ROYAL & SUNALLIANCE
WORLDWIDE GROUP OFFICE

30 Berkeley Square
London W1J 6EW
Telephone +44 (0)20 7636 3450
Facsimile +44 (0)20 7636 3451

27 September 2002

Ms Mary Keegan
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London WC1X

Dear Mary

FREDs 23 to 29 and Exposure Draft of Improvements to International Accounting Standards.

We welcome the opportunity to comment upon the exposure drafts above.

Before making comments on the individual exposure drafts, we would first like to make a general comment upon the current state of the convergence process of UK and International Accounting Standards.

The Hundred Group have already written to you expressing concern about the ASB's proposed programme of change in the period between now and the European deadline for adoption of International Accounting Standards in 2005. We are fully in agreement with concerns expressed in the Hundred Group's letter.

In particular, we believe a process of continuous change in existing UK GAAP during this interim period, followed by a further set of changes in 2005 for those standards where UK GAAP and International GAAP are not fully converged will undermine the credibility of financial statements during this time. Additionally, the insurance industry as a whole faces additional challenges in preparing for 2005 and the added complication of accounting policy changes and restatements would divert resources away from the achievement of the 2005 deadline. We urge the ASB to reconsider the enforced changes to UK accounting standards between now and 2005 and support the Hundred Group's plea that such changes should be voluntary during this period.

Turning now to the detailed issues contained in the UK exposure drafts, the main points that we have as a Group are as follows:

- FRED 23 adoption of a principal based standard that does not fully comply with IAS. We are concerned that any listed company will in any event need to adopt the more detailed requirements of IAS 39 although we concur with the need to influence IASB in this area. We shall consider this further in our responses to the IAS32/39 project and to FRED 30.
- FRED 25 reduction in the current exemptions for Group companies. We are confused by the wording in the proposed revisions to the IAS and seek clarification on the exemption.
- FRED 26 prohibition of disclosure of alternative EPSs on the face of the P&L account. We are against making restrictions on information that management believes to be of relevance to users of the financial statements. We also believe that this type of discussion should be deferred until the project of reporting performance is concluded,

We attach detailed responses to the questions upon which the ASB has invited comments.

We turn now to the exposure drafts of other International Accounting Standards, which are not currently being adopted by the ASB.

The main issue about which we have concerns relate to the hierarchy contained in paragraph 5 and 6 in the proposed changes to IAS 8. As you are aware, the IASB is unlikely to have adopted a standard to deal with accounting for insurance contracts prior to the 2005 deadline. As an interim solution the IASB has tentatively concluded that existing local accounting bases for accounting for insurance contracts should be permitted to continue as far as possible. The IASB has been considering the draft statement of principles on accounting for insurance contracts and this draft document calls into question a number of current practices and in particular their adherence with the IASB's own Framework for the Preparation and Presentation of Financial Statements. We acknowledge that it will be difficult for IASB to grant an exemption to insurers within IAS 8 itself, however for the insurance industry, it is imperative that confirmation is forthcoming from the IASB, as soon as possible, that it will allow a departure from these paragraphs in IAS 8 during the interim period between 2005 and the adoption of its standard on accounting for insurance contracts.

The other areas in the exposure drafts where we have specific issues are as follows:

- IAS 8 definition of error. We are concerned that the boundary between the definition of an error and a change in an accounting estimate may be inadequately defined for an industry such as insurance where the use of estimates in fundamental to the results reported in the financial statements.
- IAS 27 removal of the option to equity account for subsidiary companies in the parent company's accounts. We foresee difficulties in valuing subsidiaries as equity instruments under IAS 39, which may force companies to default to cost. We are not convinced that this will enhance the accounts of parent companies.

We attach detailed responses to the questions upon which the IASB has invited comments.

Yours Sincerely

Doug Logan
Director, Group Technical Accounting

FRED 23 - Financial Instruments Hedge Accounting
Responses to particular issues on which comments *are* invited

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

We agree that there is an absence of accounting guidance on hedge accounting in UK GAAP but we are not convinced that it is helpful for the UK to adopt a part of the International Standard at a time when this standard is itself under review. For listed Groups, we are not convinced that it would provide any practical ASBistance to provide a standard based upon the exposure draft since the companies will need to consider the more stringent requirement in the International Standard being mindful of the implementation dates under the proposed IFRS on First Time application of IAS.

We acknowledge that there may be a need to fill the void left by a revocation of SSAP 20 but this may be more easily met by a transitional inclusion of the relevant paragraphs within a standard emerging from FRED 24.

In summary, we would far prefer to leave the UK position unchanged during the lead up to 2005 but to use the draft standard to add support for changes to be made to IAS 39 to remedy the flaws therein.

