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12 September 2002

Mr Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
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Dear Mr Nailor

Comments on FRED29 Property, Plant and Equipment

I am writing in response to the recent Exposure Draft 29 on the subject of Property, Plant and Equipment and in particular in relation to the issue of renewals accounting raised in paragraph 38 (iii) of the ASB discussion document. The issue has fundamental importance to the water industry because of the scale of the underground infrastructure in this country. The industry currently takes advantage of the provisions in FRS 15 at paragraphs 97 99 to account for its underground infrastructure assets in a practical, cost effective and meaningful way. In summary, infrastructure renewals accounting is an integral part of the economic, regulatory and accounting framework within which water companies operate in the UK.

As you will be aware, detailed discussions took place on the subject of infrastructure renewals accounting prior to the issue of FRS 15. At that time the water industry, OFWAT and the companies' auditors stressed the importance of retaining this method of calculating "depreciation" for the underground infrastructure networks. As a result, paragraphs 97 99 were incorporated into the final standard. This has proved to be a workable solution which addresses the requirement to depreciate assets whilst still recognising the nature of the assets concerned and the impracticality of identifying individual assets/lives.

The arguments which led to this approach being accepted by the ASB (the key aspects of which are reiterated in summary overleaf) are still as relevant today and the use of renewals accounting remains the only practical way in which to determine a "depreciation" charge for underground infrastructure assets. it is crucial therefore that the current provisions are retained within the main body of the new standard to enable water companies to continue with this method of accounting and ensure consistency of approach across the water industry.

The omission of such guidance would present the water industry with major regulatory and practical difficulties that would inevitably increase costs and, therefore, charges to customers in the long term.

In response to one of the ASB's specific consultation questions, the possibility of continuing to adopt infrastructure renewals accounting in the absence of the specific dispensation would ultimately be a matter for auditors to decide. However, the risks involved would not make that an attractive option for the water companies and could potentially lead to lack of consistency in treatment between companies, which would be undesirable.

Key reasons for current approach

- Infrastructure renewals accounting was adopted by the water industry in 1989 to provide a consistent way in which to account for the underground mains and
- sewers which represent a single system managed, operated and maintained as a network in perpetuity. As individual components are of no separate economic use and have no determinable asset life, any attempt to estimate these would involve great subjectivity and would be open to manipulation. The existing accounting policy is, therefore, the most appropriate because it reflects the way underground infrastructure assets are managed, operated and maintained in a better way than conventional depreciation policies

- A significant proportion of the underground infrastructure assets in this country were created prior to 1974 and insufficient records exist with which to calculate depreciation on a conventional basis. The use of an independently certified asset management plan to determine annual expenditure required to maintain the operating capacity of the network provides a robust auditable basis of calculating depreciation.

- OFWAT have indicated to date that they will continue to require the use of infrastructure renewals accounting in the regulatory accounts and in the determination of customer charges. It is important to ensure symmetry between the statutory and regulatory accounts in order to avoid confusion for users, in particular arising from potentially different historical cost profit figures. Although the current system involves presentational differences in relation to infrastructure assets between statutory and regulatory accounts, these are easily reconcilable and result in consistent profit figures. In addition, the practicalities and cost of maintaining two separate sets of asset records and accounts would be prohibitive.

Prior to the issue of FRS 151 much valuable work was carried out involving the ASB, OFWAT and the water industry in developing a solution to address the need to depreciate infrastructure assets. The solution adopted, whereby renewals accounting was allowed by paragraph 97-99 as a method of determining the depreciation charge

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for underground infrastructure asset networks, should be retained and specific guidance to this effect should be included in the revised accounting standard.

Yours sincerely

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cc Ernst &Young
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11 September 2002

Mr Hans Nailor
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Dear Mr Nailor

Comments on FRED 25

I am writing in response to the recent Exposure Draft 25 on the subject of Related Party Disclosures in particular in relation to the issue of materiality.

Financial Reporting Standard (FRS) 8 only requires the disclosure of material transactions with related parties. Such transactions are described as material where their disclosure might reasonably be expected to influence decisions by the users of the accounts.

There is no specific mention of materiality in Exposure Draft 25. If the accounts are to remain relevant, then there is surely a need to restrict information to that which might reasonably be expected to influence users decisions.

Where there are non-material transactions with a related party, it is required by the Exposure Draft that the relationship be disclosed. I consider that for such a transaction this is sufficient information for the purpose of the users making decisions on the accounts.

I therefore suggest that the eventual standard be amended to be consistent with FRS 8 on the matter of materiality.

Pension fund contributions are exempt from disclosure under FRS 8 (para 3(d)). There is no equivalent exemption in the Exposure Draft, which in fact explicitly requires the disclosure of pension fund contributions to a pension fund.

Pension costs are adequately covered by FRS 17 (Retirement Benefits) so I also suggest that an exemption similar to that within FRS 8 be made within the eventual standard.

Yours Sincerely

J.O'Kane

John O'Kane
Group Finance Director