IAS29 FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES

A CRITICAL REVIEW – NECESSITY, APPROPRIATENESS & ACCURACY

INTRODUCTION

It seems that at the beginning one must both apologize for having the temerity to question an *issued and accepted International Accounting Standard* and to ask that there be open-mindedness to the various points raised; in the opinion of the writer, any simple dismissal of "challenge" based on the perception that the orthodox cannot and must not be challenged is neither professional nor, more importantly, in the interests of the profession as a whole. The writer does not profess to be either academician or theoretician yet believes that the imprecise natures of hyperinflation and general purchasing power indices requires that these be considered against the general principles which govern the accounting discipline.

> *"The existence of changing prices has presented the accountant with a philosophical problem which shows no sign of resolution in the near future.*
>
> *Accounting originated as a process of recording transaction of a financial nature. The double entry system of bookkeeping to record transactions led naturally to the use of historical cost as a basis of measurement. Further, traditional conservatism led to the realization concept that in terms of which revenue is not recognized until an arm's length transaction has occurred, such as a sale to a third party.*
>
> *In times of inflation, the prices of commodities alter, but at varying rates. The overall effect of the movements may be computed by some measure of general inflation, such as a consumer price index; whereas movements of individual items or groups of like items may be measured by a specific index."* (SA GAAP page 219)

That the whole issue of IAS29 in Zimbabwe is contentious (one is reminded of the demise of the old SSAP16 Current Cost Accounting in the early 1980's) and will have both its proponents and critics, the latter group being, primarily, the sector charged with compiling and living with it (i.e. commerce and industry) does mean that a close re-look is warranted. The fact that twice now a representative task force established under the stewardship of The Institute Of Chartered Accountants Of Zimbabwe has referred it back with recommendations for review and, at least temporary, setting aside of The Standard is testament to there being a problem. The fact that the Accounting Practices Board does not seem to have taken cognizance of this situation is very disturbing and, furthermore, that certain individuals consign "user-concerns" to the *waste basket of ignorance* is, at the very least, condescending in the extreme.

The purpose of this review is to consider The Standard as writ in terms of its necessity, appropriateness and accuracy of formulation. It is perhaps, appropriate at this juncture to make clear that the writer has no quarrel with the fact that Zimbabwe is experiencing high-super-hyper inflation (call it what you will) and that the effects of such rampant levels of inflation are relatively more debilitating upon the financial performance and future of a Zimbabwean based company than a company situate in a country where inflation rates are much lower; in this disclosure-regard the writer is **an advocate of disclosing inflation-effect related information** to shareholders and the like – it is merely the format and content of this information which is under debate.

The approach adopted is to firstly consider "what hyperinflation is", secondly to restate the fundamentals of accounting and financial reporting, thirdly to précis the essentials of The Standard and fourthly to overlay all three "considerations" to "check for congruence". Unfortunately based on past experience with this issue I can see no shortcut in approach.

INFLATION / HYPER-INFLATION

To begin any review of IAS29 means that one must initially consider what inflation/hyperinflation is and how businesses operate in these conditions else there is no relevance for The Standard.

For a standard to be a standard it must be applicable anywhere in the world (at least where the defined conditions exist) and local peculiarities ignored excepting where they are relevant either by way of illustration or to highlight specific difficulties with the full and true implementation of The Standard. To this end, excepting where unavoidable and identified, discussion will be kept as much to the principles of The Standard as possible.

Whilst there is considerable debate about a true definition of hyperinflation, and most often cited examples refer to several thousands of percent a month rates, the official and accepted definition and characteristics supporting The Standard are as hereunder however, it is pertinent to note that it is widely held that there is no standard definition (or percentage) of hyperinflation and that hyperinflation is "… just out-of-control inflation at an extremely high rate…".

The Standard's Definition:

(a) the general population prefers to keep its wealth in nonmonetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power;

(b) the general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency;

(c) sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short;

(d) interest rates, wages and prices are linked to a price index; and

(e) the cumulative inflation rate over three years is approaching, or exceeds, 100%

In support of the above the following "brief description" bears consideration:

> *"In the extreme, as prices shoot up sharply and unevenly, normal economic relationships are disrupted. Business owners do not know what to charge for their products. And consumers do not know what to pay. Resource suppliers will want to be paid in kind, rather than with rapidly depreciating money. Creditors will avoid debtors to escape the repayment of debts with cheap money. Money becomes virtually worthless and ceases to do its job as a standard of value and medium of exchange. The economy may literally be thrown into a state of barter. Production and exchange grind towards a halt, and the net result is economic, social, and very possibly political chaos. Hyperinflation has precipitated monetary collapse, depression, and sociopolitical disorder (Pg. 188).*
>
> *…. Such dramatic hyperinflations as those just documented are almost invariably the consequence of* ***imprudent expansion of the money supply*** *by government (Pg. 189, emphasis added)".*
>
> *McConnell, Campbell R. Economics. Tenth Edition. New York: McGraw-Hill, 1987.*

The above two descriptions in almost every respect match the writer's own observations and experiences in Zimbabwe and to the extent that these descriptions describe *hyperinflation* then the writer fully agrees that hyperinflation exists when the above conditions exist. That said, there are a number of concerns with the above some of which may, at least in terms of this paper, be Zimbabwe specific but may well be relevant elsewhere and therefore bring into concern the economic basis for The Standard.

To review:

1. generally, the use of a stable foreign currency either as an inflation hedge asset and/or as a price-trading mechanism is indeed a fair characteristic of a hyperinflationary economy
2. expectations of future inflation abound most certainly and
3. there is usually an attempt to index interest rates, wages and prices to some form of price index whether formally or informally

That said if one considers the above in the context of McConnell's description of a disruption to "normal economic relationships" and the "net result" of “economic…chaos” then, firstly, inflationary expectations and hence behavior are susceptible to wide variance of any attempt at reasonable prediction and secondly, there is – as in Zimbabwe – every likelihood that the indexing of rates, wages and prices doesn’t occur especially under conditions of price control (even if these conditions are adhered to).

Furthermore, in considering even the somewhat arbitrary 100% (or near 100%) rate of cumulative inflation at what point does, say, a declining rate of, say, 95% cease to be of concern and then what about 80% and so forth until one actually reaches first-world inflation rates? The point about inflation is that it is a rate-of-change which is always relative (never absolute) to itself, its past and its trading partners thus the potential to create a large “grey area” where the impact of inflation may still be severe yet, technically, not a situation of hyperinflation; thus when technically not hyperinflation but yet a serious inflation problem the mandatory influence of IAS29 magically disappears. Inflation/hyperinflation is always a relative/moving target. One of the fundamental problems with incorporating the economic issue of inflation/hyperinflation with “empirical accounting” is this **relative nature** of inflation; relative to other players, relative to other markets (local & foreign) and relative rates of increase/decrease.

Thus we have a situation where the above “descriptions” adequately describe the environment within which a business impacted by hyperinflation exists yet although hyperinflation is a relatively indeterminate and moving circumstance it is nevertheless used as a basis to change the financial accounting and reporting of a company. This situation means that whatever indices or calculations are applied there is every probability that they are not empirically accurate/representative and are out-of-date by the time adjusted accounts are produced; this seems to the writer to be an inappropriate basis to adjust a set of results which have as their fundamentals “identified and quantified transactions”.

In hyperinflationary economies it seems that the “rate-of-change” is more significant than the absolute movement. By way of illustration, a company achieving a nominal improvement of 90% period-to-period against a backdrop of 100% inflation has regressed by 10% but so to has a company which achieved a nominal 4,5% improvement against an inflation level of 5,0%. If one accepts that rate-of-change is crucial – and arithmetic will show this by reverting 1000% annual inflation rates to equivalent daily rates – then one must consider the time-usefulness of reported information. Quite often the unitary GPPI/CPI may be months behind thus by the time inflation adjusted accounts are available inflation has moved on so materially that even these numbers are of questionable relevance; in conditions of, say +1000% inflation, is a monthly index appropriate when people are, for example, being paid weekly?

There are a number of other traits exhibited in hyperinflationary environments and which are only, in part, alluded to in the official description of hyperinflationary conditions and yet are fundamental issues when considering the formulation of an accounting standard to "address the problem of hyperinflation" (these include observations made of Zimbabwean conditions):

- the business cycle time (i.e. working capital) comes under extreme pressure and shortens to the extent that cash transactions increase and potential "over-trading" is <u>created externally to the company</u>
- increased money supply is skewed in distribution across the economy thus reducing the general ability of operations to adjust prices either in line with "price indices" or "expectations" which, in turn, reduces the ability to trade-out of inflation or maintain position within that inflation; margins often remain static
- that other abnormal factors (price, wage & exchange controls), are introduced distorting and even disarticulating "normal model interactions" such "supply & demand" and "fiscal & monetary policies"… the consequence of this is that traditional stewardship techniques become, at least in part, invalid
- there is an understandable short-term approach to business and which revolves around "survival" for unless there is survival there is no point in "planning long-term"; for survival read "going concern/capital maintenance"
- there is the realization that under hyperinflationary conditions, savings in local currency terms lose their value… one cannot out-save hyperinflation… and this increases the need to "hold and use" assets <u>for trading</u> and <u>not investment</u> purposes; even if those assets are traditionally not "normal trading assets" they become "trading hedge assets"
- that during periods leading up to, and following achievement of, hyperinflation in many instances performance returns significantly lag inflation thus rendering the "normal" remedy of turning to the market for capital injection unlikely; the result of this, in turn, tends to be an increase in borrowing levels with a concurrent containment of long term (fixed asset) investment whether such is desirable or not – this has implications for The Standard's "net monetary adjustment" balancing item
- that the exchange rate, <u>unless artificially held</u> as is often the case, will adjust to reflect the relative inflation differentials between trading partners; this is a very important issue for it adjusts (ceteris paribus) fairly quickly to prevailing economic conditions; inter-market comparisons are thereby accounted for anyway
- that bankers tend to look towards the <u>ability to service debt</u> in monetary units not relative pricing terms i.e. in flow of units of "dollars" and towards <u>realizable values</u> of assets in terms of security; the more traditional debt/equity ratio diminishes in importance and replacement values of limited relevance
- that traditional price indices, usually set up in economically stable periods associated with fairly predictable trading and purchasing patterns, may/do become questionable in terms of being representative of reality as behavior changes
- that in many respects whilst dysfunctional, skewed and hyperinflationary conditions prevail, economies tend to become

"closed" to outside investment (disinvestments being more prevalent) as foreigners place their funds elsewhere; internally, to the extent possible local investors hedge off-shore or resort to other non-capital investments such as treasury bills where there is a short-term high return (when interest rates are high) and minimal perceived risk – long term investment all but disappears

These points do not seem to have been factored in to the economic backdrop against which IAS29 has been developed. The Standard uses characteristics that are certainly descriptive of hyperinflation and underscore the ravages of hyperinflation but which seems, to the writer, to be a flawed basis upon which to develop a Standard because of both the indeterminate nature (the nature of inflation itself) and incompleteness of circumstance (not fully accommodating other hyperinflationary characteristics). Any standard developed to tackle a particular issue or circumstance must be in congruence with that situation and not either deficient or selective. As an aside, if standards are to move into the realms of economics then surely the whole spectrum of severe economic conditions such as "stagflation" and "deflation" must also be embodied somewhere.

ACCOUNTING

As "accounting" is the basis for financial reporting it is pertinent to remind one's self about this as the foundation for financial reporting and, more importantly, ensure that the underpinning principles and bases are relevant and compatible with that standard.

It is noted that generally the IASC has held that where a conflict arises then the requirements of an IAS prevail over "the framework" however this should not be used as a means by which fundamental issues become sidetracked.

That there is much erudite defined bases and frameworks for the preparation and presentation of financial statements is not disputed and there is no intent here to reinvent these issues let alone prepare a treatise but there is a need to précis the background and in this regard the writer has drawn almost exclusively from South African GAAP Statement *AC000 – Framework For The Preparation And Presentation Of Financial Statements*. It is recognized that AC000 is a South African Standard but it does not materially differ from the principles set out in IAS1… it merely happens to be more convenient reference material.

Purpose Of Financial Statements

… to:

a) decide when to buy, hold or sell an equity investment;
b) assess the stewardship or accountability of management;
c) assess the ability of the enterprise to pay and provide other benefits to its employees;

d) assess the security for amounts lent to the enterprise;
e) determine taxation policies
f) determine distributable profits and dividends;
g) prepare and use national income statistics; or
h) regulate the activities of enterprises

(Preface to AC000 – extracted from IASC)

Objective Of Financial Statements

a) The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions. (AC000 para12)

b) Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information. (AC000 para13)

c) Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the enterprise or whether to reappoint or replace the management. (AC000 para 14)

Underlying Assumptions

a) accrual basis
b) going concern
c) understandability
d) relevance
e) materiality
f) reliability
g) faithful representation
h) substance over form
i) neutrality
j) prudence
k) completeness
l) comparability
m) timeliness
n) balance between benefit and cost
o) true and fair view/fair presentation

(adapted from AC000 paras 22 – 46)

The Elements Of Financial Statements

a) Financial statements portray the financial effects of transactions and other events by grouping them into broad classes according to their economic characteristics… The elements directly related to the measurement of financial position in the balance sheet are assets, liabilities and equity. The elements directly related to the measurement of performance in the income statement are income and expenses…. (extracted from AC000 para 47)

b) Profit is frequently used as a measure of performance or as the basis for other measures, such as return on investment or earnings per share. The elements directly related to the measurement of profit are income and expenses. The recognition and measurement of income and expenses, and hence profit, depends in part on the concepts of capital and capital maintenance used by the enterprise in preparing its financial statements. (AC000 para 69 emphasis added)

c) The revaluation or restatement of assets and liabilities gives rise to increases or decreases in equity. While these increases or decreases meet the definition of income and expenses, they are not included in the income statement under certain concepts of capital maintenance. Instead these items are included in equity as capital maintenance adjustments or revaluation reserves. (AC000 para 81)

d) Recognition of the "elements of financial statements" is dictated by:
   a. "it is probable that any future economic benefit associated with the item will flow to or from the enterprise; and
   b. the item has a cost or value that can be measured with reliability." (adapted from AC000 paras 82 & 83)

e) Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognized and carried in the balance sheet and income statement. This involves the selection of the particular basis of measurement. (AC000 para 99)

f) A number of different measurement bases are employed to different degrees and in varying combinations in financial statements. They include the following:
   a. Historical cost….
   b. Current cost….
   c. Realisable *(settlement)* value….
   d. Present value….

   (extracted from AC000 para 100)

g) Imputation of the "Concept Of Capital Maintenance" and which is "… concerned with how an enterprise defines the capital it seeks to maintain. It provides the linkage between concepts of capital and concepts of profit because it provides the point of reference by which profit is measured; it is a prerequisite for distinguishing between an enterprise's return on capital and its return of capital…" (extracted from AC000 para 105)

h) "… At the present time, it is not the intention of the Board of IASC to prescribe a particular model [of capital maintenance] other than in exceptional circumstances, such as for those enterprises reporting in the currency of a hyperinflationary economy. This intention will, however, be reviewed in the light of world developments." (AC000 para 110) The writer queries the correctness and appropriateness for a standard such as this – dealing with economics – to prescribe a particular model of capital maintenance in order to "solve" the problem of hyperinflation.

Thus the background and preconditions to be met by a standard.

IAS 29 (PRECIS OF SALIENT POINTS)

A fundamental element of The Standard is the presumption that a General Purchasing Power Index (GPP-I) is appropriate for use; conceptually credible but one must question whether empirically and appropriately accurate and suitable. Whilst the writer is no statistician, a GPP-I such as the local CPI is biased towards domestic consumption, with average prices being applied to a specific, yet subjective in many respects, basket of products and which have certain weightings applied; whether or not any "smoothing" for such issues as seasonality are used the writer cannot comment upon. Whilst undoubtedly accurate from a statistical calculation perspective, I suggest such indices are by their very generalist and biased nature imprecise when applied to accounting science.

