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The Technical Director,
ACCOUNTING STANDARDS BOARD,
Holborn Hall,
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12 September 2002

Dear Sir,

FRED 26 EARNINGS PER SHARE

Thank you for the opportunity to comment on the above document. Our responses to the questions posed are given below. Should you wish to discuss this submission please contact Stuart Hastie.

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?

No. We do not see any need for a new UK standard with a very short shelf life. The scope of an eps standard is very close to the companies that are going to be forced by EU regulation onto the revised IAS 33 for accounting periods starting on or after 1 January 2005. We do not believe it is worth fiddling with the denominator of eps calculations until the profit numerator is harmonized by adoption of IASB standards throughout the EU.

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

See 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?

Apparently, it needs to be made clearer to accountants, like the UK technical department at Deloitte & Touche, that out of the money options for loss making companies are anti-dilutive.

It would be helpful to complicate the options diluted eps example 6 as too many defective calculations have been seen in practice under FRS 14 and IAS 33. The example should illustrate that where a profitable entity has some options that are in the money and others with a higher exercise price that are out of the money, only the former are dilutive and using a weighted average of all options in existence would produce the wrong answer.

The IASB has asked commentators to respond to the following question on the proposed changes to IAS 33:

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?

Yes.

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

No. We do not attach much importance to trends within a year of quarterly diluted eps figures. We consider comparisons with earlier years of year to date diluted eps are more useful.

- 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).

IASB should change tack and amend example 7 accordingly. The fact that the full year profits meant issuing 900,000 extra shares for no additional consideration is an important dilution that should be reported directly to the shareholders and ought not be affected by the distribution of those profits over the four quarters. It is far more important to reflect the latest knowledge than trying (and failing) to make diluted eps figures additive for ridiculously short periods like quarters.

- 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.

We would prefer average prices of the year to date and feel there would be even more merit in using period end share prices instead of averages.

- 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).

For similar reasons we again prefer from the beginning of the year to date reporting period.

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Yours faithfully,

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Hans Nailor,
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13 September 2002

Dear Hans,

FRED 29 PROPERTY, PLANT & EQUIPMENT: BORROWING COSTS

Thank you for the opportunity to comment on the above document. Our responses to the questions posed are given below. Should you wish to discuss this submission please contact Stuart Hastie.

ASB (i) Do you agree with the proposal to issue new UK standards on property, plant and equipment and borrowing costs when the B issues the revised 16, unless it becomes clear that further changes to 16 are likely by 2005 as a result of the revaluation project?

No. Whilst, as a package, the two proposed standards are an improvement on FRS 15 (particularly in the area of revaluations), we do not favour issuing any new UK standards. There is no urgency, requiring this topic to take precedence over our preferred convergence route, which is a big bang change in 2005 to pure international standards (for listeds and their subsidiaries) and for others a big bang year or two later. On the contrary, as the biggest change in numbers is likely to come from the revaluation rules and the outcome or timing of the B revaluation project is uncertain, a wait and see approach is preferable, particularly for unlisted companies. The vast majority of companies are unlisted and we would not wish to see them moving from FRS 15 to 16 in 2003-5 and changing yet again in say 2006 or 7, if B is late rewriting its revaluation rules.

ASB (ii) 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 prefer the approach of FRS 15 because with rising prices the international approach typically underestimates the operating charge for the value of the asset consumed by use, in the periods prior to revaluation or disposal. An unrealised gain on revaluation of residual values should not be used to boost current income (particularly as there are probably larger unrealised gains that are not recognised in the accounts, relating to the remainder of the useful life to the entity of such assets).

ASB (iii) 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?

No, there was no need for FRS 15 to write a detailed cook book, which is a mistake /IFRS should not repeat.

Should UK entities be permitted to continue to use renewals accounting? Yes, because it is an estimation technique available under .

ASB (iv) What are your views on the differences between the requirements of FRS 15 and 16 concerning revaluations (as described in paragraphs 10 to 17 of the Preface to the FRED)?

1. Fair value is preferable to the valuation rules in FRS *15*. Suppose an asset:

a) can be kept to generate 1600 NPV from use or

b) can be sold for alternative use for 1500, buying a replacement for existing use value of 1000 so there is 500 cash generated on that deal and the 1600 NPV from use of the replacement asset.

Unless management declare the asset is surplus, a FRS 15 balance sheet would show a value of 1000 (existing use replacement cost < higher of NPV and net realisable value). Granted, if they obey the letter of the FRS there will also be an off balance sheet footnote of 1500. FRS 15 gives management plenty options including the discretion to book a holding gain of 500 in any year they like to either declare the asset surplus or decide to sell it, or indeed not to book the gain at all.