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

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

We concur that any UK standard on hedge accounting should be in line with the International Standard. We shall comment on the detailed proposals within our response to FRED 30 and the proposed changes to IAS 32 and IAS 39.

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

We support the principles set out in FRED 23.

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

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

We support the ASB in seeking to adopt a principles approach to these issues but we also mindful that ultimately our accounting policies will be driven by the relevant IFRS. As previously stated we consider that the primary value in considering this exposure draft is in seeking to influence the approach adopted by the IASB in their consideration of IAS 39.

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

We are not aware at present of any other restrictions that should be placed upon hedge accounting but we shell consider this further in our response to FRED 30 and the response to the proposed improvements to IAS 32 and IAS 39.

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

We shall consider this further in our response to the proposed improvements to IAS 32 and IAS 39.

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

If the exposure draft were adopted in the UK as a standard, then the basis of accounting would probably have to follow IAS 39 in order to limit the ultimate effort of complying with IFRS in 2005.

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

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

We agree with this treatment.

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

We acknowledge that this treatment is consistent with other currency exposures of the foreign operation.

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

We believe that there is a need for greater clarity in 17(b) as to how the accounting is intended to be interpreted. We assume that this refers to the hedge accounting from the date of the last balance sheet date up until the time of discontinuance?

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

We do not believe that the standard should be mandatory in the UK prior to 2005 and that any earlier adoption should be voluntary. It is our belief that the benefit of the exposure draft will be to add to the debate on hedge accounting under IAS.

FRED 24—The Effects of Changes in Foreign Exchange Rates/Financial Reporting in Hyperinflationary Economies
Responses to particular issues on which comments are invited

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

No, as indicated in our covering letter, we believe that accounting changes arising from the transition from UK GAAP to IAS should as far possible, be permitted to be made in a "big bang" restatement in 2005 rather than on a piecemeal basis.

If the ASB does decide to implement FRED 24 in line with the revisions to IAS then, as noted, sufficient time must be given to those companies most impacted by the change; in particular those companies translating the results of foreign entities using closing rates.

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

We can sympathise with the ASB's stance on recycling but continuing differences between UK GAAP and IAS add further credence to our argument that "convergence" adjustments should be deferred until 2005 in order to avoid "restatements of restatements"

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

The transitional arrangements that we should like to see is the optional deferral of "convergence changes" until 2005.

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

We agree with the principle and the guidance.

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

We concur with the arguments for permitting this presentation.

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

On balance we concur with this treatment.

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

We concur with the Board's reasons for removing this alternative treatment.

IASB (v) Do you agree that

(a) goodwill and

(b) fair value adjustments to assets and liabilities

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

On balance we concur with this treatment.

FRED 25 - Related Path Disclosures
Responses to particular issues on which comments are invited

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

As previously stated we have a general opposition to any compulsory implementation of new UK standards prior to 2005, however we do not believe that the changes arising from the revision of this standard are significant.

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

We have no comment to make on this.

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

We note that under the proposed revisions to IAS 27 (paragraph 33(b)), disclosure of this information is required for certain companies but we concur that it would be logical to include this for all companies and for the comprehensive requirement to be contained in IAS 24.

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

We do not believe that it is necessary to mandate disclosure of transacting parties in circumstances where this information is not needed in order to comply with the requirements set out in paragraph 14.

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

We have no comment to make on this.

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

We concur that the standard should apply only to material transactions and, this being the case guidance is helpful, when considering the definition of material in the area of related party transactions.

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

We are not aware of any other issues that need to be considered.

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

'Management' and 'compensation' would need to be defined, and measurement requirements for management compensation would need to be developed, if disclosure of these items were to be required. If commentators disagree with

the Board's proposal, the Board would welcome suggestions on how to define 'management' and compensation'.

We believe that disclosure of these items is useful to stakeholders and should be disclosed. Rather than consider this subject within IAS 24, it may be necessary to consider it as a separate exercise in view of the many different forms that management compensation may take,

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

In the absence of any reference to a major change in IAS, we presume that this exemption is intended to have the same effect as the wording previously contained in the current version of IAS 24. However we find the revised wording above confusing. The wording can be read to grant relief only where the *"related party transactions and outstanding balances are made available or published with consolidated financial statements for the group to which that entity belongs".*

Our understanding is that the current exemption applies to all related party transactions and so the new wording appears to reduce the scope of the existing exemption by removing those transactions eliminated in the consolidated accounts or not disclosed on grounds of materiality. The above interpretation appears to vary from the interpretation of the above wording given in Appendix A paragraph 6. If the interpretation in A6 is used then clarification of the meaning of *"[financial?] statements are made available or published with consolidated financial statements for the group to which that entity belongs"* would be useful.