The Standard:

a) *"In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading."* (IAS29 para2) At first glance a reasonable statement and in general terms understandable. That said, the statements of the absolutes, without supporting explanation, of *"…not useful…"* and *"… misleading…"* are assumptions. These assumptions when juxtaposed with the statement of *"… Standard does not establish an absolute rate at which hyperinflation is deemed to arise. It is a matter of judgement when…"* makes for a poor argument for mandatory implementation. Furthermore, the description of *"meaningless"* is very bold, stark and unqualified when viewed against the backdrop that despite hyperinflation, the historical cost methodology does "faithfully record the transactions" and is such used as the very basis for IAS29 based financial statements in the first place. At the end of the day, historical cost accounts still balance back to the net monetary unit value at bank… is this totally *meaningless*?

b) *"Prices change over time as the result of various specific or general political, economic and social forces. Specific forces such as changes in supply and demand and technological changes may cause individual prices to increase or decrease significantly and independently of each other. In addition, general forces may result in changes in the general level of prices and therefore in the general purchasing power of money."* (IAS29 para 5) A fair statement but the concept of general purchasing power is <u>added as a rider</u> *("… in addition…"*) <u>but has been used as the basis</u> for IAS29. This is not logical and detracts from each individual company's own particular industry sector and structure… an attempt to "paint the whole town beige". To promote more realistic reporting, surely more attention should be paid to *"…Specific forces…"*?

c) *"…Presentation of the information required by this Standard as a supplement to unrestated financial statements is not permitted…"* (IAS29 para 7). This makes IAS29 indexed accounts "the principal and only accounts".

d) *"The restatement of financial statements in accordance with this Standard requires the application of certain procedures as well as judgment. The consistent application of these procedures and judgments from period to period is more important than the precise accuracy of the resulting amounts included in the restated financial statements."* (IAS29 para 10) This statement seems to be in direct conflict with IAS29 para 2 where concern with "traditional" reporting is regarded as *"not useful"* and *"misleading"*; it begs the query as to how much more, or less, useful and misleading is a consistently applied but imprecise arithmetic multiplier exercise?

e) Balance sheet amounts are indexed with the exception of monetary items that are held in monetary unit terms and any net gain or loss is taken to the income statement. This is a departure from traditional practice where unrealized gains/losses (and GPP monetary gains/losses are unrealized in monetary unit terms) are not taken to income but to capital.

f) The restatement of prior periods may not only be confusing to the layman year-on-year but adds complexity to the production of trends and graphical analysis techniques frequently used and derived from "old annual reports", The Standard seems to make no provision for presentation of restated multiple-year statistics.

g) Does/could a credit to income arising from a monetary adjustment encourage imprudent levels of gearing? If interest rates rise in hyperinflationary conditions (conventional wisdom dictates so) and profits *improved* by *"better management of debt"* (not all interest bearing debt is necessarily monetary in nature) then where is prudence when cash flows become inadequate to sustain debt levels?

h) The income statement requires that the transactions be restated according to the period specific index at date of transaction. This seems at odds with the concept that at date of transaction, the monetary unit value of the transaction has as its basis the specific price index applicable at that time.

i) It has been stated, and is implicit in The Standard in para 29 (restatement specifications for balance sheets prepared under current cost approach) and para 39(b) (requiring disclosure as to whether the financial statements are based on historical cost or current cost), that the application of IAS29 does not change the basis of preparation of financial statements. To the extent that a change from historical cost to current cost reflects a change in accounting policy/preparation basis and that current cost requires a form of indexing (even if partial) then the foregoing statement is inconsistent with the latter fact.

j) A paradox arises where monetary assets and liabilities such as cash and overdrafts are, understandably, not indexed yet their direct product, interest (an item not directly affected by any general purchasing power index even where not artificially held/adjusted), is indexed in the income statement; interest itself translates, in turn, to a monetary asset or liability on the balance sheet. Conventional economic wisdom holds that interest rates be *held as real* therefore at any point in time they are implicitly adjusted for inflation at the time of transaction and shouldn't thus be double-indexed.

k) A fundamental flaw in the standard is that there is no compulsion to disclose or otherwise explain the "net monetary adjustment". Whilst local company reports, which may currently only comment on historical figures, can be forgiven in that there is local tolerance for allowing both sets of accounts to be published this in no way diminishes the significance of this *fundamental item arising on the adoption of IAS29*. It is interesting to note that whilst, apparently, technically provable a good number of accounting professionals have advised clients *"not to worry too much as it is the 'balancing item'"*.

   a. By way of illustration:
      A very good example of this problem is evident in the recently published (28th March 2002) abridged interim results from ZIMRE. The net monetary adjustment turns an attributable profit of some $894M in historical terms into an attributable loss of $770M in IAS29 terms; surely material? Even if the historical figures are ignored, as the inflation loss arises from a net monetary loss adjustment of $2 253M surely the most significant and material reporting item of all? That there is no comment on such a material item is disturbing but the absence of any supplementary information by way of note makes the reported results both *misleading* and not-*useful*. It is interesting to note that despite an inflation loss, the Board has still declared a final dividend of 20 cents per share.

SUMMARY & CONCLUSIONS

Whilst the malaise (hyperinflation) affecting financial reporting is understood and accepted and that there needs to be some form of treatment, the issue is really whether or not IAS29 is the remedy… a partial remedy is no real remedy and cannot, therefore, be enforced as "principal/primary" financial statements. One observation about IAS29 is that it is a standard outside the norm in that it <u>purports to address an economic situation</u> whereas virtually all other IAS's concern themselves with <u>treatment and disclosure of recorded transactions</u>, events and balances extracted from historical cost accounts. Another observation is that while high, not hyper, inflation conditions may prevail, and the effects there under very debilitating, there is no obligation for a company to either adopt current cost accounting or even to regularly revalue its assets (IAS 16) yet the moment hyperinflation is adjudged to exist then revaluations are mandatory - this seems a significant contradiction.

The principal preoccupations of IAS29 as regards hyperinflation seem to be:

a) the principle of capital maintenance
b) the principle of going-concern
c) the rate of loss of General Purchasing Power and the usefulness of general indexing in trying to reflect the loss/gain in economic purchasing power for any particular set of corporate results
d) the usefulness of "traditional" reporting under conditions of high rates of loss of GPP or rather the implication that "traditional" reporting is of <u>no use</u> despite being the basis for an arithmetical exercise
e) the misleading nature of "traditional" reporting under conditions of high rates of loss of GPP
f) the principle that GPP-Indexed accounts are the principal accounts
g) the measurement of company & management performance

The question remains as to whether the above are met by the standard and then whether the standard either meets, or conflicts with, the other "fundamentals of financial reporting" as outlined above. The issues below call into serious question the fundamental premise of The Standard that IAS29 compliant financial statements are to be the principal accounts; this premise is further undermined by the necessity for taxation purposes to maintain conventional historical cost accounts which, in turn, tends to make the act of "management conversion to IAS29" more protracted, at the very least.

<u>Capital Maintenance</u>
There are two aspects here. Firstly, The Standard does not call for management to disclose and explain its approach to, and constraints upon, capital maintenance but prefers to impose a vague general concept as a universal and general remedy. Secondly, in periods of extreme hyperinflation it is unlikely that assets can be re-valued (and adequately accurately impair-adjusted) at fast/adequate enough rates as will ensure capital adequacy. I submit that The Standard does not adequately meet the requirement of Capital Maintenance.

<u>Going-concern</u>
The criticisms as regards Capital Maintenance are applicable here excepting that, in addition, it presupposes that under hyperinflationary conditions the correct business decision is to remain as a going-concern. I submit, therefore, that The Standard does not adequately meet the requirement of Going-concern.

<u>General Purchasing Power Indexing</u>
The following points are relevant:

a) a GPP-Index such as the CPI is not necessarily a true and fair representative of prevailing GPP even if it is the only index in existence
b) a GPP-Index is still historical and in most instances management will be working on inflation-expectations

c) by the time indexed results are to hand, under extreme/exponential rates of hyperinflation, the information is relatively too late and therefore outdated
d) general indices are not necessarily relevant to the industry type and this is especially true where such industry is of long duration such as mining and forestry; a food-based CPI for a 20 year timber cycle skews the reported results whereas under "normal conditions" the differences between supermarkets and forestry operations are embodied in the structure and nature of the results and balance sheet… stakeholders assess based on the industry, their preferences and risk profiles. Within a hyperinflationary economy but not reporting under IAS29 inter-firm comparisons are still possible but without skewing the relationship between them as each is affected, implicitly, by its own specific inflation indices.
e) GPP-Indexes such as the CPI are, in the writer's local experience, significantly different both in quantum and timing from those general indices as apply to both construction costs and plant purchase costs. Thus the use of a CPI assumes that the original purchase price if indexed for general consumption is either sufficiently indicative of replacement costs (depreciation & capital maintenance) or of resale value … resale values worldwide of second-hand plant rarely if ever relate closely to CPI's their being either significantly discounted in first-world markets or "premium rated" in third-world markets; to index and then try and "impair" seems an inappropriate method when there exists professionally qualified valuation experts in the first place.

I submit that The Standard, by applying a GPP-Index, does not adequately meet the requirement being generally useful and thus does not adequately and accurately reflect the effects of hyperinflation.

Traditional Reporting – Usefulness & "Misleading" Qualities

The Standard does **attempt** to address the effects of rampant inflation which undermine the financial soundness of business but the following should be considered:
a) even with education and the onus of users to become semi-financially literate the adjustments for net monetary gains/losses (which are economic concepts and not quantified measurements of transactions) are not easily interpreted; if not meaningfully interpreted then they are not useful
b) as "net monetary adjustments" are economic and not tangible items it begs the question as to whether management can actually use this information (even if it adequately comprehends it) or not; if not then not useful
c) to be useful, reporting needs to be timely and under hyperinflation – assuming indices are immediately available – the normal reporting interval of 1-month can result in markedly outdated information; that The Standard does not address the frequency of reporting interval makes its usefulness questionable
d) in considering "misleading" one needs to consider the following:

a. “relevance”: that the need to address the effects of hyperinflation partially meets the “relevance” criterion; that The Standard does not seem to consider the other significant traits exhibited by a hyperinflationary environment detracts from that relevance
b. “materiality”: that the issue of the effects of hyperinflation are material the “materiality” criterion is met in general terms but by using a GPP-Index can also be misleading on an industry specific basis
c. “reliability”: given the imprecise nature and likely magnitude of indexing factors together with The Statement’s own admission that *“a precise definition of hyperinflation doesn’t exist”* and that *“consistent application … is more important than precise accuracy…”* calls into question the reliability of the indexed financial statements (especially when no reliable degree of error can be quantified) thus the “reliability” criterion is not met
d. “faithful representation” : the issues surrounding “reliability” and adequacy of a uni-GPP-Index by extension means that the criterion of “faithful representation” cannot be assured and therefore not met
e. “neutrality”: to the extent that a uni-GPP-Index is not relevant to a particular company/industry sector by default implies bias and thus the criterion of “neutrality” is not met
f. “comparability” : to the extent that a uni-GPP-Index is not relevant then true inter-company comparability is not possible against the backdrop of hyperinflation as it destroys the normal and unique company differentials thus the criterion of “comparability” is not met; to the extent that exchange rates adjust for inflation differentials and that other non-hyperinflationary economies are not applying IAS29 also means comparability is not met
g. “benefit & cost” : apart from the initial high cost of implementation, against the backdrop of the above points there is no real and measured benefit thus the cost cannot justify the benefit
h. “true & fair” : in the light of the above inadequacies The Standard cannot, by itself, purport to present “true and fair” accounts

If truly useful, then all companies, worldwide, should be adopting and incorporating either The Standard (where applicable) or the essence of The Standard in daily operating reports… what proportion of large non-public companies do this whilst here, in Zimbabwe, there seems to be a pre-occupation with the listed counters.

Principal Accounts

The issue of principal accounts must, on the basis of the above, be a questionable foundation for The Standard and is therefore totally inappropriate

Management Performance

This is a difficult issue but to the extent that firstly, there probably exist abnormal constraints thus negating normal remedies and that secondly, management is in all likelihood working on inflation expectations The Standard by itself is inadequate to judge management performance. The Standard does not call for explanation or supplementary detail to place decision-results into context and, as regards inflation rates, it reduces performance measurement to "adjudging management's ability to guess the future".

It also seems a little incongruous to index "dividends" in the income statement yet the shareholder only receives a dividend (monetary asset?) in net monetary units i.e. dollars and cents.

Of some passing interest is the general "accounting convention/policy statement" employed widely throughout the world in that "… financial statements are prepared under the historical cost convention… exception of certain plant at valuation… and no other procedures have been adopted to reflect the impact of specific price changes or changes in the general level of prices…". This is actually a disclaimer of all inflation until, magically, hyperinflation appears – this does not seem to be a consistent approach.

Finally, it occurs to the writer that the "creation" of either a "net monetary asset" or "net monetary liability" is not too far removed from the principles espoused concerning the identification, definition and treatment of "Intangible Assets" (with immediate period amortization a prerequisite) excepting that this "asset/liability" does not appear to meet the criteria laid down in either IAS32 or IAS38. If, indeed, we do have an intangible asset through application of IAS29 then we also have incompatibility with these two standards as well. The *"IAS29 intangible"* is, surely and logically by its very nature and not by the IAS29 definition, a monetary affair thus the omnibus paragraph 5 of IAS38 cannot be used and yet, an "IAS29 monetary asset" is not in harmony with the IAS32 definitions of *"financial instrument"* and *"financial asset"*.

RECOMMENDATION

Whilst there is need to provide shareholders/stakeholders information as regards the effects of high/hyperinflation IAS29 as a standard and as writ is unnecessary, inappropriate and inaccurate. The "bottom line" is that IAS29 as set out does "not do the job" of adequately explaining the effects of inflation and the concept of GPP-Indexed as **Mandatory Principal Accounts** must be discarded. It is interesting to note that, thus far in Zimbabwe, IAS29 does not seem to have "appropriately influenced" dividend policy where certain "*negative* IAS29 results" have still shown high levels of dividends being declared yet other companies, with good historical cost results, either holding dividend cover or even not declaring dividends *"due to prevailing economic conditions"*.

As regards what to do, I believe a modified version of IAS15 coupled with the various recommendations made by The Task Force can easily be adopted and implemented and, if deemed appropriate, even made mandatory. This would include a format of abridged and appropriately indexed financial statements (no notes) as supplementary information together with added material as to the general economic environment (this could be an ICAZ issued statement for consistency/comparability) plus any other specifics as relate to the individual company's circumstances. Additionally, there should be some commentary as regards management's strategy to deal with the situation; this might also include volumetric information such as day's inventory/debtors to at least partially interpret the inflationary effects of financial quantum. An alternative, using either a realistic or free-market exchange rate, is to simply translate into a stable hard currency; use of a hard currency is becoming increasingly accepted internationally and, significantly, matches both *(a)* and *(b)* of The Standard's own definition of hyperinflation.

B.P. South
March 2002

IAS29 – OPTIONS

Notes Relating To IAS29 Options & Alternatives

In considering alternatives, it is relevant that the important issues affecting disclosure rationale be determined and agreed. To this end, I suggest that the following items are those important issues and relate to any real form of indexing and not merely IAS29 methodology:

1. The relative movement in operating performance between trading periods
2. The relative return on trading versus some form of market bench-mark return
3. The relative reduction in purchasing power of the unit of currency when measured against constant volumes and not the relative benefits of increased borrowing levels as IAS29 disclosure might suggest
4. The attempt to more correctly present the balance sheet investment in fixed assets which pertains when true hyperinflation exists, and revaluations not carried out, but which do not, per se, exist when stagflation conditions prevail
5. The attempt to ensure that adequate replacement-depreciation charges are made for the "infinite long term" thereby implying a "perpetual going concern"
6. The attempt to provide a "real" rather than "nominal" return on a "current asset cost" and not on an "historical investment or sunk cost" basis

If one accepts that the above are correct then, in reverse order, items 4 – 6 become invalid in the present Zimbabwean context due to the severe macro-economic distortions and items 1 –3 would, in my opinion, provide a strong argument for providing a simple and abridged approach to the whole inflation disclosure issue.

Equally, one must not lose sight of the fact that from industry to industry the ability to cope with the demands of ultra-inflation differ markedly even where management has made immense strides in improving efficiencies, reducing waste and taking advantage of alternatives and opportunities. It is, particularly, in this area that non-indexed numbers are probably of more use and attention to physical unit/volume changes becomes more relevant.

One area that has not as yet been considered is the concept of re-indexing the prior period figures to try and arrive at an original base. In keeping with the arguments on indexing fixed assets I think this approach is flawed and in keeping with the premise of trying to show year-on-year improvements/deteriorations I do not think such is necessary. Thus only index the current year back to the prior comparative; additionally there doesn't seem to be much worth in re-indexing only the prior year IF sufficiently detailed re-indexed comparatives for 3 or 5 or 7 or 10 or whatever years as would provide meaningful trends are not computed.

Whilst Radar has, this year, produced a complete set of USD comparatives – based on the premise of comparing results in relatively stable currency terms – it is imperfect for, apart from all distortions associated with any form of indexing (some's worse than others here), the most obvious present drawback of the absence of a free-market exchange rate.

Personally I'd prefer to see a much scaled back approach – too many imponderables, averages, estimates, *incalculables* and the like to warrant IAS29 type approach – where there is, say and by way of note:

1. A general economic statement as to the prevailing conditions in the economy over a particular period – this could be prepared by authoritative economic authorities under a mandate from ICAZ and updated quarterly; one issue which might well need consideration is whether this "statement" should be in the notes to the accounts or is more appropriate as a separate inclusion, say under a financial commentary, in the report as a whole.

2. An abridged trading account indexed to the most appropriate to that particular industry but indexed year-on-year only i.e. prior figures not re-indexed in line with the above reasoning; it might also be necessary to expand the index note where such index is not a from a "pure source" such as the CPI's is from the Dept. Of Census & Statistics and therefore in the public domain

3. A review of working capital management as relates, say, to those hyperinflation combat techniques and which would include stock-turn and debtor/creditor day ratios

4. More emphasis on the business' ability to generate cash and here "free cash flow" is probably more appropriate (again a standard ICAZ approved definition might be warranted); this goes hand in hand with ability to service debt whereas under high inflation and indexing of numbers traditional gearing ratios become fraught with danger; free cash is essentially the cash generating ability of the company produced from operations and which is "available" for shareholders and lenders

5. A statement as to the company's position on asset valuations (remembering that even prior to IAS29 this whole issue was contentious) but perhaps such could include a note as to the values provided for insurance purposes – a latent benefit here might be more assurance to the shareholder that the assets are "adequately" protected for insured perils

I cannot adequately stress the importance of item #1 – the economic commentary. If one accepts that IAS29 is part economics/part accounting and that the intent behind the standard is as much to evidence the effect of economic conditions on the operations of a company as it is for purposes of general disclosure then it is immutable that a proper economic background be painted; such background will also reduce the inferred effects of adopting a uni-index irrespective of industrial sector.

One item of recent vintage as regards the use of the CPI must be the effects of price control… to the extent that these are "effective" then there will be an artificially depressed index which will, for those businesses not subject to control, incorrectly improve the reported results… a situation not as likely to occur where a more specific (and unregulated) index is available/used. Attached and purely by way of illustration are several different indexed figures demonstrating the differing results obtained using different indices and different weighting-periods. What is, perhaps, interesting is that whilst the weighted annual results are not too far different, each six-month set of indexed figures **are significantly different.** The results using "my index" rather than the CPI for each 6-month period reflect a better performance in the June half-year than the December half-year. The point? Well apart from accepting that some form of periodic indexing (as opposed to annual indexing only) is preferable – here maybe six monthly is actually quite adequate to match public reporting – equally the use of an industry-appropriate index is also preferable to the use of a uni-index.

So now to a purely hypothetical and illustrative indication of the above suggestion for alternative disclosure – <u>all figures must be taken as purely illustrative</u>:

NOTE "X" : INFLATION

X.1 <u>Prevailing Conditions</u>: During the period under review, the local economy experienced hyperinflationary conditions as measured by the cumulative and compounded three year CPI where such was, to June 2001, an annual 64% and a three year multiplier of 4,06 times (June 2001 index of 765.7 over June 1998 index of 188.4 based on 100%=1995). Allied to this, is the fact that the real GDP Growth Rate dropped from 2.9% in 1998 to 1.7% in 1999 and a projected –4.2% in 2000. Furthermore, the all sector volume of manufacturing production (1980=100) dropped from 126.3 in 1997 to 108.9 in 1999 with further, anticipated, declines to ??? in 2000 and to ??? in 2001. M3 money supply has continued to grow at a rate of 73,9% in the year to June 2001 and interest rates have been reduced whereby 90-day Bankers Acceptances have declined from 68% in June 2000 to between 10.5% and 31.5% at June 2001. Exchange rates, after a 41% devaluation in August 2000 have been held constant at USD1:ZW$55 by central authorities.