It is better stewardship accounting to include in the balance sheet the uplift to alternative use value of 1500, reducing the return on capital employed in subsequent years to something more realistic. The increase in value should be booked when it arose and neither deferred at management’s whim under FRS 15 nor concealed from shareholders, hiding poor management decisions on failing to sell or switch use.

2. There was no need for FRS 15 to write a detailed cook book on valuations, which is a mistake /IFRS does not repeat. The requirement to keep valuations up to date is sufficient, without needing to specify full valuations every *5* years, interims in year 3 etc. or provide a guide on index selection for plant and machinery.

3. Acquisition and selling costs are rarely material enough to warrant guidance in an accounting standard, it can be left to the valuation professionals.

4. IAS 16 is preferable to FRS 15 as it has simpler rules for losses on revaluation. Under IAS 16 a negative revaluation reserve on an individual asset cannot arise (which unlike FRS 15 accords with what many believe to be existing EU law). IAS 16 is more practical, as it does not try to split artificially a drop in value between falling prices and impairment, a feat that despite FRS *15,* is in practice rarely feasible.

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?

Disclosure of the name and qualifications of valuers would be a useful additional protection for users. They should be put on warning about amateur valuations and named professionals are less likely to be associated with misleading valuations.

ASB (vi) Do you agree with the ASB's proposal, as a transitional measure (see paragraph 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 B's projects on insurance and reporting financial performance?

Yes

ASB (vii) The transitional arrangements for the first-time application of FRS 15 allowed an entity that does not adept 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 FRS 15's transitional arrangement to continue to recognise the carrying amounts under that arrangement?

Yes

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

See (i) above.

ASB (ix) Are there any other aspects of the draft standard on property, plant and equipment that the ASB should request the B to review when finalising the revised IAS 16?

1. **Disclosure** Para 66 should be tightened up or deleted. We dislike the mere encouragement to disclose items in standards. Disclosures should either be required where material or they should not be referred to. Regarding the four optional disclosures in para 66, the most important one to make mandatory is to reveal fair values that are materially different from book values. It seems likely that the UK government will abolish the directors' report and its weak, unaudited market value of land and buildings disclosure rule. Even if the government retains it, it will continue to be ineffective, as too many directors (who are not impartial) view even substantial differences as not significant enough to report.

2. **Push down accounting** We would like an explicit exception from the requirement to keep valuations up-to-date, if a subsidiary's only revaluation is to incorporate in its own books fair values for its assets at the date it gets a new parent. They should not be faced with the current choice of getting onto an annual revaluation treadmill or suffering the cost of consolidation adjustments to their pure historical cost entity accounts.

ASB (x) Do you agree that the capitalisation of borrowing costs should remain optional?

Yes, at the moment, as there are more pressing items for international harmonisation.

If you had to choose between mandatory capitalisation and prohibition of capitalisation which would you support and why?

Prohibition for two reasons.

1. Gearing should not determine the carrying value of assets and it is likely to be many years before there will be a consensus to permit notional equity funding capitalisation for those that use historical cost accounting.

2. If the world moves to an up-to-date revaluation regime there seems little point in complicating accounts with capitalisation, if future balance sheet amounts and depreciation charges will be the same, as a revaluation occurs within a year of completion.

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 do not support such trivial differences between UK and B accounting. You should try and persuade B to change its standard, but if you do not succeed, you should fall into line with IAS 23.

ASB (xii) What are your views on the difference between IAS 23 and FRS 15 referred to in paragraph 24 of the Preface to the FRED concerning borrowing costs eligible for capitalisation?

We prefer the gross accounting for investment income that FRS 15 reaches, but it is not a significant matter. You should try and persuade B to change its standard, but if you do not succeed you should fall into line with IAS 23.

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

If, as seems likely, B, like ASB continues to sit on the fence and allow a choice of capitalising or not, IAS 23 should contain sufficient disclosure to enable users to compare companies that adopt different policies. We therefore suggest an additional footnote disclosure for those entities that adopt capitalisation whose assets have not been revalued. They should state what the net book value would have been if they had expensed finance costs.

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

B (i) Do you agree that all exchanges of items of *property, plant and equzpment* 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] FRS on property, plant and equipment)?

Yes.

B (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?

Yes.

B (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 paragraph 59 of the [draft] FRS on property, plant and equipment)?

Yes.

Yours faithfully,

Disclosure Solutions Limited