the Preface. If this is the case, the reference to paragraph 12 of the Preface needs to be deleted from the opening paragraph to each of the standards. (The ASB has not reproduced this IASB opening paragraph in its FREDs, but has similar authority in paragraph 13 of its Foreword to Accounting Standards.)

We recommend that the ASB encourage the IASB to reinstate in the Preface the concept that standards need not be applied to immaterial items, to reinforce the above statement in the opening paragraph of each standard. Clearly, the costs of applying IASs/IFRSs to immaterial items would far exceed any benefits of so doing.

Public Sector Issues

We are concerned that the IASB does not appear to consider the public sector in its development of IASs/IFRSs. Whilst these are developed primarily for the private sector, the principles contained therein are taken up by the IFAC Public Sector Committee, and will increasingly be taken up by local public sector bodies, in the development of accounting standards for central governments and public sector bodies more generally.

We suggest that consideration be given in the course of the development of the respective IASs/IFRSs to the application of the principles contained in those standards to the public sector. If the IASB feels that it does not have the resources to address public sector issues directly, then we would suggest a more proactive mechanism for ensuring public sector comments at the standard setting stage are sought through national standard setters, such as ASB, and through IFAC's Public Sector Committee.

Regardless of whether the IASB responds to these concerns, we recommend that the ASB considers the public sector aspects of the standards it proposes to introduce into the UK.

Detailed Comments

Our detailed comments on FRED 26 are included in the attached Appendix.

We hope that our comments are of assistance to you in the finalisation of these standards and in your consideration of their implementation. If you wish to discuss any of our comments further, please do not hesitate to contact me.

Yours sincerely

DAVID A WOOD
Deputy Director, Accounting & Auditing
Secretary to the Accounting Standards Committee

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on FRED 26 “Earnings per Share”
September 2002

Responses to ASB Questions

(1) 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?

Please refer to the comments on the convergence process in the covering letter. Our general position is that we would be happy for new standards to be published, but recommend that implementation be deferred until 2005. In the case of earnings per share, however, because FRS 14 was itself based on the old IAS 33, we would be more relaxed about a new UK standard being issued and implemented as soon as the new IAS 33 is approved by the IASB.

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

No. Subject to our answer in (i) above, we do not see why any specific transitional arrangements should be necessary in the implementation of the standard.

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

Additional BPS Figures

We see no reason why additional earnings per share figures should be prohibited from the face of the profit and loss account, and would be happy for such additional figures to be disclosed on the face of the profit and loss account so long as:

- they are not given more prominence than the four earnings per share figures required by paragraph 58; and
- explanation of these additional figures is given in the notes, as required by paragraph 65.

In-substance Share Buy-backs

Paragraph 25 of the draft standard addresses one particular situation which, in substance, represents a share buy-back. We believe that this should be broadened to apply to any arrangements which are in substance share buy-backs. One example is where a company issues B shares via a bonus issue or share split, which are then redeemed for cash, together with a share consolidation of the original shares (Severn Trent plc, 1998).

Dilutive Options and Dilutive Potential Ordinary Shares

Paragraph 35 lays down a principle which is then not followed in the test of the document. The principle in paragraph 35 has been applied to options, but not, say, to convertible debt. Paragraph 35 therefore needs to be revised, to make it clear that it is dealing only with share options and similar dilutive instruments such as warrants.

Contracts to be settled by Issuing New Shares etc

There is a section on contracts to be settled in shares or cash – Paragraphs 51 to 55. We suggest that there should also be a section on contracts to be settled by issuing new shares or by buying shares in the market.

Responses to IASB Questions

(i) ***Do you agree that contracts that may be settled either in ordthary 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. This seems to be the most prudent approach, consistent with the calculation of diluted earnings per share.

(ii) ***Do you agree with the [following] approaches to the year-to-date calculation of diluted earnings per share (as illustrated in Appendix II, examples 7and 12)?***

No. We do not agree with the proposed approaches. These would result in different EPS for companies which report on a quarterly or half-yearly basis from those which only report annually, and this would be exacerbated for companies with seasonal variations in profit.