X.2 <u>Abridged Trading Results</u>: based on a six month weighted industry relevant index for the company extracted from the Building Materials Price Index; the weighted index for the year ended June 2001 is 138,7. Comparatives have not been indexed.

	2001 $000	**2000 $000**	**Change %**
Turnover	1 977 156	1 356 729	+ 46
Gross Profit	710 668	459 446	+ 55
Operating Income	258 624	99 978	+ 159

X.3 <u>Working Capital</u>: these figures have not been indexed.

	2001 $000	**2000 $000**	**Change %**
Inventories	360 064	272 145	+ 32
Trade receivables	364 885	267 345	+ 36
Trade payables	300 253	191 120	+ 57
Inventory days	75	111	- 36
Receivables days	49	72	- 23
Payables days	63	78	- 15

X4. Free Cash Flow: these figures have not been indexed.

	2001	**2000**
	$000	**$000**
Profit/(loss) after tax	149 086	(44 365)
Add: non-cash flow items	59 351	37 804
Add: after tax interest payment	175 385	111 498
Less: cash invested in working capital	(11 809)	(10 354)
Less: investment in fixed assets	(155 258)	(35 738)
FREE CASH FLOW FOR THE PERIOD	216 755	58 845

X5. Asset Valuations: as stated in previous annual reports your Board believes that prevailing conditions preclude any meaningful determination of either replacement or fair-market or impaired values of assets and have thus not adjusted values in the balance sheet since the last valuation conducted in 199X. That said, your company’s assets are insured for all-risks perils, with the exception of forest plantations where insurance cover is not available, for a sum in excess of $7Bn

notice of annual general meeting

Time	11.00 am
Date	6 December 2001
Place	2nd Floor, Charter House, Leopold Takawira Avenue/Fort Street, Bulawayo

NOTICE IS HEREBY GIVEN that the Annual General Meeting of the members of Radar Holdings Limited will be held in the Board Room of the registered office of the Company to conduct the following business :

1. To receive and consider the audited financial statements for the year ended 30 June 2001 together with the reports of the Directors and Auditors.

2. To re-appoint retiring Directors.

3. To determine the remuneration of the non-executive Directors.

4. To confirm the remuneration of the Auditors for past services and to appoint Auditors for the ensuing year.

5. To consider, and if thought fit, to pass, with or without amendment, the following resolutions as ordinary resolutions :

   a) That the unissued shares remain under the control of the Directors who may issue them on such terms and conditions as they see fit, subject to the limitations of the Companies Act (Chapter 24:03).

   b) That loans granted to senior members of staff, officers and directors of the Company, or its subsidiaries, in the sum of $60 000,00 be and are hereby ratified.

6. To transact such other business as may be transacted at an Annual General Meeting.

In accordance with the requirements of the Companies Act, members of the Company are notified that they are entitled to appoint one or more proxies to attend, speak and vote at the meeting on their behalf. A proxy need not be a member of the Company. Proxies must be lodged with the Secretary not less than forty-eight hours before the meeting.

By order of the Board,
Radar Investments (Private) Limited
Secretaries

Charter House
51-57 Leopold Takawira Avenue/
Fort Street
Bulawayo

Bulawayo
20 September 2001

2001

group financial highlights

		2001 $'000	2000 $'000
Operating results	Turnover	**2 742 384**	1 356 729
	Operating Profit	**361 562**	99 978
	Income/(Loss) before tax	**183 724**	(65 356)
	Attributable Income/(Loss)	**71 786**	(21 507)
Percentages and ratios	Pre-interest return on total assets (%)	**14.5**	6.0
	After tax return on shareholders' funds (%)	**14.5**	(10.4)
	Total interest bearing liabilities to shareholders' funds (%)	**119.7**	303.3
	Current ratio (:1)	**0.9**	0.7
Ordinary share performance (Comparatives adjusted)	Earnings/(Loss) per share (cents) - basic	**129.5**	(38.8)
	Dividends per share (cents)	**-**	13.0
	Dividend cover (times)	**-**	(3.0)
	Net asset value per share (cents)	**894.4**	372.7
	Market price per share at 30 June (cents)	**290**	300

SHAREHOLDERS' CALENDAR in respect of the year to 30 June 2001

Financial reports	Interim results announced - 1 March 2001 Year end results announced - 27 September 2001 Annual report posted to shareholders - 9 November 2001
Annual General Meeting	**6 December 2001**

Shareholders are reminded to notify **Radar Investments (Private) Limited, P O Box 2346, Bulawayo** of any change of address.

directorate

Board	C J L Schofield	Chairman
	P W T Chipudhla	Deputy Chairman
	E T Rusike	
	Z L Rusike	
	K R R Schofield	
	J R Sly	
	B P South	
Secretaries	Radar Investments (Private) Limited	

OPERATING COMPANIES

Radar Investments (Private) Limited		
Directors	P W T Chipudhla	Chairman
	J R Sly	Deputy Chairman
	C J L Schofield	Managing Director
	Z L Rusike	Deputy Managing Director
	B P South	Finance
	J D Andrews	
	A A Bulman	
	J Gadzikwa	
	M J Rowland	
	K R R Schofield	
Border Timbers Limited		
Directors	P W T Chipudhla	Chairman
	K R R Schofield	Deputy Chairman
	J Gadzikwa	Managing Director
	J Anderson	Finance
	Z L Rusike	
	B P South	
	H B A J von Pezold	
	R von Pezold	
Commercial & Industrial Holdings Limited		
Directors	C J L Schofield	Chairman
	M J Rowland	Managing Director
	J S Vaghmaria	Finance
	N J Macdonald	
	J R Sly	
Group Company Secretary	N Lang	

Bankers

Kingdom Merchant Bank Limited
Stanbic Bank Zimbabwe Limited
Syfrets Corporate and Merchant Bank Limited
Trust Merchant Bank Limited
National Merchant Bank of Zimbabwe Limited
Trade & Investment Bank Limited
Century Bank Limited

Transfer Secretaries

Radar Investments (Private) Limited
5th Floor, Charter House
Leopold Takawira Avenue/Fort Street
Bulawayo Telephone (09) 74548/9

Auditors

Ernst & Young

Legal Practitioners

Atherstone & Cook
Calderwood, Bryce Hendrie & Partners
Sansole & Senda
Wintertons

Registered Office
5th Floor, Charter House, Leopold Takawira Avenue/Fort Street, P O Box 2346, Bulawayo
Telephone: (09) 74548. Telefax: (09) 75942. e-mail: radar@radargroup.co.zw

FINANCIAL YEAR END
30 JUNE 2001

board of directors

CHAIRMAN *** -** Chris Schofield - age 62
Appointed to the board in July 1987. Elected Chairman in June 1989. He is Managing director of Radar Investments (Private) Limited, of Radar Properties (Private) Limited, Chairman of CIH Limited, a member of the Border Timbers Limited Audit committee and a director of other Zimbabwean companies outside the Radar group.

DEPUTY CHAIRMAN * - Philip Chipudhla - age 71
Appointed to the board in September 1983 and appointed Deputy Chairman in June 1989. He is Chairman of Radar Investments (Private) Limited and of the Compensation Committee. He is Chairman of Gestetner Zimbabwe Limited and Border Timbers Limited. He serves as a director of Beverley Building Society and several other Zimbabwean companies.

DIRECTOR - Elias Rusike - age 60
Appointed to the board in August 1989. He is Chief Executive of Modus Publications (Private) Limited, publishers of the Financial Gazette and is a member of the boards of a number of other Zimbabwean companies.

DIRECTOR * - Zivanayi ("Zed") Rusike - age 45
Joined the group in April 1983 and was appointed to the board in November 1991. He is Managing Director of the United Builders Merchants division and Deputy Managing Director of Radar Investments (Private) Limited. He is a director of Continental Capital (Private) Limited, a subsidiary of the Finhold group. He is also a director of Border Timbers Limited and past President of the CZI.

DIRECTOR * - Richard Sly - age 66
Appointed to the board in October 1989. He is Chairman of the Audit Committee and Chairman of Haddon & Sly Limited. He is a director of CIH Limited and a member of the Audit Committee. He is a director of Fincor Finance Corporation Limited and several other local companies and institutions. He is past President of the National and the Bulawayo Chambers of Commerce.

DIRECTOR - Kenneth Schofield - age 38
Appointed to the board in November 1994. He is a director of Radar Investments (Private) Limited, Deputy Chairman of Border Timbers Limited and a director of a number of other Zimbabwean companies outside the Radar group.

DIRECTOR - Brett South - age 41
Appointed to the board in March 2000. He is a director of Radar Investments (Private) Limited and Border Timbers Limited.

Executive Director
*** Member of Audit and Compensation Committees**

GROUP SENIOR MANAGEMENT

RADAR METAL INDUSTRIES

Jonathan Rowland	Managing
Alan Soule	General Manager
Vusumuzi Mahaja	Finance

UNITED BUILDERS MERCHANTS

Zed Rusike	Managing
Kennedy Mashava	Finance
Martin Sadambura	
Sylvester Mauni	
Kenneth Schofield	
Richard Gaft	
Malcolm Davidson	

MACDONALD BRICKS

Albert Bulman	Managing
Peter Mutsokoti	Finance
Martinus Barnard	Consultant
Rick Simms	Production (Willsg rove)
Irwin Westermeyer	Production (Montgomery)
Lazarus Ncube	Human Resources
Jonathan Rowland	

RADAR CASTINGS

Kenneth Schofield	Chairman
Tony Havercroft	Managing
Gerry Chigwande	Finance
Elijah Chideme	Production

COMMERCIAL & INDUSTRIAL HOLDINGS
Operational Management

Rob Miller	General Manager, Bulawayo Toyota
Bobby Hall	General Manager, Coronet Buttons & Plastics
William Maroleng	General Manager, Cotton Waste
Richard Pope	General Manager, Home Furnishers
Paul Brown	General Manager, International Hardware
Graham Bryce	General Manager, Hogarths / National Fencing

BORDER TIMBERS
Operational Management

Heinrich von Pezold	Chairman
Kenneth Schofield	Deputy Chairman
John Gadzikwa	Managing
John Anderson	Finance
Dave Robinson	Forestry & Sawmilling
Irvin Kanyemba	Border Timbers International/Paulington
Chris Vengesa	Marketing

chairman's statement to shareholders

Dear Shareholders,

As indicated in the abridged comments on the group's results for year ending June 2001, some progress was made in comparison to prior years. Nonetheless, and however unpalatable this will be, the group faces a very uncertain future. Why so? For one very good reason: the group, busier than ever, is busy going out of business. That is, ladies and gentlemen, the bottom line; shareholders attention, in this respect, is drawn to the comment contained in the Group Financial Director's report which says it all.

"Whilst the Group tried to keep pace with inflation, the various volume declines experienced are of concern. It is pertinent to note that despite the influences of mix and volumes no operating unit achieved a net price increase either equal to or above inflation level."

It will require a sea change in Government's implemented policy, as against the endless gibberish we are currently subjected to, if the forecast contained in the opening paragraph is not to be borne out. In the interim, the salient features of the group's trading are as follows:

	2001	2000
	$'000	$'000
Turnover	2 742 384	1 356 729
Income before interest	437 538	108 996
Net interest payable	253 814	174 352
Profit/(loss) for the year	84 701	(28 705)
Shareholders' Funds	495 667	206 530
Net current liabilities	(106 446)	(250 516)

Zed Rusike, John Gadzikwa and Jonathan Rowland cover comment on divisional activities, while Brett South covers the group's financial management performance. Shareholders attention is drawn to the Border annual report and to the inserts accompanying this report.

At a point in time when virtually every aspect of trade is related, directly and indirectly, to the U.S. Dollar, your Board's decision to provide, in addition, U.S. Dollar denominated financial results would appear to be vindicated. Equally, your Board's stance vis-a-vis reporting as per IAS 29 would seem justified ... the points covered by the Group Financial Director in the enclosure to the Annual Report for the year ending June 2000 are every bit as applicable today as they were then.

ORGANISATION, CORPORATE GOVERNANCE AND CORPORATE INVOLVEMENT IN THE PUBLIC SECTOR

Shareholders attention is drawn to the revised structure of the group which has been put in place subsequent to year end. The preamble to the revised Board compositions explains the raison d'etre. Zed Rusike, who took up the Presidency of the CZI for a year, deserves to be commended for keeping the CZI firmly on track while contending with the seemingly endless pressure that goes with the position.

It has been encouraging for all of us at Radar to receive recognition of the fact that every effort is being made to "get it right". In terms of financial reporting it is particularly pleasing to have seen Border Timbers Ltd. and CIH take first and second places (in the category in which the two companies fell) at the recent Zimpapers/ZSE awards. Equally, it was pleasing to see the Radar stand at the Bulawayo Trade Fair carry off first prize in the industrial section, while Bulawayo Toyota was adjudged the second best stand in the automotive sector. Particularly pleasing was Border Timbers award of the "Exporter of the Year" ... following on the devastation that took place in the aftermath of Cyclone Eline, Border put in a truly remarkable performance.

It is perhaps appropriate to mention here the time, and effort, that the Border people devoted - in common with a number of Mutare companies but particularly Zimboard - to rehabilitating the facilities at the Mutare Showgrounds. The group has made a commitment to further assist those involved at the show next year.

LITIGATION

The Board is looking at taking legal action to seek recourse for prejudice the group has suffered both as a result of widespread fraud at Border and with respect to issues related to operation at one of Border's mills.

INDUSTRIAL RELATIONS

As commented on in the 2000 Annual Report, the exodus of specialist skills remains a very major concern. One cannot but compare the approach taken by our southern neighbour, where a concentrated effort is in place not only to bring back home those who have, over recent years left, but also immigrants who have skills not readily available. In our own country the powers-that-be seem hell bent on driving out whatever skills we have ... as about a half-witted, short-sighted an approach as anyone could possibly dream up. As an aside, a recent survey in South Africa came up with an interesting finding: each 'skilled' immigrant to the Republic creates an additional 6 jobs. Here at home, faced with mounting job losses, and a downsizing of our industrial base this might be something to mull over.

OVERVIEW AND FUTURE PROSPECTS

Only a total sceptic is entitled to the view that with no foreign direct investment (FDI), widespread retrenchments, collapsing services - one could go on ad nauseum - Government's approach to "job creation" is to let loose hordes of jobless/landless to careen over the countryside. Regardless of one's viewpoint, the reality is that "the programme" has cost the country countless billions and acquired the cachet of a "pariah state". What next?

One could come up with some corporate mumbo jumbo such as "due to the uncertain economic environment we are unable to provide a forecast"... and so on. Or provide a forecast that for any number of reasons, comes nowhere near close to reality ... but by then little attention is paid other than if a dividend has been promised and not delivered. Alternatively, and here I turn to the singular, I could ask your forbearance and put on paper something that takes me back many years when I was sitting with my Dad, in a sail boat on Kariba, as the sun was going down. I'd remarked on how beautiful it all was and he said, *"Wind and sail is pretty much what life is all about. There are times when one is becalmed (completely still) ... one just has to be patient. At the same time it gives one an opportunity to potter about and do some house cleaning ... sorting things out, making certain that everything is in working order. Then there are times, magical times when the wind caresses the sail ... a gentle tug here, a little push there. These are serene moments in life, a time to stand in awe, a time for loving and being loved. But then there's a change, sometimes almost imperceptible, the senses are heightened, an awareness that one is about to be tested. For some, it will simply be a long haul; for others, reaching for the outer edge, it will be exhilarating. And then of course there are times, thankfully few and far between, when nature - and man for that matter - seems to lose its marbles. Savage, demented gales blow mindlessly, lashing out in mindless destruction. That's a time to batten down the hatches and ride out the storm. Not everything survives ... but that's the way life is. It is in the aftermath, surveying the needless destruction that you will need to remind yourself that what has just taken place is but one part of the matrix of life ... and you will need to get on and pick up the pieces. "Cause that's the way life is".*

Speaking for myself, and looking at what is taking place all around us, what was said then seems so utterly pertinent to today. Wherever you are right now Dad, you'll have a fairly good idea of what it's all about.

And that's about it. Shareholders may well have read some pretty banal comments about "not concentrating on the negatives"... which is pretty much akin to the Captain of the Titanic saying to the passengers *"may I draw your attention to the quality of the bed linen"* ... while all around is gurgle, gurgle.

Midst the ongoing mayhem, group management set about doing

chairman's statement to shareholders

(continued)

what we said we would ... concentrated on asset management and the expansion (or at worst retention) of our export markets. Some headway has been made in reducing the group's borrowings ... certainly the lower interest rates that applied in the last six months of our financial year made an appreciable, positive, difference. This position may well change in the not too distant future - though for all the wrong reasons. The same commentators, who are calling for "realistic" interest rates, ignore the very basis of supply and demand. As of now, with M3 simply rocketing, the country is awash with Zimbabwe dollars ... the Victoria Falls may well be one of the seven wonders of the world, but with the deluge of printed notes flowing from Fidelity Printers, that concern may well be added to the list. Cut the velocity of money supply and market forces will, of themselves, very quickly adjust as borrowers are forced to "cherchez la cash".

A major, negative, difference impacting upon the group has been firstly, the Reserve Bank's diktat that 25% of forex earned (that percentage has now been increased to 40%) be surrendered and secondly, that the official, farcical, rate of conversion be held at 55:1 to the USD. The latter is obviously of greater import.

Shareholders may be interested in an in house model we ran (again Border only) which reflects the following:

Had the Zimbabwe dollar/USD traded down in correlation with the CPI index, then total export proceeds would have amounted to $1385M as against reported export earnings of $1026M ... resulting in proceeds being some 358 million dollars lower than what would have/could have been achieved. Thus in two years, if one accepts the correlation model (in our view better than trying to "guesstimate" the "true" value of the Zim dollar), Border has, alone, been deprived of some 550 million dollars. Repeat: some 550 million dollars. Accepted that a *portion* of those earnings (remembering too that BTI is an EPZ project) would have flowed back to Treasury by way of Company tax, the prejudice is enormous. Over-borrowed ... or overtaxed? Or, simply, short-changed? Take your pick.

If one extrapolates those numbers to total, national, export proceeds then it is not very difficult to determine why we are living on borrowed time in every sense of the word.