We also consider that where the exemption is used then its use should be disclosed.

<u>FRED 26 - Earnings Per Share</u>
<u>Responses to particular issues on which comments are invited</u>

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?

As previously stated, we believe that the resources of UK Groups would be better channelled into preparation for the changeover to IAS in 2005 as opposed to making changes to UK GAAP (albeit relatively small changes in the case of FRED 26) during the interim period.

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

This is covered in (i) above.

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

We do not believe that the IASB should prescribe the treatment of the results additional earnings per share calculations, by relegating such information to the notes to the financial statements. We consider that where such disclosures are made then, by definition, management consider this provides more relevant information than the basic EPS calculation.

Additionally, the IASB has undertaken a project on reporting performance and we consider that this project will itself need to review the EPS calculation and disclosures and this would provide an opportune timing for a review of all aspects of performance disclosures.

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

We do not disagree with this treatment.

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

- **The number of potential ordinary shares is a year-to-date weighted average of the number of potential ordinary shares included in each interim diluted earnings per share calculation, rather than a year-to-date weighted average of the number of potential ordinary shares weighted for the period they were outstanding (ie without regard for the diluted earnings per share information reported during the interim periods).**
- **The number of potential ordinary shares is computed using the average market price during the interim periods reported upon, rather than using the average market price during the year-to-date period.**
- **Contingently issuable shares are weighted for the interim periods in which they were included in the computation of diluted earnings per share, rather than being included in the computation of diluted earnings per share (if the conditions are satisfied) from the beginning of the year to-date reporting period (or from the date of the contingent share agreement, if later).**

We have no disagreement with the illustrations.

FRED 27— Reporting Events after the Balance Sheet Date
Responses to particular issues on which comments are invited

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?***

As previously stated, we believe that the resources of UK Groups would be better channelled into preparation for the changeover to IAS in 2005 as opposed to making changes to UK GAAP during the interim period

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

See response to (i) above.

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

We do not have any comments to be forwarded to IASB.

<u>FRED 28 - Reporting inventories construction and service contracts</u>
<u>Responses to particular issues on which comments are invited</u>

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

As previously stated, we believe that the resources of UK Groups would be better channelled into preparation for the changeover to IAS in 2005 as opposed to making changes to UK GAAP during the interim period

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

We have no comment on this proposed change.

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

See (i) above.

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

We do not have any comments to be forwarded to IASB

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

We do not have any comments to be forwarded to IASB

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

We agree with the reductions of options in Accounting Standards and hence, while not impacted by the change directly, support the proposed change.

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

We have no reason to oppose this treatment.

FRED 29 - Reporting property, plant and equipment borrowing costs
Responses to particular issues on which comments are invited

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?***

As previously stated, we believe that the resources of UK Groups would be better channelled into preparation for the changeover to IAS in 2005 as opposed to making changes to UK GAAP during the interim period.

ASB(ii) ***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 pr ices 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 can understand the reasons for the proposed change but can foresee strange results that could occur when residual values are increased.

The major impact for insurers will be in respect of owner occupied properties and there are arguments for continuing the existing practice adopted by insurers in Europe of treating all properties as investment property. This is particularly relevant when insurers own properties backing insurance liabilities whose value may, in part be determined by the valuation of the property assets.

ASB (ii) ***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?***

We have no comments on this issue.

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 above?**

We do not have any specific comments on the existing treatments under UK GAAP and the arguments that should be used by ASB if it is generally considered by UK companies that the ASB approach is preferable.

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?***

As mentioned above we believe that there are circumstances in which it is more relevant for insurers to report changes in owner occupied properties through the Profit & Loss Account. We shall address this issue further when the exposure draft resulting from the project on reporting performance is exposed for comments.

ASB (vi) ***Do you agree with the ASB 's proposal, as a transitional measure (see paragraph 18 above), that the present exemption in FIRS 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 performance reporting?***

If ASB revises FRS 15 we would support the treatment in the exposure draft pending the outcome of the project on reporting performance. If this exemption were dropped, a particular problem would arise in respect of properties owned by the long term fund of an insurance company.

ASB** (vi **i) ***The transitional arrangements for the first-time application of FIRS 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 FIRS 15's transitional arrangement to continue to recognise the carrying amounts under that arrangement?***

We have no comment on this transitional arrangement.

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

We have no other comments on transitional arrangements.

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?***

We do not have any comments to be forwarded to IASB

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 have no comments on this issue.

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 have no comments on this issue.

ASB(xii) ***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 have no comments on this issue.

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

We do not have any comments to be forwarded to IASB

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] FIRS on property, plant and equipment)?***

As a principle we would concur with using fair values for an exchange of assets.

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

We agree.

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

We agree.