UK 37

16 September 2002

Mr Stephen McEwan
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London WC1X 8AL

Dear Mr McEwan

FRED 24: The effects of changes in foreign exchange rates

SSAP 20 (paragraphs 51, 57 and 58) contains certain choices on the treatment of hedges of net investments in foreign operations that we believe should be retained in the UK. FRED 24 does not contain equivalent choices because the ASB is proposing, in FRED 23, to issue a new accounting standard addressing hedge accounting in general, including the treatment of hedges of net investments in foreign operations.

Overall, we support the ASB's proposals, in FRED 24, for the implementation in the UK of a standard based on a revised IAS 21 and IAS 29 to succeed SSAP 20. However, since we believe that FRED 23 should be withdrawn, this would leave a gap in UK accounting literature on hedges of net investments in foreign operations. Therefore, we recommend that the paragraphs in SSAP 20 on hedges of net investments in foreign operations form part of FRED 24.

Yours sincerely

Rosemary Thorne
Chairman
100 Group Technical Committee
Bradford & Bingley plc
8 Bennet Street
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Allan Cook Esq
The Technical Director
ACCOUNTING STANDARDS BOARD
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Dear Allan

FRED 26 Earnings per share

We are writing in response to the invitation to comment on the proposed text of FRED 26. We have written to you separately in relation to the overall approach to the adoption of IAS standards in the UK. This letter addresses only one issue of important detail.

Paragraph 65 of the proposed standard addresses the possibility of disclosure of additional amounts per share based on income statement components and states that they shall be disclosed in the notes to the financial statements. We presume that the text was intended to convey that these additional disclosures should only be presented in the notes and never on the face of the income statement, however the draft language is not sufficiently explicit. For that reason alone it might be difficult to enforce such a conclusion.

We do not support any prohibition on additional earnings per share amounts being disclosed on the face of the income statement. We believe that clear disclosure of the amounts which are the focus of management's comparison of the business from period to period is a crucial element in communicating with shareholders, and where management believe this is appropriate they should be able to disclose such amounts in the primary statements. Hence we continue to support the guidance in FRS 3.d and FRS 14.74.

We understand the benefits of comparability of EPS data to investors. However, we note that Standard and Poors has recently published its thoughts on amended EPS amounts, which add to similar but different thinking from the analyst community in the form of Headline EPS. Further we understand that the IASB is currently developing a two column format for the performance statement that may result in more than one per share amount becoming commonplace. In the continuing absence of a consensus on how elements of performance should be subdivided, we believe that this is not the moment either to prejudge the outcome of the current debate by relegating additional EPS measures to the back of the financial statements.

16 September 2002

Mr Hans Nailor
Accounting Standards Board
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Dear Mr Nailor

FRED 27: events after the balance sheet date

One of the effects of FRED 27 is that dividends will not be provided at the balance sheet date unless declared by that date. For most companies this will mean that, because it is generally not possible to determine the amount of dividend that can be paid until the profits for the period have been determined, the annual dividend will not be recognised as a liability at the balance sheet date. This will in turn mean that, where a dividend is to be paid from a subsidiary to a parent company, the parent will not be able to recognise the dividend as a debtor. This could have a knock on effect to the ability of the parent itself to pay dividends.

This move is not only in accordance with the IASB framework, but also seems to be an inevitable consequence of a general move within international requirements. Consequently, we would find it difficult to resist the move in international standards.

We note that the DTI is currently consulting on whether from 2005 IFRSs should be applied in a listed company's own accounts. Should it be decided in due course not to extend the coverage of IFRSs to a Company's individual accounts, there may be advantage in maintaining the present UK position whereby dividends are provided at the balance sheet date. However, if the ASB changed this requirement in the UK standard, this option would no longer be available.

Consequently, we would urge the ASB not to implement this revised standard at least until the question of distributable profits is addressed.

Yours sincerely

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FRED 28 : Inventories – Construction and Service Contracts

The 100 Group Technical Committee has no general comments to make on FRED 28.

In respect of the particular questions raised:

19 **The ASB would welcome comments in particular on the following :**

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 a general principle, the 100 Group would prefer to align to international standards in one step at 2005. Therefore, our preferred approach would be to adopt IAS 2 in 2005.

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

We believe it is also appropriate to incorporate part of IAS 18 into the standard on construction contracts that is adopted in 2005.

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

Given the changes are minimal we do not believe consideration need be given to transitional arrangements.

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?**

There are no particular areas that give us concern.

v) **Are there any aspects of the standard on construction contracts**

There are no particular areas that give us concern.