The retention of our export markets is becoming increasingly problematic ... exacerbated by the recent events in the U.S. Americans are casting an increasingly jaundiced look at areas where they perceive there to be terrorism, thuggery and an abandonment of the rule of law. The proposed Democracy Bill, if passed by the House, will only serve to increase the negative perceptions that the U.S. has apropos Zimbabwe. Border has seen of late, a fall off in exports to the U.S. ... any major slow down in home building activity can only further impact negatively on sales into this our single largest export market.

Turning very briefly to the local market, the buoyancy that prevails fuelled - a particularly appropriate word - by the torrential money supply - will in all probability continue ... at least to the forthcoming Presidential election. In addition, there is very immediate evidence of the resumption of capital expenditure on a wide range of projects ... this may well necessitate increased Government borrowing with the consequent impact on interest rates. That said, group operations should continue to benefit from the consumer "boom". All of us within the Radar Group remain committed to attaining the objectives we previously set.

The group has sound management, a solid asset base and a track record of adapting to changing circumstances.

APPRECIATION

As always, our thanks go to our customers and to our suppliers - both of goods and services. On behalf of shareholders and members of the Board, may I also express our thanks for the commitment given by so many within the Radar Group at every level.

Elias Rusike has resigned from the RHL Board, having served Radar for some 12 years. During that period of time he was able to provide his colleagues with a penetrating insight with what can best be described as "the greater picture". It is a measure of the man that now he feels he cannot give the time required to enable him to give of his best, he has chosen to step down. Au revoir, Elias and Margaret, and thank you both for your support over the years.

PERSONAL

Having recently been classified, by virtue of the colour of my skin, as a non human being, I might as well close this statement with a Hungarian folk tale. Appropriately, it is not about humans...

There was once a family of Hungarian frogs that went on a hopping holiday in the mountains of Transylvania. The mountains were swarming with wolves and wildcats so that mother frog warned her children to be quiet. Her youngest son boasted, "*I am proud to be a frog, and it is in the nature of a frog to croak*". In due course he became noticed and was killed ... "*I told him not to croak*" the mother frog mourned. "*Do not scold your dead son*," said the father "*he had the courage to be himself*."

Somewhere in there is a message for all of us. We have a wonderful country. We have achieved so much, in so many fields. The last thing in the world we need to do is to pass on to future generations a poisoned chalice.

Sincerely

Chris Schofield
20 September 2001

operational reviews

RADAR

The year under review was very challenging for all Divisions, without exception. In common with all sectors (except financial) the construction industry was not spared from the effects of the negative macro economic environment. Throughout the year, Management and all Staff had to use all of their resources to ensure that their "eyes were not taken off the ball", despite the continuously declining order books within the Divisions. With little confidence in the economy, investment declined, company closures increased and unemployment reached alarming levels. These all led to reduced disposable income and reduced demand for our goods and services. We all hoped that "sanity" would prevail in the nation's decision-making process, resulting in stimulating industrial and export growth. That, unfortunately, did not happen.

Due to the above scenario, Management was faced with a daunting challenge to ensure that their Divisions survived. This they did - admirably.

"RADAR HUBS"

During the year the Group introduced the "hub" concept in Mutare, Harare and, to a lesser extent, Bulawayo.

Aimed at achieving a "one stop shopping" concept within an area, the first hub opened at the Border Timbers' Nyakamete complex. This includes the operations of MacDonald Bricks, Radar Metal Industries and UBM Timbers. After a very slow start, the hub has gained momentum since May 2001. The second opened on Wolverhampton Road in Bulawayo and this includes International Hardware and UBM Timbers. The last and most active is the Harare hub situated on Beatrice Road. This includes MacDonald Bricks, National Fencing, Radar Metal Industries and UBM Timbers. All except UBM Timbers have experienced a surge in trading during the last quarter of the year.

UNITED BUILDERS MERCHANTS

Following an extremely slow start to the year, the Division experienced a surge in trading during the fourth quarter. Turnover to March 2001 was 6.60% up on the previous year whilst for the last three months this was 81.20% up on the last quarter in 2000. The low returns from the money market, resuscitation in mortgage lending and the anticipation of price increases led customers in the domestic housing sector to build new structures or upgrade their places of residence. There were, however, few major "city centre" contracts, greatly reduced investment in the commercial farming sector and fewer international donor funded projects.

As with the two previous years, the three month sales promotion campaign was a success to such an extent that the selected suppliers could not meet demand at prior agreed prices. The campaign is retail based, affording customers the opportunity to purchase selected popular products at extremely competitive prices for cash.

Working Capital Management continued to take centre stage, with the Division concentrating on debtors days, stock turns and increased cash sale levels. I am pleased to report that the Division achieved success, with all three areas reaching record levels by financial year end. The temptation to extend credit to achieve higher sales levels was resisted, as in all likelihood those customers would have been provided for at year end.

The customer service training, run by Margie Jackman of the Co-Ordinators, paid dividends in the improved approach to customers by our Staff. It has also had the effect of enhancing the "UBM Team" concept as all employees attended training sessions.

The marketing and advertising strategy changed during the year to meet the expectations of the changing market. The Group's contracted advertising agency, Brown and Kinloch, were instrumental in conceptualising and leading the revised campaign.

The Division expects another challenging first six months of the new year as evidenced by the trading results for July and August 2001. The focus will, however, be on real growth after factoring out inflation. It is now common to receive supplier price increases without notice and at regular intervals. The purchase of imported raw materials at rapidly changing landed costs is being seen as the major cause. The Division cannot now hold prices firm for imported product not in stock on the date of quoting.

RADAR METAL INDUSTRIES

During the year the Harare factory was re-sited to the Radar "hub" to create a "one-stop" building material supply facility. This was followed by a Management restructuring exercise in Harare during the second half of the year to cater more effectively for the rapid and continuous changes in the market. The two moves have already achieved the anticipated levels of success.

Radar Metal Industries opened at the Nyakamete "hub" to be in more direct contact and thus improve service levels to Manicaland customers.

As with others, the Division experienced a sub-inflationary increase in turnover year on year with a volume drop-off in the local market due largely to the decrease in major construction projects. This decrease, shrinking the already ailing market, negatively impacted on margins. The effect was compounded by the continued heavy discounting by a major competitor and the thriving informal market.

Fortunately, the time spent on developing the external market resulted in a 93% year on year increase in export sales to Botswana and South Africa. Our depreciating currency also assisted in making the product more competitive. Whilst the Division will continue to focus on export sales, the lack of meaningful export incentives and the recent decision by the Reserve Bank to increase its export proceed retention from 25% to 40% has threatened the viability of this crucial market.

Whilst large increases were experienced against selected overheads including advertising, vehicle operating expenses, freight charges and rates, there were massive savings achieved against electricity costs (despite higher unit costs) as a result of tight controls and sound management systems implemented during the previous financial year.

As with UBM, the Division saw an improved volume off-take towards the last quarter of the year, both in the local and export markets. This, coupled with changes in manufacturing systems and product design aimed at improving material utilisation, should have a positive effect on margins.

RADAR CASTINGS

As a result of the diminishing local market, the Division concentrated its efforts on exports. Although turnover was below inflationary levels, the year on year 41% increase was not disastrous. By year end, Radar Castings was sitting with a three-month back order book, auguring well for the future. During the year the Division clinched a niche market for high quality grinding balls (for power stations) and has developed a market for motor vehicle spare parts such as hubs and brake pads.

Despite operating a state of the art foundry, Radar Castings experienced a high incidence of furnace breakdowns, adversely affecting production. The debt carrying costs being borne by the Division and the Group as a whole, also curtailed investment in new equipment which would have improved efficiencies and above the line expenses. The critical shortage and high cost of scrap also contributed to "stop-start" operations.

The shortage of technical skills in the local foundry industry contributed to the increased levels of scrap during production. Whilst product development of steel castings contributed to the high level,

operational reviews

(Continued)

the main reason is that of a lack of skills.

Despite Management's attempt to strictly manage working capital, the cycle was adversely affected by delayed payments by export debtors and a material local mining house. The "Catch 22" scenario was evident as the Division relies heavily on orders emanating from these two customers. Non-supply would have adversely affected sales.

MACDONALD BRICKS

Once the mainstay of the Group, MacDonald Bricks experienced low orders throughout the year particularly as a result of the reduced building activity in the Matabeleland and Manicaland markets. The nature of the product, resulting in high transportation costs, does not lend itself for competing in distant markets. This is particularly true with regard to common bricks, which carry lower profit margins.

The low off-take necessitated the temporary closure of the Willsgrove plant as fixed and variable costs could not be covered by revenue.

Exports into Botswana continued to be strong. These were supported to a lesser extent by those into Zambia and the northern parts of South Africa. Increased external advertising has had a positive effect.

Except for a major kiln refurbishment at Montgomery, there were not any material disruptions to production.

COPPERWARES

The Division was sold to a third party early in the financial year.

APPRECIATION

I am pleased to report that, yet again, the commitment of Management and Employees has remained steadfast throughout the year despite the unfavourable operating environment. The impeccable industrial relations record throughout the year shows that we truly have a "Radar Team" approach.

May I thank the Group for affording me the time to act as the President of the Confederation of Zimbabwe Industries (CZI) for a term. The support was unwavering. The office was an honour and the greatest challenge I have faced. I certainly hope I did justice to it!

"ZED" RUSIKE
Deputy Managing Director
Radar Investments (Private) Limited

BORDER TIMBERS LIMITED

INTRODUCTION

The 12 months under review show a marked improvement in comparison to the previous financial year. This improvement comes against a background of the current harsh macro-economic environment. Your company continues to strive to keep its head above water with the hope that somehow in the near future the economic environment will return to normal.

FORESTRY AND SAWMILLS

Silviculture

The planting program continued relatively smoothly in the course of the year with the backlog that had accumulated in the previous financial year being wiped off. The exception to the planting programme was Sawerombe Estate where continuous destruction of plantation and property has made planting and silvicultural activities difficult. This has continued in the new year and until the national land reform issue is resolved the planting programme in this area may continue at a reduced pace. The weeding programme was also successful while the shortfall in the pruning programme has been carried forward to the new financial year.

Forest Protection

The incidences of fire in the forest were exacerbated by the presence of illegal individuals who, in what can only be described as arson, started fires with the intention of clearing planted forests for the purpose of preparing the land for tillage. The majority of these fires were in the sections of Sawerombe that are listed for acquisition by the government for the resettlement programme. The area of planted trees lost this way totalled approximately 300 hectares.

All these fires were reported to the relevant authorities that have, as in the rest of the country, done nothing to bring the criminals to book.

Shareholders will recall that in the last annual report it was indicated that application had been made to FSC seeking exemption on the use of a banned pesticide, namely brodifacoum, to control baboon damage in the forests. The response from FSC was received at the end of July 2001. Border’s application was denied on the basis that pine is not an indigenous species and baboons are. The sustainability of Zimbabwe’s timber industry is apparently not a consideration. Management is evaluating the options available in respect of baboon control and will address the problem as a matter of utmost urgency.

A few incidents of eland damage to pine trees were identified during the year. Eland damage is becoming more pronounced as the eland, particularly from the National Parks Eland Sanctuary, came across seeking refuge from what is, reportedly, wide spread poaching. Discussions with various parties are underway with the intention being the capture and relocation of the eland. In the meantime salt licks are being placed at various points to entice the eland away from the plantations.

Harvesting

The thinning programme plan was not met during the year. The budget in the new year reflects a thinning to waste programme which is intended to ignore this year’s efforts to find markets for timber with a diameter of less than 15 cm.

Clearfelling sawlog production for the year was 90% of what Border had budgeted for. This was a slight improvement to the 88% achieved in the previous year. In the early part of the year work continued in the cyclone affected areas where sawlog productivity was reduced because of accessibility problems and the state of the logs themselves. In the later months Border experienced machinery availability problems with the worst affected being skidders and teleloggers. This was further worsened by the non-availability of foreign currency to our suppliers of machinery spares. It is encouraging to note, though, that by the end of the year as a result of a stringent, proactive, maintenance programme plant availability improved.

Pulpwood deliveries to our customers were 97% of the budget and Border continues to experience collection problems from the forests by customers.

Demand for telephone and transmission poles continued to improve towards the end of the year with both the local and regional markets calling for more than the dry stock that was available from the forests. It is envisaged that this level of the demand will continue, especially in the local market, for at least six months. Efforts are being directed to those markets in the region, which Border has not dealt with before.

operational reviews

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Sawmills

The sawmills production in the year under review was characterised by a number of factors, which adversely affected both input and output. The U71 framesaw at Charter broke down in September 2000 and the nature of this breakdown rendered the machine irreparable. The replacement machine, a Moehringer U71 framesaw was only received on 19 February 2001 and was commissioned on 5 March 2001. Production output was affected in three ways being, firstly, the daily volume throughput was materially reduced, secondly, efficiency of recovery fell due to non-optimal log sizes having to be processed and, thirdly, increased costs of working where large diameter logs had to be re-routed to the Tilbury sawmill.

The shortages of sawlogs experienced at Charter during the year arise from the recognition that if the sawmill had continued cutting at the levels that the mill is capable of then the age of the trees that would have had to be clearfelled would have been reduced substantially thus affecting sustainability of the forest on a rotational basis and the quality of the logs going through the mill. A decision was taken to purchase standing timber from a third party, which will ensure adequate quality logs for the mill for the next five years. This will mean that in five years time the forest plantations will return to a desired rotational period of at least 25 years.

ZESA power outages continued during the year where in some cases full shift production was lost. Again your board took the decision to look for alternative sources of power, which would guarantee continued supply.

The resultant production input for the year was 86% of budget, a slight improvement over the previous year. The production input has, however, continued to improve from the February 2001 levels in the latter part of the year. Grading procedures have continued to place emphasis on the recovery of clear, furniture grade and structural material.

MANUFACTURING

Paulington Factory

The overall performance of the factory was acceptable. The board product production strategy continued emphasis on the maximisation of blockboard and thinply products whose profitability far exceeds that of multiply. The local, regional and overseas markets continue to call for multiply. The door production was also reasonable, however, the demand for the flash panel and double clad doors remained subdued for most of the year, demand started improving in the last two months of the year. These doors are sold mainly in the local market.

As experienced with the sawmilling products Paulington product demand in the local market escalated in the last two months of the year and has continued to do so in the new year.

BORDER TIMBERS INTERNATIONAL

The fall off of demand in the home sector of the US economy is impacting adversely on BTI's exports; equally true is the increasing concern amongst our end users in the U.S. as to the sustainability of supplies from Zimbabwe. Neither of these two factors are likely to see an improvement over the next two quarters.

As stated in the previous annual reports efforts to improve BTI's customer base outside the country were stepped up and sample doors were sent to Europe, Canada, USA and South Korea. The British regard our product as a commodity product where quality status does not necessarily result in a premium price like in Canada or USA. The Canadian and USA markets are concerned at the negative publicity that our country currently has and therefore doubt the sustainability of deliveries from Border, this is inspite of assurances from Border that deliveries would not be affected. Feedback is still awaited from the Asian market.

Machinery for a new product, french door, has been ordered from the USA and delivery is expected early in the new financial year. It is expected that production of this product will commence within the first six months of the new year and will be destined, initially, for the USA market.

CAPITAL EXPENDITURE

Expenditure for the year amounted to $109.6 million compared to $36.3 million in the previous review period. The breakdown of the capex is as follows:

(i) Plantation expenditure of $85.4 million
(ii) Plant, machinery, motor vehicles and other amounted to $24.2 million

LAND INVASIONS AND DESIGNATION

Despite repeated assurances from the country's leadership that the Government policy was not to settle people on forestland that, as far as Government is concerned, constitutes agro-industry, a total of 18 properties were listed for acquisition for the purposes of resettlement. The total area of these listed properties is over 20 thousand hectares, which is close to 50% of Border's total land area. The areas now listed comprise part of Imbeza, Sheba, Charter, Tilbury and Sawerombe estates.

A total of about 300 hectares were burnt by what we presume are illegal settlers, in order to prepare the land for tillage purposes. There has been intensive ploughing in some of the areas in Sawerombe where members of staff residing in company housing have been asked to vacate these premises to make way for the settlers.

The majority of the Sawerombe estate has been pegged into plots by the Agritex officials who together with the District Administration employees have invited people to this area in order that land could be allocated to them. All these illegal activities were reported to the police who, however, have not taken any action to date. Border continues to seek restitution through the legal framework.

HUMAN RESOURCES

The thoroughly hostile environment prevailing in Zimbabwe is placing enormous stress on all employees but particularly at higher levels of management who are continually being called upon to address issues over which they have very limited control. We view with the utmost concern the departure from Border of some of our key people ... a situation we know is not uncommon across the length and breadth of the country.

T. Gadzikwa

JOHN GADZIKWA
Managing Director
Border Timbers Limited

COMMERCIAL & INDUSTRIAL HOLDINGS LIMITED

OVERVIEW

The comparison of year on year results is once again difficult and misleading due to the different composition of the group in the comparative periods and the duration of the periods under review. This is the first full financial year for the group since the takeover by Radar Holdings Limited, with the prior results covering the 6 months only for the period ended 30 June 2000.

Market instability, compounded by delays in restructuring the group, impacted adversely on overall performance, with an operating profit of Z$28,5 million generated from sales of Z$596.6 million. Interest

operational reviews

(Continued)

income of Z$7.8 million for the year was considerably reduced on prior periods following the reduction in interest rates and cash reserves with the extensive investment in the new operations by way of restructuring. Resultant pre-tax profit amounted to Z$36.3 million, with taxation relatively low due to the effects of the restructuring. A post-tax profit of Z$30.4 million was thus realised for the year. An amount of Z$12.9 million was realised from capital reserves from the sale of fixed assets. The net result was basic earnings per share of 43,9 cents and headline earnings per share of 16.7 cents.

Capital employed increased significantly from Z$148.1 million at the end of June 2000 to Z$257.2 million at the end of June 2001 with increased borrowings largely as a result of the acquisitions made during the period. As would be expected under the circumstances, current assets rose from Z$128.0 million to Z$238.6 million, while current liabilities increased from Z$49.8 million to Z$165.6 million during the same period. Resultant asset value per share rose to 241 cents by the end of June 2001 from the 188 cents at the end of the previous year.

