BRITISH AIRWAYS

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Mr Hans Nailor
Accounting Standards Board
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Dear Sir,

FRED 29 - Property, Plant and Equipment; Borrowing Costs

We enclose our comments on the proposals included in the exposure draft including responses to the questions included in the preface.

In general terms whilst we agree with the principle of convergence of accounting practices, we have concerns over the nature of some of the suggested proposals included within the exposure draft and the continued differences between the UK and IAS standards on property, plant and equipment. We are opposed to a continuous transition from UK GAAP to IFRS over the next three years as we believe a piecemeal adoption process does not facilitate comparability or transparency between financial statements.

We have limited our responses to questions where we have specific comment; where we have no issue with the proposal, we have not included a response.
Our responses to the detailed questions are as follows:

Q1 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 lAS 16, unless it becomes clear that further changes to IAS 16 are likely by 2005 as a result of the revaluation project?

We agree with the principle of convergence to improve the comparability of accounts between different accounting jurisdictions however we are opposed to implementing any proposed changes now that could potentially be superseded by the results of IASB's revaluation project. As detailed in our response to question 7, we would strongly recommend that the transitional provisions currently proposed in FRED 29 are retained in the new UK standard and in any future revisions.

Q2 As explained in paragraph 7 above, 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?

Whilst we agree with the requirement to review residual values on a regular basis, we disagree with the use of 'current prices' to revise residual values. There does not appear to be any reference to this measure in other IAS or UK accounting guidance and therefore further clarification is needed.

We believe a longer-term market position needs to be taken into account when revising residual values. This is particularly relevant to specific assets such as aircraft, which have long useful lives and therefore a normalised market position compared to the proposed 'point in time' measure would be more relevant. In addition, short term market demand fluctuations inherent in the second-hand aircraft market could result in significant variations in annual residual values and hence a volatile annual depreciation charge.

This approach appears inconsistent with IASB's depreciation methodology of allocating depreciation on an item of property, plant and equipment on a 'systematic' basis over its useful life.! Such fluctuations would not represent impairment gains or losses as the 'current price' measure does not take into account the present value of future cash flows obtainable as a result of the asset's continued use which would still support the asset's recoverable amount.

Q4 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 above?

As stated above, we support the move towards a single accounting practice that allows greater comparability between entities' financial statements, including the more systematic approach to revaluations prescribed in IAS 16. Our concern relates mainly to the outcome of the IASB' s revaluation project which could result in further changes to the new requirements.

We agree with the inclusion of transitional provisions in FRED 29 and would urge the IASB to include such provisions in any future amendments to IAS 16.

Q5 Are there any other aspects of the differences between the proposed standards and current UK accounting requirements that you wish to comment on?

We disagree with the recommended disclosures on the gross carrying amount of any fully depreciated property, plant and equipment that is still in use and the fair value of property, plant and equipment when this is materially different from the carrying amount (detailed in explanatory paragraph 66). The information requested would be commercially and competitor sensitive.

Q7 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 revelations instead of carrying amounts to historical cost. Do you believe that a transitional arrangement should be included in a new UK standard to allow entities that adopted FRS 15's transitional arrangements to continue to recognise the carrying amounts under that arrangement?

We support the inclusion of the transitional arrangements for previously revalued property in a new UK standard. To impose a requirement to restate the carrying values at depreciated historical cost would be inconsistent with 'recoverable amount' methodology in both UK and International Accounting Standards.

Q10 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 borrowing costs should remain optional. We do not support any proposed change that enforces a mandatory capitalisation or prohibition.

Q11 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 do not agree with the exclusion of exchange differences from capitalised borrowing costs. Foreign exchange differences arising as a result of the funding facilities of qualifying assets are essentially finance costs and should be included in the definition of borrowing costs eligible for capitalisation.

Q12 What are your views on the difference between IAS 23 and FRS 15 referred to in paragraph 24 above concerning borrowing costs eligible for capitalisation?

We believe that the lAS 23 definition of borrowing costs eligible for capitalisation i.e. the actual borrowing costs less any investment income received from the temporary reinvestment of unutilised borrowings more accurately reflects the actual interest costs of the borrowings used to finance asset acquisitions.

IASB questions:

Q14 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?

We agree with the principle of 'fair value' to measure the underlying value of a transaction where it can be determined reliably.

Q15 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?

As detailed in our response above, the use of fair values is only relevant when it can be determined reliably.

Q16 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?

We do not agree that depreciation should automatically continue when an item of property, plant and equipment becomes temporarily idle. To do so does not take into account specific assets with high residual values such as aircraft, where usage often determines the rate at which the economic benefits are consumed. For such assets, the useful life may be extended during a period of non use, negating the need for depreciation during this period.

Conclusion

In conclusion, whilst we reaffirm our general support for international convergence of accounting requirements to improve comparability of financial statements we have raised concerns about a piecemeal transition process. We prefer the alternative approach of full adoption in 2005 or earlier if appropriate with the current focus being on improving IAS and planning for its implementation.

Our specific concern on FRED 29 relates to the use of 'current prices' in revising residual values. We urge the ASB and IASB to reconsider the use of this measure in light of our comments above.

Yours sincerely

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