20 **The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 2 :**

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 believe that it is appropriate to eliminate LIFO since this method can lead to a distortion in the value of inventories and hence the income statement.

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 (para 30). IAS 2 also requires the amount of any reversal of any write-down of inventories to be recognised in profit or loss (para 31).**

Do you agree with retaining those requirements?

We believe it appropriate to reverse inventory write-downs when the circumstances causing the original write-down no longer exist, in order to value more accurately the value of the inventory. This reversal should be recognised in the profit or loss, reversing the effect of the inventory write-down.

FRED 29 (IAS 16 + existing 23) : Property, Plant and Equipment – Borrowing Costs

Revaluations not included

1. The ASB is requesting comments on any aspect of the FRED by 16 September 2002 – the same date as the IASB has set for comments on its proposed revisions to IAS 16.

38. **The ASB would welcome comments in particular on the following :**

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 a general principle the 100 Group would prefer to align to international standards in one step at 2005. Therefore our preferred approach would be to adopt IAS 16 in 2005.

ii) **As explained in para 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?**

We can see merits in the current UK approach in that a more constant depreciation figure is struck as a result of a more stable valuation base, whether acquisition cost or latest valuation. The international approach, based on an annual revaluation, will base the depreciation on the current value of the asset. We are concerned that this approach introduces current values into what is essentially an historical cost based measure. We also have some concerns that this approach is more onerous to implement and would give rise to some fluctuation in the income statement. We suggest that FRS 15 is not revised until the outcome of the revaluation project is known.

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?**

It would appear that IAS 16 would preclude entities from using the renewals accounting method, however, we have no strong view on this topic.

iv) **What are your views on the differences between the requirements of FRS 15 and IAS 16 concerning revaluations as described in para 10 to 17 above?**

Clearly the key difference is that FRS 15 allows non-specialised properties to be valued on an existing use value (EUV) whereas IAS 16 adopts an open market value (OMV) approach. The 100 Group is slightly uncomfortable with a full OMV approach since circumstances could exist where OMV is higher than EUV were a property capable of being adapted for alternative use. If the entity has no intention of either changing the use of the property or selling the property, it seems such an approach is inconsistent with accounting for the asset on a going concern basis.

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

No, there are no other aspects on which the 100 Group has strong views

vi) **Do you agree with the ASB's proposal, as a transitional measure (see para 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 performance reporting?**

Yes, we believe this is appropriate, pending the outcome of the project on reportins performance.

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 para 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?**

We believe that such transitional arrangements should be included to enable entities to continue to report assets at FRS 15 levels.

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

We do not have any particularly strong views on this question

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, there are no other areas on which we have strong views.

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?**

Yes we believe that optional capitalisation is appropriate because it is not clear that there is an international concensus on either approach. We would support mandatory capitalisation if a choice had to be made, this would give a more consistent valuation cost between an internationally greatest asset and the full acquisition cost.

xi) **Do you agree that para 5(e) or IAS 23, which allows certain exchange differences to be capitalised, should be deleted in the draft standard on borrowing costs?**

If such exchange differences arise because the development of an asset is funded in a different currency to the currency of expenditure on the asset, it appears to us inappropriate to capitalise such exchange differences.

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

We believe it is more appropriate to capitalise only the interest costs arising on that portion of the funding which has been utilised to-date to fund development of the asset. Capitalising of losses/gains arising from investment of surplus funds feels inappropriate since this is an indirect consequence of the development of the asset not a direct one. Such treatment might be open to abuse.

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

No, there are no other areas on which we have strong views.

2. The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 16 :

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 paras 21 and 21 A of the [draft] FRS on property, plant and equipment)?**

We believe that further work is required in this area. Recognising fair value on exchanges of swaps of similar assets having similar use in the same line of business causes us some concern. We believe that it is possible to draw a distinction between this situation and those transactions that are, in reality, sales of dissimilar assets. Any change to existing requirements should await the completion of the revenue recognition project.

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?**

In principle, we agree with this approach. However circumstances may obtain, such as those outlined in i) above, where an exchange of *intangible* assets might not properly regarded as a sale of such assets. In this situation we would be uncomfortable with a fair value approach.

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 para 59 of the [draft] FRS on property, plant and equipment)?**

We agree that depreciation should not cease when the relevant asset becomes temporarily idle; in such circumstances, it is likely that such an asset will continue to reduce in value notwithstanding the fact that it is not being used. Should an asset be retired from use and held for disposal, we would expect depreciation to be suspended; however such an asset might well need to be revalued downwards to reflect its revised fair value.