Divisional performance varied considerably, with the steel and engineering divisions battling due to lack of contract work and a general decrease in the number of meaningful projects being undertaken throughout the country largely resulting from lack of investor confidence. Conversely, this situation had a positive impact on a number of the remaining divisions where a hyperinflation mentality, synonymous of Brazil in its crisis years, was evident in the market place viz buy now because tomorrow the price will have doubled. In addition, the weak Zimbabwe dollar in relation to neighbouring currencies gave rise to considerable cross-border trading with foreign buyers taking advantage of the comparatively low prices locally. Throughout much of the year operations were dogged by the uncertainty brought about by political strife and the down stream effects of the collapse of law and order. Some customers discontinued operations as the market, in general, imploded and alternate outlets had to be secured. Politically driven factory stoppages were more frequent than ever before and management, in some instances, had to contend with self-styled “union representatives” who were strongly supported by government. Against this backdrop, divisional management flexed their operations to meet the changes in the market, and the restructuring of the group proceeded to create the desired base to secure future stability and intended growth.

Of note, the impact of the overall Radar Group synergies on performance was considerable. Overall export income met the group’s import needs without which a number of divisions would have floundered. The consolidation of select units created a more diverse base in specific markets increasing the potential to secure work and, equally if not more important, the pooling of skills and resources in such instances bolstered units that otherwise would have struggled badly under the trying market conditions.

The year under review represented a period of ongoing change and evolution of the group towards objectives stated on previous occasions both publicly and by way of notices to shareholders. Internally, the objective of consolidating the steel and related manufacturing operations within the Radar Group at large into a cohesive unit with the desired critical mass and capability to offer product and services regionally remained key. Subsequent to the acquisition of the Anglo American shares in CIH, Radar Holdings Limited was required to make an equivalent offer to minority shareholders. It was not Radar’s intention to increase their shareholding beyond the level then held of approximately 65% of the issued share capital, but restrictive Zimbabwe Stock Exchange regulations in respect of both the disposal and acquisition of assets necessitated the purchase of as many of the shares held in the market as possible to allow the desired restructuring of the group to proceed relatively unhinderd. As a result Radar increased its holding to 97% of the issued capital and, as the group thus no longer complied with listing regulations, CIH was delisted in May of this year. Further delay in restructuring resulted from the general instability in the local market where prospective buyers of non-core operations were hesitant to increase their levels of investment in manufacturing businesses within Zimbabwe.

As the restructuring occurred progressively throughout the financial year there will be duplication in reporting between the Radar and CIH reports. In such instances this report should be read in conjunction with the Radar Holdings Limited report.

In summary, the following changes were effected during the year ended 30 June 2001:

- The assets and liabilities of Automation Business Forms were sold to a consortium of private buyers, including management, in October 2000. CIH retained a minor holding by way of an investment.
- Hogarths was purchased from Radar Investments (Private) Limited in July 2000 and consolidated into the National Fencing operation.
- Radar Metal Industries and Radar Castings were purchased from Radar Investments (Private) Limited with effect from January 2001.
- A number of properties including the old CIH head office, the premises occupied by Automation Business Forms, the premises occupied by National Fencing in Harare and a Bulawayo premises sublet to a third party were sold during the period.

Despite considerable downsizing in the engineering operations and the disposal of some non-core operations, employee levels increased with the acquisitions from 811 to 1349.

SEGMENTAL PERFORMANCE

MANUFACTURING SEGMENT
Automation Business Forms
Coronet Buttons and Plastics
The Cotton Waste Company
Home Furnishers
National Fencing (including Hogarths)
Radar Metal Industries
Radar Castings

Profits generated in Automation Business Forms, Home Furnishers, Bulawayo Toyota and Coronet offset the losses incurred in the engineering and steel related divisions and Cotton Waste, with this segment breaking even for the year under review. Majority interests in Automation Business Forms were disposed of in October 2000 with CIH retaining an investment interest only. It is pleasing to note the continued growth and profitability of this business under the new ownership. Hogarths was purchased and consolidated into National Fencing in July 2000. Lack of capital projects and a general decline in the overall level of contracting work in the local market impacted adversely on the engineering and steel units, with operational structure revised accordingly. Radar Metal Industries increased their export base in Botswana while Home Furnishers and Coronet expanded their control in the local market, both taking share from competitors.

TRADING SEGMENT
Bulawayo Toyota
International Hardware

These divisions generated modest profits despite the fuel crisis in the country and the downstream effects of currency constraints on both suppliers and customers. With the increasing overall age of the national fleet, the sale of vehicle spares continued to rise in Bulawayo Toyota. Those vehicle sales achieved were mainly to returning residents and non-profit organisations and NGO’s with external funds. The erratic supply of fuel gave rise to a new modus operandi on the forecourt, whilst the quantum of fuel sales actually increased significantly driven by the large price increases implemented during the year. International Hardware increased their level of imported goods to compensate for the decline in the supply of locally manufactured equivalents due to those suppliers being unable to

operational reviews

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source currency to meet their material needs. Intergroup synergies, mainly with UBM, once again played to advantage particularly in the area of local procurement.

SERVICES SEGMENT
Finance and Management Services Division
Commercial and Industrial Holdings Limited (property)
CIH Trading & Finance (Private) Limited (property)
Ingwe Property Holdings (Private) Limited
Masterbuild (Private) Limited
Regent Invicta (Private) Limited

Investment income decreased year on year due to reduced cash reserves with the acquisitions detailed above. Profit was realised on the sale of Ingwe Property Holdings (Private) Limited and other assets during the course of the year with this income comprising a significant source of profit. The services segment was further bolstered in the internal audit section ensuring that group internal controls remain within acceptable norms in this tumultuous market where the ongoing skills drain is becoming evident within the operating divisions.

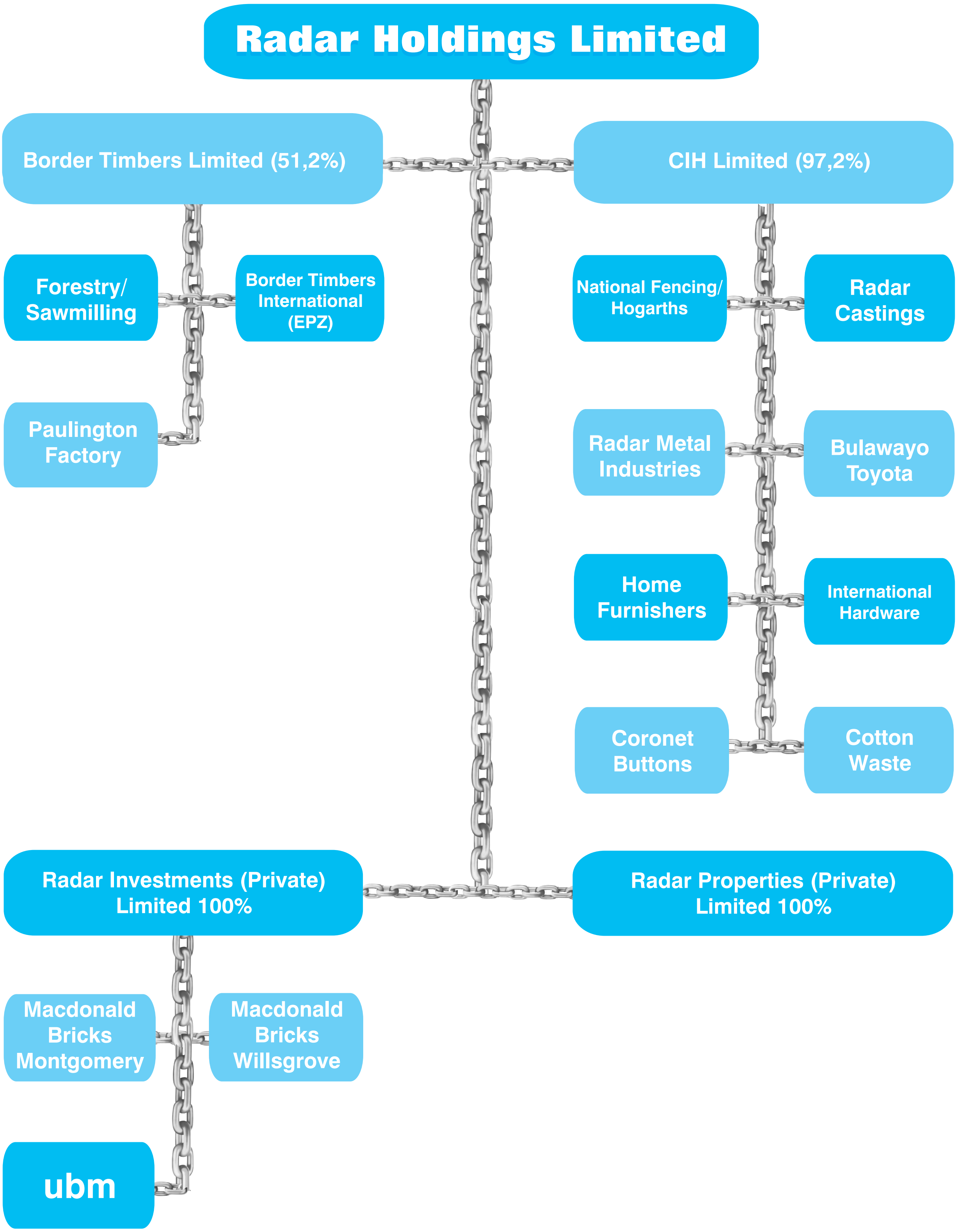
OUTLOOK

Subsequent to the financial year-end, restructuring continued with the disposal of International Hardware to Border Timbers Limited in July and The Cotton Waste Company to private buyers in September.

Political uncertainty continues unabated with the ongoing detrimental impact affecting group operations and the country as a whole. The urgency to effectively implement full regional operational capability is even more pronounced to reduce the dependence on the withering local market and to simultaneously generate foreign currency. The effect of central bank regulations in respect of exchange rates and the handling of export proceeds is self-destructive and, if not addressed in the short term, will be the death knell of those locally based operations that are unable to generate their own currency needs via export sales. Unless government face up to the reality of the problems facing the country and then actively and urgently address them in accordance with accepted international norms, the future of the group will be at best mediocre. If, however, a responsible and committed stance is adopted by the country's leadership, CIH is well placed to benefit immediately from the type of reconstruction that will be essential to return the Zimbabwean economy to a state of viability.

M J ROWLAND
Managing Director
CIH

Radar Holdings Limited
Group Operating Structure



2001
financial commentary

In keeping with the last few years, the group's results make for interesting review as a result of the significant changes the Group has undergone. The issue of the high level of stagflation will be covered later in this commentary but its existence certainly makes interpretation even more fraught with difficulty.

Comment will, unless appropriateness dictates otherwise, be largely confined to your Group's overall performance and shareholders' attention is drawn to the inserts in this annual report as regards the specific performance of CIH Limited and Border Timbers Limited.

Operating Results

At first glance, the operating results for the year, when compared with those for June 2000, are pleasing, however, such initial response must be tempered with recognition of the following factors which distort pure year-on-year review:

a) the comparative period reflects only six months of trading for CIH and Border Timbers and, in Border's case, the six months to June 2000 were exceptionally severe following Cyclone Eline
b) the Group has undergone restructuring during the year and comparatives, inter alia, reflect the disposal from the Group of the majority shareholding in ABF and a number of properties
c) trading conditions have continued to deteriorate
d) inflationary input cost pressures continue to undermine performance - on a rapidly accelerating basis.

Review of the Income Statement and Segmental Analysis set out in the report reflects significant year-on-year improvement ("inequalities" of reported results aside) for the year ended 30 June 2001.

Reported turnover and operating profit have increased by 102% and 262% respectively and such has resulted in the operating margin improving to 13% from 7% at June 2000.

In monetary terms average monthly group turnover value increased, however such increase was below inflation levels. Whilst the Group tried to keep pace with inflation, the various volume declines experienced are of concern. It is pertinent to note that despite the influences of mix and volumes no operating unit achieved a net price increase either equal to or above the inflation level.

The impact of the improved results from Border, where a one third average increase in volume sold was achieved, has made the largest impact upon Group results. Equally important to Border have been the effects of management-negotiated improvement in certain export prices (despite the prevailing flat marketplace) and much closer attention to operating expenditure.

It must be stressed that such reported and improved results at Border are partly a factor of the forest valuation policy where, historically, three-year average costs were employed in the computation of standing timber. This methodology resulted in depletion rates lagging far behind inflation hence improving reported results. This policy is being reviewed.

Whilst the Group's engineering operations had an extremely difficult year primarily due to paucity of work coupled with high inflationary pressures, of more concern has been the drop in volumes experienced by both Macdonald Bricks and UBM - albeit the latter operation having recently shown some improvement - where average unit volumes were, respectively, 25% and 22% below prior year averages; pricing to a large extent offset the full effect of these drops.

Of particular note is the Group's interest charge for the year. At some $253,8M it is material; nevertheless interest cover for the Group has increased year-on-year to 1,4 times (June 2000 0,6 times). Of import is the fact that the charge for the six months to June 2001 is only 43% of the charge for the previous six months and such reflects both the reduction in interest rates as well as the reduction in the Group's borrowing levels.

In reverse order, any failure to reign in inflation without providing exporters - and your Group is a significant exporter - a realistic return is a recipe for disaster and will reduce the rate of, if not entirely suppress, debt reduction through trade, let alone creating viability problems. Attention is drawn to the comments on exchange rates made under IAS29 below and the enclosed USD comparatives.

An added burden carried by exporters is the compulsory sale of, presently, 40%, of export proceeds at absolutely unrealistic rates of exchange; such loss in revenue can only be regarded as an indirect form of taxation that is counter-export productive and which will continue to create viability problems for all concerned. However, it is very interesting to note, from our own analysis, that there is a high degree of correlation between the increase in M3 money supply and the CPI for the period January 1999 to date. This correlation suggests that money supply is the real issue and not the cost of money. In this regard we would query why some economic commentators continue to call for an increase in interest rates rather than address the over-supply of money - the only basis supporting an increase in interest rates would be a return to a command economy.

Shareholder attention is drawn to the taxation charge for the year, and related notes, in that the bulk of the $34,6M relates to deferred tax. In fact, the Group's normal tax liability for the year amounts to $2,3M and a capital gains tax liability for the year of only $1,6M. Such low levels of current tax relate closely to the strained trading conditions experienced by your Group over the past few years.

Group Working Capital

Group inventories increased in value by about 32% over the year (an increase well below the average inflation level) as a result of increased efforts in inventory management with the result that average inventory days dropped from 111 at June 2000 to 75 as at June 2001.

Trade receivables followed a similar increase in value terms, although the impact of decreased activity levels by June this year played their part, however average days receivables also reduced from 72 last year to 49 by end June 2001 without any significant provisions for doubtful debts being required.

Trade payables, at first glance, reflect an increase of some 57% year-on-year and whilst there is a significant inflation effect therein, some of the increase may be ascribed to period end timing. That said, of significance is that the days payables outstanding have reduced from 78 days last year to 63 days by end June 2001. It has long been Group policy to pay creditors within agreed terms in order to avoid placing undue strain on suppliers who may be experiencing financial pressure.

Overall, the status of the working capital for the year ended June 2001 is commendable and reflects the attention being paid to working capital. Shareholders should take particular note of the net increase in cash resources, as shown in the Cash Flow Statement, over the last year.

Fixed Assets

There has been no material expenditure on fixed assets during the year, save in areas where maintenance of capital base mandated such expenditure; the impact of inflation inflates the acquisition cost beyond historical norms resulting in comparatively minor expenditure becoming major in nominal terms. Your Board continues to hold the view that present trading conditions characterised by no free-market adjustment mechanisms makes the issue of revaluation, and any related impairment, inappropriate.

Biological or Non-current Assets

This year sees the separation of plantations from fixed assets. Your

financial commentary

(Continued)

Board has for some while now felt that the inclusion of forests with other fixed assets is inappropriate. Coincidentally, the new Standard on agriculture, IAS 41, clearly sets out a new asset class and it is in keeping with this that separate disclosure has been made.

Whilst the basis for valuing forest plantations has not yet been changed - IAS41 is still being evaluated - historically the computation was based on three-year average costs. Given prevailing inflation rates this, in the opinion of your Board, has resulted in the balance sheet not reflecting a fair value of the prime "productive" asset at Border Timbers in addition to insufficiently matching costs and revenues in the income statement. Accordingly, the value of plantations has been restated over a shorter cost horizon that is considered to be more appropriate under present conditions whilst the new accounting standard is fully explored.

International Accounting Standards

IAS29 (Hyperinflation)

In last year's Annual Report comment was made as regards your Group's position on IAS29 (Hyperinflation). Since that date your Group's position has not altered and shareholders attention is drawn to the insert containing recent statements made by various listed companies as regards the Standard.

Whilst it is not this writer's intention to enter debate as regards the economic definition of *hyperinflation*, the real cost, worth and usefulness of the Standard in terms of both its intrinsic integrity and applicability in a high/hyper/stag-flationary and recessive economy remains questionable. Equally the ability to apply it as an effective inflationary-management tool remains unproven.

That said, your Board is acutely aware of the devastating effects of inflation on real worth and has, again, presented US Dollar denominated accounts based on a trade-weighted realistic rate of exchange computed by the indexing, on a compound basis, of the Zimbabwe Dollar since January 1999 by the CPI(1995=100). The rate used in the income statement is ZW$99.53:US$1 (2000: ZW$64.81:US$1) and in the balance sheet a rate of ZW$127.99:US$1 (2000: ZW$77.88:US$1) has been applied.

As regards the computation of a realistic exchange rate, it is interesting to note that if the principle of inverse-doubling (where money supply doubles the exchange rate halves in value) is applied to the exchange rate ruling at January 1999, being the rate after the last free market adjustment, (using the M3 money supply over the same period) returns to date - as would be expected - an almost identical rate to that computed from the CPI.

IAS41 (Agriculture)

During the course of the year the International Accounting Standards Committee (IASC) issued a standard relating to agriculture - IAS 41 (Agriculture) - at the same time as your Board was reviewing the Group's accounting policy relating to forest plantations.

Thus far the new Standard, which only becomes mandatory in 2003, is receiving very detailed and active consideration as regards its adoption by 2003 if not earlier. Your Board believes that there is a high degree of worth in the Standard but a number of issues still need to be fully examined and clarified - these generally relate to the methodology of determining a satisfactory market value and the present treatment of gains and losses, especially those arising on initial adoption of the Standard, being taken directly to profit in the year of adoption.

As part of this review process, discussions have been held with other major forestry operations in the region; indications are that the major players are likely to adopt the Standard by mandatory date and such adoption is considered to be important if forestry operations in the region are to be able to provide comparability of performance.

Staffing & Skills

Over the past year your Group has managed to retain an acceptable level of financial skills against a very unsettled national environment. Sadly, this situation is not stable and there are a number of regrettable losses from emigration being experienced throughout the Group since the year-end. Whilst it is not policy or intention to reduce expertise levels the ability to recruit equivalent experience and capability is being sorely tested with the increasing loss of skills from the country.

Despite all the negatives, I am pleased to advise that major improvements in audit quality have been achieved throughout the Group - the most noteworthy being the improvements at Border Timbers where audit hours have been reduced by an amount in excess of 40%. Equally it would be remiss if I did not express my sincere appreciation to all the Group Finance Staff for meeting, and successfully meeting, an extremely challenging audit timetable thus keeping actual hours in line with budget.

Brett South
Group Financial Director
20 September 2001

audit and compensation committees

These two committees which comprise two non-executive directors and the Chairman, have carried out their normal functions during the past year.

The Audit Committee is responsible for monitoring the Group's financial reporting, compliance with accounting policies and the requirements of regulatory bodies. The Committee also reviews the annual audit plan and reports from the external auditors and managements' responses.

During the past year greater emphasis has been placed on the internal audit function, whose team, together with the external auditors, have unrestricted access to the Audit Committee.

Specific comment has been made elsewhere in the annual report regarding I.A.S. 29 (Hyperinflation) and our reasons for non compliance. In order to better illustrate the effects of inflation we have also produced U.S. Dollar denominated accounts.

J.R. Sly
Director
20 September 2001

directors' report

for the year ended 30 June 2001

Your Directors have pleasure in submitting their report and consolidated financial statements for the year ended 30 June 2001.

Results

The results as set out below show retained income/(loss) for the year of $84 701 000 [2000 - ($28 705 000)], made up as follows:-

	2001 $'000	2000 $'000
Turnover	2 742 384	1 356 729
Income before interest and taxation	437 538	108 996
Net interest payable	253 814	174 352
Income/(loss) before taxation	183 724	(65 356)
Taxation	34 638	(27 883)
Income/(loss) after taxation	149 086	(37 473)
Extraordinary item	-	(6 892)
Income after taxation and extraordinary item	149 086	(44 365)
Minority interest	(77 300)	22 858
Dividends		
- Final year ended 30 June 1999	-	(7 204)
Transfer from Capital Reserve	12 915	6
Retained income/(loss) for the year	84 701	(28 705)

Non Distributable Reserves

Details of movements in reserves are shown in note 12 to the financial statements.

Directors

Messrs. P W T Chipudhla and C J L Schofield retire by rotation and, being eligible, offer themselves for re-election.

Directors' Emoluments

Members will be asked to determine the remuneration of the non-executive Directors for the year to 30 June 2002. An amount of $402 500,00 has been recommended by your Directors.

Auditors

Members will be asked to approve the Auditors' remuneration for the past audit and to confirm the re-appointment of Messrs. Ernst & Young as Auditors to the Company for the ensuing year, they having signified their willingness to continue in office.

On behalf of the Board

C J L Schofield
Director

P W T Chipudhla
Director

Bulawayo
20 September 2001

report of the independent external auditors

to the members of Radar Holdings Limited

We have audited the Zimbabwe currency denominated annual financial statements set out on pages 18 to 42 for the year ended 30 June 2001.

Respective responsibilities of Directors and Auditors
The financial statements are the responsibility of the Directors of the Company. Our responsibility is to express an opinion on these financial statements based on our audit.

Scope
We conducted our audit in accordance with approved International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures included in the financial statements.
- Assessing the accounting principles used and significant estimates made by management, and
- Evaluating the overall financial statement presentation.

The Zimbabwean economy is recognised as being hyperinflationary for purposes of financial reporting. These financial statements have not been prepared in conformity with International Accounting Standards in that the requirements of IAS 29 (Financial Reporting in Hyperinflationary Economies) have not been complied with. The Standard requires that financial statements that report in the currency of a hyperinflationary economy should be stated in terms of the measuring unit current at the balance sheet date. The requirements of all other International Accounting Standards have been complied with under the historical cost convention.

The financial effect of non-compliance with IAS 29 has not been formally established for the reasons given in Note 26.

Disclaimer of opinion
In view of the material effect of the matter referred to in the previous paragraph on the overall financial statement presentation, and the effective limitation of the scope imposed on our work, as a result of the absence of the information that should have been extracted from the Group's records, necessary to assess the materiality of that non-compliance, we are unable to express an opinion on the financial statements as regards conformity with International Accounting Standards.

Opinion
The attached financial statements have been prepared under the historical cost convention (modified by the revaluation of certain assets) and would form the basis for the restatement in terms of IAS 29.

In our opinion the historical cost financial statements give a true and fair view, in all material respects, of the financial position of the Company and the Group at 30 June 2001 and of the results of their operations and Group cash flows for the year then ended, as measured by that convention, in conformity with International Accounting Standards as adopted for use in Zimbabwe, and in compliance with the Companies Act (Chapter 24:03) and the relevant Regulations made thereunder except for those included in Note 16.5.

ERNST & YOUNG
CHARTERED ACCOUNTANTS (ZIMBABWE)

Bulawayo
20 September 2001

ERNST & YOUNG
Chartered Accountants (Zimbabwe)

accounting policies

1. **ACCOUNTING CONVENTION**
The financial statements are prepared under the historical cost convention, with the exception of freehold land, buildings, plantations and certain plant and machinery which are included at valuation as stated in policy notes 5 and 6 below. No other procedures have been adopted to reflect the impact of specific price changes or changes in the general level of prices.

2. **BASIS OF CONSOLIDATION**
The assets, liabilities, income and losses of the subsidiaries are consolidated on the basis of audited financial statements for the year ended 30 June 2001. Results are included from the effective dates of acquisition.

3. **INTERESTS IN SUBSIDIARY COMPANIES AND INVESTMENTS**
Interests in subsidiary companies and investments are stated at cost to the Group. Provision is made only for any material and permanent diminution in the value of these investments.

4. **REVENUE RECOGNITION**
Turnover from the sale of goods is recognised when the goods are delivered.

5. **VALUATION OF FIXED ASSETS**
Land, buildings and certain plant, machinery and motor vehicles are shown at valuation with subsequent additions at cost. Revaluations are carried out at the discretion of the directors normally within a 3-5 year period, but within shorter periods where there has been a substantial change.

Surpluses on revaluation of all relevant fixed assets are transferred to non-distributable reserves. On realisation, the appropriate portion of the non-distributable reserves is transferred to distributable reserves. Details of such revaluations are stated in Note 16.4 to the financial statements.

6. **VALUATION OF PLANTATIONS**
Plantations comprise forests owned by a subsidiary company. They are stated at the lower of valuation less depletions, and estimated market value. Plantations are revalued annually based on average annual costs incurred in that year. In periods of low inflation, revaluation intervals are normally three years. The financial effect of this policy is set out in Note 17 to the financial statements.

Surpluses on revaluation are transferred to non-distributable reserves.

7. **LEASED ASSETS**
Fixed assets acquired under finance leases are capitalised at their cash cost equivalent and the corresponding liabilities raised. Such assets are depreciated on a basis consistent with other Group fixed assets. The interest element of the lease rental obligations is accrued and expensed annually, based on the effective rate of interest applied to the remaining balance of the liability and is included in that related liability. Such liabilities are reduced as and when payments are made in terms of the agreements. Operating leases are not capitalised and rentals are expensed when incurred.

8. **GOODWILL**
On acquisition, the difference between the price paid for new interests and the fair value of identifiable net assets acquired is capitalised and amortised at 20% per annum.

9. **DEPRECIATION**
a) With the exception of Border Timbers Limited which does no provide, no depreciation has been provided in respect of freehold buildings. This policy, insofar as it is applied to buildings, is contrary to International Accounting Standards. The notional depreciation on buildings is stated in Note 16.5 to the financial statements.

b) Other fixed assets are depreciated over their expected useful lives on a straight line basis as follows:-

Plant and machinery	5 to 30 years
Motor vehicles	5 to 7 years
Furniture and fittings	4 to 15 years

accounting policies

10. **STOCK**
    a) Raw materials are valued at cost on a first in-first out basis.
    b) Finished goods and work in progress are valued at cost. Cost includes materials, direct labour and a proportion of direct expenses.
    c) Merchandise is valued at cost on a first in-first out basis.
    d) The values of obsolete and slow moving inventories are reduced, where necessary, to estimated net realisable values.

11. **TAXATION**
    a) **Normal :**
    Provision is made for normal taxation at 30,9 (2000 - 36,05) cents in the dollar on taxable income for the year.
    b) **Residents' tax on interest :**
    Provision is made fortaxation on local bankinterest at 30 cents in the dollarto 31 December 2000 and 20 centsin the dollar from 1 January 2001.
    c) **Deferred :**
    In accordance with International Accounting Standard 12 provision is made for all temporary differences arising between the tax bases of assets and liabilities and their carrying values at 30,9 cents in the dollar.
    d) **Capital Gains :**
    Provision is made for capital gains taxation calculated at 10 and 20 cents in the dollar on the attributable gain for the year. Pro vis ion is also made for the potential liability arising from the revaluation of qualifying assets.

12. **FOREIGN CURRENCIES**
    Transactions during the year are translated at rates ruling at the relevant dates. Assets and liabilities are translated at the rates ruling at the financial year end. Differences arising from the realignment of currencies are included in the trading results for the year.

13. **PENSION FUNDS**
    a) All Group Companies are members of an approved pension fund which is administered by a life assurance society as an insurance scheme on a defined contribution funding basis.
    b) Group Companies and all employees contribute to the National Social Security Authority Pension and Other Benefits Scheme.

14. **FINANCIAL INSTRUMENTS**
    Financial instruments carried on the balance sheet include cash, trade debtors, trade creditors, leases and borrowings. The particular recognition methods adopted are disclosed in Note 24.

2001

group income statement

for the year ended 30 June 2001

	Notes	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
TURNOVER	2	2 742 384	1 356 729	27 553	20 934
Cost of Sales		1 752 471	897 283	17 607	13 845
GROSS PROFIT		989 913	459 446	9 946	7 089
Other operating income		90 575	32 097	910	495
Distribution and selling expenses		(449 875)	(190 602)	(4 520)	(2 941)
Administration expenses		(268 959)	(200 963)	(2 831)	(3 197)
Other operating expenses		(92)	-	(1)	-
OPERATING INCOME BEFORE EXCEPTIONAL ITEMS AND GOODWILL AMORTISATION		361 562	99 978	3 504	1 446
Operating exceptional items		48 453	(4 173)	487	(64)
- Profit on sale of investments		-	18 340	-	283
- Fraud		-	(10 110)	-	(156)
- Rationalisation expenses		-	(12 403)	-	(191)
- Cyclone Eline insurance claim proceeds		48 453	-	487	-
OPERATING INCOME BEFORE GOODWILL AMORTISATION		410 015	95 805	3 991	1 382
Goodwill amortisation		27 523	13 191	215	169
INCOME ON ORDINARY ACTIVITIES BEFORE INTEREST AND TAXATION		437 538	108 996	4 206	1 551
Net interest payable	3	253 814	174 352	2 550	2 690
INCOME/(LOSS) BEFORE TAXATION	4	183 724	(65 356)	1 656	(1 139)
Taxation	6	34 638	(27 883)	272	(359)
INCOME/(LOSS) AFTER TAXATION		149 086	(37 473)	1 384	(780)
Extraordinary item	7	-	(6 892)	-	(107)
INCOME/(LOSS) FOR THE PERIOD		149 086	(44 365)	1 384	(887)
Minority Interests	13	(77 300)	22 858	(777)	353
INCOME/(LOSS) ATTRIBUTABLE TO ORDINARY SHAREHOLDERS		71 786	(21 507)	607	(534)
Dividends	8	-	(7 204)	-	(93)
Transfer from Capital Reserve	12	12 915	6	101	-
RETAINED INCOME FOR THE YEAR		84 701	(28 705)	708	(627)
RETAINED INCOME AT 30 JUNE 2000		63 861	92 566	642	1 428
Balance at 30 June 2000		-	-	801	1 428
Restatement of opening balance		-	-	(159)	-
RETAINED INCOME AT 30 JUNE 2001		148 562	63 861	1 350	801
Retained by - holding company		50 910	52 141	512	822
- subsidiaries		97 652	11 720	838	(21)
		148 562	63 861	1 350	801
EARNINGS/(LOSS) PER SHARE (BASIC)	9	129.5	(38.8)	1.1	(1.0)
EARNINGS/(LOSS) PER SHARE (HEADLINE)	9	16.5	(65.3)	0.1	(1.1)

group balance sheet

at 30 June 2001

	Notes	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
FUNDS EMPLOYED					
Share capital	11	**27 709**	27 709	**216**	356
Capital reserve	12	**319 396**	114 960	**2 160**	1 586
Retained income		**148 562**	63 861	**1 350**	801
SHAREHOLDERS' FUNDS		**495 667**	206 530	**3 726**	2 743
MINORITY INTERESTS	13	**540 906**	296 628	**4 371**	3 734
DEFERRED TAXATION	14	**401 055**	239 732	**3 133**	3 060
LONG AND MEDIUM TERM LIABILITIES	15	**20 105**	27 591	**158**	355
		1 457 733	770 481	**11 388**	9 892
EMPLOYMENT OF FUNDS					
FIXED ASSETS	16	**680 695**	725 983	**5 318**	9 321
PLANTATIONS	17	**960 641**	394 390	**7 506**	5 065
GOODWILL	18	**(96 902)**	(118 719)	**(758)**	(1 525)
INVESTMENTS AND LOANS	19	**19 745**	19 343	**154**	249
CURRENT ASSETS	20	**928 384**	651 204	**7 253**	8 361
CURRENT LIABILITIES	21	**1 034 830**	901 720	**8 085**	11 579
NET CURRENT LIABILITIES		**(106 446)**	(250 516)	**(832)**	(3 218)
		1 457 733	770 481	**11 388**	9 892

The financial statements on pages 18 to 42 were approved by the Board of Directors and authorised for issue on 20 September 2001 and are signed on its behalf by:

C.J.L. SCHOFIELD
DIRECTOR

P.W.T. CHIPUDHLA
DIRECTOR

BULAWAYO
20 September 2001

group statement of changes in equity

for the year ended 30 June 2001

	Share capital $'000	Capital reserves $'000	Revenue reserves $'000	Total $'000
Balance at 1 July 1999	27 709	54 918	92 566	175 193
Transfer (to)/from deferred taxation		(34 458)		(34 458)
Transfer (to)/from deferred capital gains tax		1 153		1 153
Revaluation - plantations		93 353		93 353
Net adjustment on sale of land and buildings		(6)	6	-
Income for the year after taxation attributable to shareholders			(37 473)	(37 473)
Minority interests in current year's loss			22 858	22 858
Extraordinary item - cyclone Eline costs			(6 892)	(6 892)
Dividends			(7 204)	(7 204)
Balance at 30 June 2000	27 709	114 960	63 861	206 530
Balance at 1 July 2000	**27 709**	**114 960**	**63 861**	**206 530**
Transfer (to)/from deferred taxation		**(64 973)**		**(64 973)**
Transfer (to)/from deferred capital gains tax		**1 625**	**12 915**	**14 540**
Revaluation - fixed assets and plantations		**280 336**		**280 336**
Net adjustment on sale of land and buildings		**(12 552)**		**(12 552)**
Income for the year after taxation attributable to shareholders			**149 086**	**149 086**
Minority interests in current year's profit			**(77 300)**	**(77 300)**
Balance at 30 June 2001	**27 709**	**319 396**	**148 562**	**495 667**

	Share capital US$'000	Capital reserves US$'000	Revenue reserves US$'000	Total US$'000
Balance at 1 July 1999	356	705	1 428	2 489
Transfer (to)/from deferred taxation		(442)		(442)
Transfer (to)/from deferred capital gains tax		15		15
Revaluations - plantations		1 199		1 199
Net adjustment on sale of land and buildings		-	-	-
Income for the year after taxation attributable to shareholders			(780)	(780)
Minority interests in current year's loss			353	353
Extraordinary item - cyclone Eline costs			(107)	(107)
Dividends			(93)	(93)
Exchange rate translation differences		109		109
Balance at 30 June 2000	356	1 586	801	2 743
Balance at 1 July 2000	**356**	**1 586**	**801**	**2 743**
Transfer (to)/from deferred taxation		**(508)**		**(508)**
Transfer (to)/from deferred capital gains tax		**13**	**101**	**114**
Revaluation fixed assets and plantations		**2 190**		**2 190**
Net adjustment on sale of land and buildings		**(98)**		**(98)**
Income for the year after taxation attributable to shareholders			**1 384**	**1 384**
Minority interests in current year's profit			**(777)**	**(777)**
Exchange rate translation/restatement differences	**(140)**	**(1 023)**	**(159)**	**(1 322)**
Balance at 30 June 2001	**216**	**2 160**	**1 350**	**3 726**

group cash flow statement

for the year ended 30 June 2001

	Notes	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
CASH FLOWS FROM OPERATING ACTIVITIES					
Income before interest		**437 538**	108 996	**4 206**	1551
Non-cash items and separate disclosures	25.1	**59 351**	37 804	**464**	496
OPERATING INCOME BEFORE WORKING CAPITAL CHANGES		**496 889**	146 800	**4 670**	2 047
(Increase)/decrease in working capital	25.2	**(11 809)**	(10 354)	**1 503**	(133)
Cash generated from operating activities		**485 080**	136 446	**6 173**	1 914
Net interest paid	3	**(253 814)**	(174 352)	**(2 550)**	(2 690)
Net cash generated after servicing finance costs		**231 266**	(37 906)	**3 623**	(776)
Taxation paid	25.3	**(24 721)**	(27 755)	**(345)**	(355)
Net cash generated from/(utilised in) operating activities		**206 545**	(65 661)	**3 278**	(1 131)
Dividends paid	25.4	**-**	(7 204)	**-**	(93)
Net cash retained/(utilised)		**206 545**	(72 865)	**3 278**	(1 224)
Investing activities					
Investment in subsidiary companies	25.5	**(20 409)**	(220 416)	**(174)**	(2 830)
Purchase of fixed assets		**(69 897)**	(35 382)	**(546)**	(454)
Plantation expenditure		**(85 361)**	(356)	**(667)**	(3)
(Increase)/decrease in capital work-in-progress		**(8 506)**	5 579	**(67)**	72
Plantation redemption costs		**-**	(12 122)	**-**	(156)
Proceeds on disposal of fixed assets		**97 363**	3 978	**761**	51
Net increase/(decrease) in investments and loans	25.6	**(402)**	13 515	**(3)**	173
Proceeds on disposal of investments	25.7	**-**	72 650	**-**	980
Extraordinary item cyclone-damanged timber and related costs		**-**	(19 835)	**-**	(306)
Net cash utilised in investing activities		**(87 212)**	(192 389)	**(696)**	(2 473)
Non-recurring expenditure					
Fraud		**-**	(10 110)	**-**	(156)
Rationalisation expenses		**-**	(12 403)	**-**	(191)
Financing					
Interest bearing liabilities	25.8	**57 737**	276 143	**(1 047)**	3 894
Increase/(decrease) in cash and cash equivalents		**177 070**	(11 624)	**1 535**	(150)
Movement in cash and cash equivalents	25.9	**177 070**	(11 624)	**1 535**	(150)

notes to the group financial statements

for the year ended 30 June 2001

1. SEGMENT INFORMATION

Year ended 30 June 2001

	Forestry $'000	Manufacturing $'000	Trading $'000	Services $'000	Unallocated $'000	Group $'000	Forestry US$'000	Manufacturing US$'000	Trading US$'000	Services US$'000	Unallocated US$'000	Group US$'000
Revenue												
Turnover	726 934	1 445 481	567 220	2 749		2 742 384	7 304	14 523	5 699	27	-	27 553
Results												
Operating profit before goodwill amortisation	133 166	252 123	29 574	(4 848)		410 015	1 296	2 454	288	(47)		3 991
Goodwill amortisation					27 523	27 523					215	215
Net interest payable		(32 899)	(5 810)	(215 105)		(253 814)		(331)	(58)	(2 161)		(2 550)
Taxation					(34 638)	(34 638)					(272)	(272)
Minority interests					(77 300)	(77 300)					(777)	(777)
Income attributable to ordinary shareholders	133 166	219 224	23 764	(219 953)	(84 415)	71 786	1 296	2 123	230	(2 208)	(834)	607
Balance sheet												
Assets	1 323 823	694 997	150 757	419 888	(96 902)	2 492 563	10 342	5 430	1 178	3 280	(757)	19 473
Liabilities	111 594	271 168	79 248	592 924	941 962	1 996 896	880	2 138	625	4 676	7 428	15 747
Other Information												
Capital expenditure	18 405	37 619	4 392	9 481	-	69 897	144	294	34	74	-	546
Depreciation	19 642	21 616	3 840	12 828	-	57 926	154	169	30	100	-	453
Employees	2 393	2 177	362	62	-	4 994	2 393	2 177	362	62	-	4 994

Year ended 30 June 2000

	Forestry $'000	Manufacturing $'000	Trading $'000	Services $'000	Unallocated $'000	Group $'000	Forestry US$'000	Manufacturing US$'000	Trading US$'000	Services US$'000	Unallocated US$'000	Group US$'000
Revenue												
Turnover	203 367	759 946	391 051	2 365	-	1 356 729	3 138	11 726	6 034	36	-	20 934
Results												
Operating profit before goodwill amortisation	35 628	89 961	24 820	(54 604)		95 805	514	1 297	358	(787)		1 382
Goodwill amortisation					13 191	13 191					169	169
Net interest payable		(22 901)	(6 721)	(144 730)		(174 352)		(353)	(104)	(2 233)		(2 690)
Taxation					27 883	27 883					359	359
Minority interests					22 858	22 858					353	353
Extraordinary items	(6 892)					(6 892)	(107)					(107)
Income attributable to ordinary shareholders	28 736	67 060	18 099	(199 334)	63 932	(21 507)	407	944	254	(3 020)	881	(534)
Balance sheet												
Assets	798 936	696 333	105 469	190 182	(118 719)	1 672 201	10 259	8 941	1 354	2 442	(1 525)	21 471
Liabilities	47 976	138 869	41 480	700 985	536 361	1 465 671	613	1 774	530	8 957	6 854	18 728
Other information												
Capital expenditure	4 976	19 092	3 628	8 042	-	35 738	64	245	47	103	-	459
Depreciation	9 193	18 509	3 456	6 002	-	37 160	118	238	44	77	-	477
Employees	2 525	2 612	362	65	-	5 564	2 525	2 612	362	65	-	5 564

The Group is organised into four main business segments:
- Forestry : growing and milling of hardwood and softwood timber.
- Manufacturing : manufacture and supply of product to the agricultural, mining, engineering and building sectors; and clothing/textile industries.
- Trading : supplying product and services to the retail trade.
- Services : Property holdings and corporate office activities.

All business segments operate in Zimbabwe.

notes to the group financial statements

for the year ended 30 June 2001

		2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
2.	**TURNOVER**				
	Turnover comprises net sales to customers, group companies and divisions. Consolidated turnover excludes sales to group companies and divisions.	2 742 384	1 356 729	27 553	20 934
3.	**NET INTEREST**				
	Long and medium term liabilities	6 199	7 276	62	112
	- paid	6 199	7 278	62	112
	- received	-	(2)	-	-
	Short term liabilities	247 615	167 076	2 488	2 578
	- paid	266 013	190 285	2 673	2 936
	- received	(18 398)	(23 209)	(185)	(358)
		253 814	174 352	2 550	2 690
4.	**INCOME BEFORE TAXATION**				
	Income before taxation is stated after				
	- charging:				
	Auditors' remuneration	11 917	8 510	120	131
	- current	9 905	6 577	100	101
	- prior year under provision	2 012	1 933	20	30
	Directors' emoluments	21 969	16 813	221	259
	- as directors	350	280	4	4
	- for management	21 619	16 533	217	255
	Exchange loss	-	445	-	7
	Plantation redemption	54 227	12 122	424	156
	Provisions:	57 582	59 518	310	822
	- depreciation	57 926	37 160	453	477
	- provision for stock obsolescence charge/(reversal)	51	12	(3)	-
	- provision for doubtful debts (reversal)/charge	(395)	22 346	(140)	345
	Staff costs (note 5)	592 141	324 056	5 949	5 000
	- crediting:				
	Dividends received	-	9 464	-	146
	Exchange profit	81 813	4 734	822	73
	Profit on sale of fixed assets	25 279	2 460	198	32
5.	**STAFF COSTS**				
	Salaries and wages	543 577	291 132	5 461	4 492
	Pension costs	38 884	27 811	391	429
	Medical aid contributions	9 680	5 113	97	79
		592 141	324 056	5 949	5 000
	Group manning levels at 30 June 2001	Nos.	Nos.	Nos.	Nos.
	Permanent	3 724	4 264	3 724	4 264
	Contract	1 270	1 300	1 270	1 300
		4 994	5 564	4 994	5 564

notes to the group financial statements

for the year ended 30 June 2001

	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
6. TAXATION				
Normal	**2 246**	22 081	**18**	283
- current	**2 248**	21 528	**18**	276
- prior year	**(2)**	553	**-**	7
Deferred	**30 671**	(49 238)	**240**	(632)
- current	**33 036**	(49 238)	**258**	(632)
- prior year	**(2 365)**	-	**(18)**	-
Capital Gains	**1 721**	(726)	**14**	(10)
- current	**1 600**	192	**13**	2
- prior year	**121**	-	**1**	-
- deferred	**-**	(918)	**-**	(12)
	34 638	(27 883)	**272**	(359)

The Group's effective rate of taxation is below the current rate of 30.90% (2000 - 36.05%) and is reconciled as follows:

	%	$'000	%	$'000	%	US$'000	%	US$'000
Taxation at normal rate	30.90	**56 771**	(36.05)	(28 316)	30.90	**444**	(36.05)	(364)
Permanent timing differences	(3.76)	**(6 907)**	(10.85)	(8 525)	(3.76)	**(54)**	(10.85)	(109)
Taxation allowances and timing differences	13.91	**25 551**	(99.62)	(78 248)	13.91	**200**	(99.62)	(1 005)
Taxation on interest at rates below normal rate	(1.42)	**(2 600)**	(7.04)	(5 530)	(1.42)	**(20)**	(7.04)	(71)
Unproductive interest	9.25	**16 986**	37.42	29 396	9.25	**133**	37.42	377
Prior year	-	**(2)**	0.70	553	-	**-**	0.70	7
Capital Gains taxation	0.94	**1 721**	(0.93)	(726)	0.94	**13**	(0.93)	(9)
Taxation losses	(30.97)	**(56 882)**	80.86	63 513	(30.97)	**(444)**	80.86	815
	18.85	**34 638**	(35.51)	(27 883)	18.85	**272**	(35.51)	(359)

	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
7. EXTRAORDINARY ITEM				
Cyclone-damaged timber/related costs	**-**	(19 835)	**-**	(306)
Taxation thereon	**-**	7 150	**-**	110
	-	(12 685)	**-**	(196)
Less: minority interests	**-**	5 793	**-**	89
	-	(6 892)	**-**	(107)
8. DIVIDENDS				
- Final i.r.o. financial year ended 30 June 1999	**-**	7 204	**-**	93

notes to the group financial statements

for the year ended 30 June 2001

9. HEADLINE EARNINGS PER SHARE

Headline earnings per share is based on the Group's headline earnings divided by the number of shares or, where applicable the weighted average number of shares, in issue during the year. 55 419 042 shares were in issue for both years.

Reconciliation between earnings and headline earnings:

	Net income $'000	**2001 Per share cents**	Net income $'000	2000 Per share cents	**Net income US$'000**	**2001 Per share cents**	Net income US$'000	2000 Per share cents
Earnings as reported (Basic)	**71 786**	**129.5**	(21 507)	(38.8)	**607**	**1.1**	(534)	(1.0)
Adjustments:								
Profit on sale of fixed assets	**(25 279)**		(2 460)		**(198)**		(32)	
Operating exceptional items	**(48 453)**		4 173		**(487)**		64	
- Profit on sale of investments	**-**		(18 340)		**-**		(283)	
- Fraud	**-**		10 110		**-**		156	
- Rationalisation expenses	**-**		12 403		**-**		191	
- Cyclone Eline insurance proceeds	**(48 453)**		-		**(487)**		-	
Goodwill amortisation	**(27 523)**		(13 191)		**(215)**		(169)	
Extraordinary item - gross	**-**		19 835		**-**		306	
Total tax effect on exceptionals and extraordinary item	**14 972**		(6 958)		**117**		(110)	
Total minority interest on exceptionals and extraordinary item	**23 626**		(16 075)		**237**		(158)	
Headline Earnings	**9 129**	**16.5**	(36 183)	(65.3)	**61**	**0.1**	(633)	(1.1)

10. INCOME AFTER TAXATION

	2001 $'000	2000 $'000	**2001 US$000**	2000 US$000
The income after taxation in the accounts of the Holding Company amounts to	**(1 231)**	5 483	**(12)**	84

11. SHARE CAPITAL

	Number of Shares	**2001 $'000**	2000 $'000	**2001 US$000**	2000 US$000
Ordinary shares of 50 cents each					
- authorised	300 000 000	**150 000**	150 000	**1 926**	1 926
- unissued	244 580 958	**122 291**	122 291	**1 570**	1 570
Issue and fully paid	55 419 042	**27 709**	27 709	**356**	356
Restatement of opening balance				**(140)**	-
	55 419 042	**27 709**	27 709	**216**	356

On 14 January 2000 the company increased its authorised share capital from 65 million to 300 million ordinary shares of 50 cents each.

The unissued shares are under the control of the Directors who may issue them on such terms and conditions as they see fit, subject to the limitation of the Companies Act (Chapter 24:03). The period of this authority is unlimited.

notes to the group financial statements

for the year ended 30 June 2001

	2001 $'000	2000 $'000	2001 US$000	2000 US$000
12. **CAPITAL RESERVE**				
At 30 June 2000	114 960	54 918	1 477	705
Restatement of opening balance			(579)	
Surplus arising on revaluation of:				
- land and buildings	6 142	-	48	-
- plantations	274 194	93 353	2 142	1 199
Transfer to Deferred Taxation	(64 973)	(34 458)	(508)	(442)
Transfer from Deferred Capital Gains	1 625	1 153	13	15
Adjustment on sale of land and buildings - net of minority interests	(12 552)	(6)	(98)	-
At 30 June 2001	319 396	114 960	2 495	1 477
Non-distributable reserve arising on currency translation				
At 30 June 2000	-	-	109	-
Current year's movement	-	-	(444)	109
At 30 June 2001	-	-	(335)	109
	319 396	114 960	2 160	1 586
Analysis				
Surpluses on revaluation				
- land, buildings and plantations	278 791	88 926	2 178	1 143
- plant and machinery	40 605	26 034	317	334
Non-distributable reserve arising on currency translation	-	-	(335)	109
	319 396	114 960	2 160	1 586

	2000 $'000	Acquisition	2001 $'000	2000 US$'000	Restatement of opening balances	Acquisition	2001 US$'000
13. **MINORITY INTERESTS**							
Share of capital and revenue reserves at acquisition	274 792	(22 689)	252 103	3 528	(1 381)	(177)	1 970
Post acquisition:							
- Share of movements in capital reserves	50 483	3 376	53 859	648	(254)	26	420
- Share of retained profit	(22 858)	(6 409)	(29 267)	(353)	174	(64)	(243)
- Share of extraordinary item	(5 793)	(390)	(6 183)	(89)	31	(4)	(62)
- Share of transfer ex capital reserves	4	(3)	1	-	-	-	-
Current year:							
- Share of movements in capital reserves			193 093				1 509
- Share of current year's net profit			77 300				777
	296 628	(26 115)	540 906	3 734	(1 430)	(219)	4 371

notes to the group financial statements

for the year ended 30 June 2001

	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
14. DEFERRED TAXATION				
Timing Differences				
At 30 June 2000	230 083	28 993	2 936	372
Restatement of opening balance			(1 138)	
Acquisition of subsidiaries	-	194 763	-	2 501
Sale of subsidiary adjustment	(340)	-	(3)	-
Transfer ex Capital Reserve	132 907	62 715	1 038	805
Current year change	30 671	(56 388)	240	(742)
At 30 June 2001	393 321	230 083	3 073	2 936
Capital Gains				
At 30 June 2000	9 649	4 898	124	63
Restatement of opening balance			(49)	
Acquisition of subsidiaries	-	7 095	-	91
Transfer ex Capital Reserve	(1 915)	(1 426)	(15)	(18)
Current year change	-	(918)	-	(12)
At 30 June 2001	7 734	9 649	60	124
	401 055	239 732	3 133	3 060

	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
15. LONG AND MEDIUM TERM LIABILITIES				
Interest Bearing				
At 30 June 2000	22 209	16 827	286	217
Restatement of opening balance			(112)	
Movement	(3 557)	5 382	(28)	69
At 30 June 2001	18 652	22 209	146	286

Analysis

Loans secured: Rate of interest	Repayable	Note	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
24%	1999/13	(a)	10 324	3 846	81	49
22%	1999/02	(a)	4 680	2 503	37	32
32.35%	2000/05	(b)	-	6 636	-	85
59.5%	2000/05	(b)	-	2 000	-	26
39.75%	2000/05	(c)	1 160	-	15	
40.0%	2000/20	(a)	1 129	1 184	9	15
Hire Purchase Agreements			-	1 190	-	15
Lease Hire Agreements			24	595	-	8
AAC Management Motor Vehicle Loan			5 250	7 875	41	102
			21 407	26 989	168	347
Deduct: Transfer to short term liabilities (Note 21)			2 755	4 780	22	61
			18 652	22 209	146	286

Notes:

a) Secured by mortgage bonds over land and buildings having a book value of $8 948 057 (2000 - $8 948 057)

b) Secured by mortgage bonds over land and buildings having a book value of $7 400 000 (2000 - $7 400 000)

c) Secured by mortgage bonds over land and buildings having a book value Of $7 800 000 (2000 - $7 800 000)

	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
Interest Free				
Total taxation payable	9 541	29 955	75	385
Deduct: Taxation due within one year (Note 21)	8 088	24 573	63	316
	1 453	5 382	12	69
	20 105	27 591	158	355

16. **FIXED ASSETS**
16.1 Fixed Assets Reconciliation

	LAND AND BUILDINGS		PLANT AND MACHINERY		MOTOR VEHICLES		FURN. & FITTINGS	LOOSE TOOLS	ELECT. CONNEC.	
COST	COST $'000	REVAL $'000	COST $'000	REVAL $'000	COST $'000	REVAL $'000	COST $'000	COST $'000	COST $'000	TOTAL $'000
OPENING BALANCE 1.7.2000	**40 495**	**292 687**	**71 485**	**342 273**	**145 142**	**803**	**68 364**	**415**	**12 375**	**974 039**
RE-ALLOCATIONS			**(70)**					**70**		**-**
ADDITIONS	**3 809**		**38 698**		**20 498**		**6 796**	**96**		**69 897**
DISPOSALS	**(5 723)**	**(23 027)**	**(14 960)**	**(36 330)**	**(11 130)**		**(4 069)**	**(35)**		**(95 274)**
TRANSFERS:										
IN	**250**	**34 800**	**1 256**	**6 118**	**2 332**		**1 053**	**129**		**45 938**
(OUT)	**(250)**	**(34 800)**	**(1 256)**	**(6 118)**	**(2 332)**		**(1 053)**	**(129)**		**(45 938)**
C.W.I.P.										
(OPENING BALANCE)	**(1 721)**		**(3 979)**				**(82)**			**(5 782)**
CLOSING BALANCE	**2 143**		**7 252**		**4 653**		**240**			**14 288**
REVALUATION		**6 319**								**6 319**
CLOSING BALANCE 30.6.2001	**39 003**	**275 979**	**98 426**	**305 943**	**159 163**	**803**	**71 249**	**546**	**12 375**	**963 487**

	LAND AND BUILDINGS		PLANT AND MACHINERY		MOTOR VEHICLES		FURN. & FITTINGS	LOOSE TOOLS	ELECT. CONNEC.	
DEPRECIATION	COST $'000	REVAL $'000	COST $'000	REVAL $'000	COST $'000	REVAL $'000	COST $'000	COST $'000	COST $'000	TOTAL $'000
OPENING BALANCE 1.7.2000	**343**	**36 338**	**14 080**	**80 038**	**92 897**	**803**	**23 557**			**248 056**
CURRENT YEAR'S CHARGE	**272**	**8 311**	**3 955**	**16 080**	**17 228**		**12 080**			**57 926**
DISPOSALS			**(2 740)**	**(9 960)**	**(8 320)**		**(2 170)**			**(23 190)**
TRANSFERS:										
IN			**486**	**3 414**	**1 729**		**676**			**6 305**
(OUT)			**(486)**	**(3 414)**	**(1 729)**		**(676)**			**(6 305)**
CLOSING BALANCE 30.6.2001	**615**	**44 649**	**15 295**	**86 158**	**101 805**	**803**	**33 467**	**-**	**-**	**282 792**
N.B.V. AT 30.6.2001	**38 388**	**231 330**	**83 131**	**219 785**	**57 358**	**-**	**37 782**	**546**	**12 375**	**680 695**
N.B.V. AT 30.6.2000	40 152	256 349	57 405	262 235	52 245	-	44 807	415	12 375	725 983

16. **FIXED ASSETS (continued)**

16.1 Fixed Assets Reconciliation

	LAND AND BUILDINGS		PLANT AND MACHINERY		MOTOR VEHICLES		FURN. & FITTINGS	LOOSE TOOLS	ELECT. CONNEC.	
COST	COST US$'000	REVAL US$'000	COST US$'000	REVAL US$'000	COST US$'000	REVAL US$'000	COST US$'000	COST US$'000	COST US$'000	TOTAL US$'000
OPENING BALANCE 1.7.2000	520	3 758	918	4 395	1 864	10	878	5	158	12 506
RESTATEMENT OF OPENING BALANCES	(204)	(1 471)	(359)	(1 721)	(730)	(4)	(344)	(2)	(61)	(4 896)
RE-ALLOCATIONS			(1)					1		-
ADDITIONS	30		302		160		53	1		546
DISPOSALS	(45)	(180)	(117)	(284)	(87)		(31)			(744)
TRANSFERS:										
IN	2	272	10	48	18		8	1		359
(OUT)	(2)	(272)	(10)	(48)	(18)		(8)	(1)		(359)
C.W.I.P. (OPENING BALANCE)	(13)		(31)				(1)			(45)
CLOSING BALANCE	17		57		36		2			112
REVALUATION		49								49
CLOSING BALANCE 30.6.2001	305	2 156	769	2 390	1 243	6	557	5	97	7 528

	LAND AND BUILDINGS		PLANT AND MACHINERY		MOTOR VEHICLES		FURN. & FITTINGS	LOOSE TOOLS	ELECT. CONNEC.	
DEPRECIATION	COST US$'000	REVAL US$'000	COST US$'000	REVAL US$'000	COST US$'000	REVAL US$'000	COST US$'000	COST US$'000	COST US$'000	TOTAL US$'000
OPENING BALANCE 1.7.2000	4	467	181	1 028	1 193	10	302			3 185
RESTATEMENT OF OPENING BALANCES	(1)	(183)	(71)	(403)	(466)	(4)	(119)			(1 247)
CURRENT YEAR'S CHARGE	2	65	31	126	135		94			453
DISPOSALS			(21)	(78)	(65)		(17)			(181)
TRANSFERS:										
IN			4	27	14		5			50
(OUT)			(4)	(27)	(14)		(5)			(50)
CLOSING BALANCE 30.6.2001	5	349	120	673	797	6	260	-	-	2 210
N.B.V. AT 30.6.2001	300	1 807	649	1 717	446	-	297	5	97	5 318
N.B.V. AT 30.6.2000	516	3 291	737	3 367	671	-	576	5	158	9 321

notes to the group financial statements

for the year ended 30 June 2001

16. **FIXED ASSETS (continued)**

16.2 **Encumbered Assets**

Details of fixed assets encumbered are included in Note 15.

16.3 **Capital Commitments**

Capital expenditure approved 30 June 2001

Contracted	**$12 212 003**	**US$ 95 414**
Not contracted	**$ 5 538 553**	**US$ 43 273**

16.4 **Revaluation of Fixed Assets**

Independent professional valuations were conducted as follows:

(i) Land and buildings - open market value:

Original Radar Group	-	30 June 1997
Border	-	31 December 1997
C.I.H.	-	31 December 1993

(ii) Plant and machinery - depreciated replacement value according to age, obsolescence, use and condition:

Original Radar Group	-	30 June 1996
Border	-	31 December 1997
C.I.H.	-	31 December 1993

16.5 **Notional Depreciation**

If a life of forty years is assumed, the notional depreciation charge for the year on buildings, calculated on a straight line basis, would have amounted to:

June 2001	**$2 045 732**	**US$ 15 984**
June 2000	$ 1 872 759	US$ 14 632

The policy of not providing depreciation on buildings is contrary to International Accounting Standards.

			2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
16.6 Leased Assets						
Included in the net book value of motor vehicles are leased assets in aggregate of:						
Cost			**353**	7 265	**3**	93
Aggregate depreciation			**139**	4 092	**1**	53
Net Book Value			**214**	3 173	**2**	40
17. PLANTATIONS						
Valuation at 30 June 2000			**394 390**	222 207	**5 065**	2 856
Restatement of opening balance					**(1 983)**	
Expenditure for the period			**85 361**	29 812	**667**	383
Revaluation surplus			**535 117**	171 827	**4 181**	2 206
			1 014 868	423 846	**7 930**	5 445
Deduct:						
Plantation redemption			**(54 227)**	(12 122)	**(424)**	(156)
Extraordinary item cyclone-damaged timber				(17 334)		(224)
Valuation at 30 June 2001			**960 641**	394 390	**7 506**	5 065
Comprising	**2001 Hectares**	2000 Hectares				
1 - 6 years	**11 189**	11 827	**148 994**	56 248	**1 164**	724
7 - 12 years	**6 769**	6 237	**190 193**	70 722	**1 486**	908
13 - 18 years	**3 282**	2 939	**157 531**	57 208	**1 231**	735
19 - 24 years	**2 919**	2 780	**186 109**	70 854	**1 454**	910
25 - 40 years	**512**	733	**42 789**	24 235	**334**	311
Over 30 years	**1 955**	2 530	**235 025**	115 123	**1 837**	1 477
	26 626	27 046	**960 641**	394 390	**7 506**	5 065

Revaluation of plantations

Revaluations were carried out at 30 June 2001 and 30 June 2000. This is a change from the previous practice of revaluing every three years and has been necessitated by sustained high inflation and cognisance of the risks attached to understating the value of commercial assets. The effect of this change is to increase the balance sheet value of plantations at 30 June 2001 by $535 117 000 (US$4 180 928).

notes to the group financial statements

for the year ended 30 June 2001

	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
18. GOODWILL				
Balance at acquisition	**(131 910)**	(131 910)	**(1 694)**	(1 694)
Restatement of opening balance			**663**	
Adjustment on change in shareholding	**(5 706)**	-	**(45)**	-
Amortisation:	**40 714**	13 191	**318**	169
- At 30 June 2000	**13 191**	-	**169**	-
- Restatement of opening balance			**(66)**	
- Current year's credit	**27 523**	13 191	**215**	169
Balance at 30 June 2001	**(96 902)**	(118 719)	**(758)**	(1 525)

The negative goodwill arising on the acquisition of Border Timbers Limited and Commercial & Industrial Holdings Limited is amortised on a straight line basis at 20% per annum.
Acquisition by the holding company of minority shareholdings in both subsidiaries has given rise to the current year adjustment to goodwill.
Current year amortisation reflects a full year's credit while prior year has been pro-rated from the effective date of acquisition of the subsidiaries.

	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
19. INVESTMENTS AND LOANS				
Shares at cost	**9 198**	4 448	**72**	57
- unquoted (Directors' valuation $4 929 166)	**4 929**	179	**39**	2
- Balance at 30 June 2000	**179**	179	**2**	2
- Restatement of opening balance			**1**	
- Purchases	**4 750**	-	**36**	-
- quoted (market value $184 150 583)	**4 269**	4 269	**33**	55
- Balance at 30 June 2000	**4 269**	4 269	**55**	55
- Restatement of opening balance			**(22)**	
Loans	**10 547**	14 895	**82**	192
- Housing Scheme (note a):				
Directors	**3 961**	4 100	**31**	52
Staff	**3 319**	3 624	**26**	47
Balance at 30 June 2000	**3 624**	1 200	**47**	15
Restatement of opening balance			**(19)**	
Net movement	**(305)**	2 424	**(2)**	32
- Vehicle Purchase scheme (note b):				
Directors	**-**	-	**-**	-
Staff	**3 226**	7 130	**25**	92
Balance at 30 June 2000	**7 130**	814	**92**	10
Restatement of opening balance			**(36)**	
Net movement	**(3 904)**	6 316	**(31)**	82
- Other	**41**	41	**-**	1
Balance at 30 June 2000	**41**	41	**1**	1
Restatement of opening balance			**(1)**	
	19 745	19 343	**154**	249

Notes
a) Comprises loans made under a group housing scheme.
b) Comprises loans made under a group vehicle purchase scheme.

notes to the group financial statements

for the year ended 30 June 2001

	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
19. INVESTMENTS AND LOANS (continued)				
Analysis of Directors' loans				
- Housing Scheme				
Balance at 30 June 2000	4 100	3 047	52	39
Restatement of opening balance			(20)	
Advances	60	5 236	-	67
Repayments	(793)	(4 591)	(6)	(59)
Interest	594	408	5	5
Balance at 30 June 2001	3 961	4 100	31	52
- Vehicle Purchase Scheme				
Balance at 30 June 2000	-	102	-	1
Restatement of opening balance			-	
Repayments	-	(110)	-	(1)
Interest	-	8	-	-
Balance at 30 June 2001	-	-	-	-
20. CURRENT ASSETS				
Inventories	360 064	272 145	2 813	3 494
- raw materials	127 254	90 647	994	1 164
- work-in-progress	28 516	34 036	223	437
- finished goods	107 263	77 426	838	994
- merchandise	97 031	70 036	758	899
Trade debtors	364 885	267 345	2 851	3 433
Other debtors and prepayments	56 362	50 860	440	653
Cash resources	147 073	60 854	1 149	781
	928 384	651 204	7 253	8 361
Stocks are shown after deducting a provision for obsolescence of	852	801	7	10
Trade debtors are shown after deducting a provision for doubtful debts of	26 770	27 165	209	349
21. SHORT TERM LIABILITIES				
Interest Bearing	574 636	604 193	4 490	7 758
Bank overdraft	-	90 851	-	1 167
Local bank loans	1 173	-	9	-
Acceptance credits	570 708	508 562	4 459	6 530
Current portion of long and medium term liabilities (Note 15)	2 755	4 780	22	61
Interest Free	460 194	297 527	3 595	3 821
Trade creditors	300 253	191 120	2 346	2 454
Other creditors and accruals	151 853	81 834	1 186	1 051
Taxation (Note 15)	8 088	24 573	63	316
	1 034 830	901 720	8 085	11 579

notes to the group financial statements

for the year ended 30 June 2001

22. **BORROWING POWERS**

The company's Articles of Association limit the borrowing powers of the company, without prior sanction of a general meeting, to a ceiling of $1 billion (2000 - $600 million).
The level of borrowings of the Company and its subsidiaries at 30 June 2001 did not exceed said limit.

23. **PENSION FUND**

23.1 **The Radar Group Pension Fund**

The Fund was converted to a defined contribution scheme with effect from 1 July 2000 and as such is not subject to Actuarial valuation. Preliminary valuation of the Fund at the time of conversion indicates that there are no under funded liabilities in respect of past service obligations. Employer/employee contribution rates are 10,0% and 5,0%, exclusive of N.S.S.A. contributions, respectively.

23.2 **Border Timbers Limited**

The transfer of Border employees' pension benefits to the overall Radar Holdings Pension Fund is in progress and indications have been received from the Anglo American Actuaries that past service obligations are fully met in terms of the value of funds transferred. The Fund contribution rates following transfer are in accordance with the Radar Holdings Pension Fund rules.

23.3 **Commercial & Industrial Holdings Limited Pension Fund**

This fund is a defined contribution fund and is not subject to Actuarial valuation.
Employer/employee contribution rates are 12,5% and 5,0%, inclusive of N.S.S.A. contributions, respectively.

23.4 **National Social Security Authority Scheme (NSSA)**

This scheme was promulgated under the National Social Security Act (Chapter 17:04) 1989. Group employer/employee contributions under the scheme are limited to specific contributions as legislated from time to time and which at 30 June 2001 were 3% of pensionable emoluments up to a maximum of $120 per month per employee.

24. **FINANCIAL RISK MANAGEMENT**

24.1 Derivative financial instruments are not used by the Group in its management of foreign currency nor are they held for trading purposes.

24.2 The Board executive meets regularly to consider and to adopt effective strategies to manage the following risks:

- exposure to exchange rate fluctuations;
- borrowing facilities in the form of bank overdrafts and acceptance credits are negotiated with approved registered financial institutions at acceptable interest rates;
- investment of surplus funds in the form of treasury bills, bank acceptances and money at call are placed with approved registered financial institutions and building societies at favourable rates on a short term basis;
- credit risk in the form of trade debtors which consist of a large, wide-spread approved customer base. Specific provisions for doubtful debts are regularly adjusted. Where appropriate, credit guarantee insurance is purchased;
- insurance of group assets with the exception of Border's plantation forests which are not insured.

24.3 The estimated net fair values of all financial instruments approximate the carrying amounts shown in the balance sheet.

notes to the group financial statements

for the year ended 30 June 2001

	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
25. CASH FLOW INFORMATION				
25.1 Non cash items and separate disclosures				
Depreciation	**57 926**	37 160	**453**	477
Plantation redemption costs	**54 227**	12 122	**424**	156
Profit on sale of fixed assets	**(25 279)**	(2 460)	**(198)**	(32)
Profit on sale of investments	**-**	(18 340)	**-**	(283)
Goodwill amortisation	**(27 523)**	(13 191)	**(215)**	(169)
Fraud costs	**-**	10 110	**-**	156
Rationalisation costs	**-**	12 403	**-**	191
	59 351	37 804	**464**	496
25.2 Movement in working capital				
Inventories	**(87 919)**	(51 854)	**681**	(666)
Debtors	**(103 042)**	37 314	**795**	479
Short term interest free liabilities	**179 152**	4 186	**27**	54
	(11 809)	(10 354)	**1 503**	(133)
25.3 Taxation paid				
Taxation movement	**(20 414)**	(5 482)	**(310)**	(70)
Current taxation provision	**(4 307)**	(22 273)	**(35)**	(285)
	(24 721)	(27 755)	**(345)**	(355)
25.4 Dividends paid				
Dividends current year	**-**	(7 204)	**-**	(93)
25.5 Analysis of acquisition of subsidiary undertakings				
Fixed assets	**-**	(792 568)	**-**	(10 177)
Investments	**-**	(7 801)	**-**	(100)
Inventories	**-**	(121 537)	**-**	(1 561)
Debtors	**-**	(273 431)	**-**	(3 511)
Short term liabilities	**-**	185 108	**-**	2 377
Taxation	**-**	17 085	**-**	219
Deferred taxation	**-**	201 859	**-**	2 592
Long and medium term liabilities	**-**	9 783	**-**	126
Short term interest bearing liabilities	**-**	134 233	**-**	1 724
Net cash acquired with subsidiary undertakings	**-**	20 151	**-**	259
Acquisition of additional shareholding in existing subsidiaries	**(20 409)**	-	**(174)**	-
	(20 409)	(627 118)	**(174)**	(8 052)
Interest of minority shareholders	**-**	274 792	**-**	3 528
	(20 409)	(352 326)	**(174)**	(4 524)
Capital reserve on acquisition of subsidiary undertakings	**-**	131 910	**-**	1 694
Purchase of subsidiary undertakings	**(20 409)**	(220 416)	**(174)**	(2 830)
25.6 Investments and loans				
Quoted investments				
- Purchases	**(4 750)**	(204 981)	**(37)**	(2 632)
- Re-allocation to investment in subsidiary undertakings	**-**	220 416	**-**	2 830
	(4 750)	15 435	**(37)**	198
Directors' loans	**4 348**	(1 920)	**34**	(25)
	(402)	13 515	**(3)**	173

notes to the group financial statements

for the year ended 30 June 2001

		2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
25	**CASH FLOW INFORMATION (continued)**				
25.7	**Proceeds on sale of investments**				
	Cost of investments sold	-	54 310	-	697
	Profit thereon	-	18 340	-	283
	Proceeds	-	72 650	-	980
25.8	**Financing**				
	Interest bearing liabilities				
	- long & medium term	(3 557)	(4 401)	(140)	(56)
	- short term	61 294	280 544	(2 101)	3 602
	Effect of exchange rate movement on opening balances			1 194	348
		57 737	276 143	(1 047)	3 894
25.9	**Liquid resources**				
	Cash resources	86 219	20 617	368	264
	Bank overdrafts	90 851	(32 241)	1 167	(414)
		177 070	(11 624)	1 535	(150)

26 **NON-COMPLIANCE WITH IAS 29**

These financial statements have not been prepared in conformity with International Accounting Standard 29, "Financial Reporting in Hyperinflationary Economies", as the directors are of the view that the current method and principles of preparing inflation adjusted financial statements are still subjective and under discussion. In monitoring and assessing the performance of the group and company based on the historical cost financial statements and other relevant factors, the directors do consider the effects of the high rate of inflation in Zimbabwe. The directors also believe that the cost of preparing inflation adjusted financial statements would be out of proportion to the perceived benefits to the members.

The financial effects of non-compliance with IAS 29 have, accordingly, not been formally established. Consideration will, however, be given to full compliance with the requirements of IAS 29 once wider acceptance of the principles involved is established and the resultant costs can be justified in relation to the benefits to members.

27. **CONTINGENT LIABILITIES**

Offers to Minorities

The company has a contingent liability arising from an offer to minorities to purchase their respective shareholdings in Border the quantum being:

At 30 June 2001		
Border minority shareholders	**$8 589 672**	**US$67 112**

In terms of Section 194(2)(b) of the Companies Act (Chapter 24:03) the three month compulsory acquisition period effective in terms of said Offer to Minorities expired on 20 July 2001.

28. **POST BALANCE SHEET EVENTS**

28.1 **Transfer of Division**

With effect from 1 July 2001 as part of the Board's ongoing reorganisation of the Radar Group:

a) Bulawayo Toyota, a division of C.I.H. Limited was transferred to Radar Investments (Private) Limited at net asset values.

b) International Hardware, a division of C.I.H. Limited was transferred to Border Timbers International (Private) Limited at net asset values.

28.2 **Sale of Division**

With effect from 1 July 2001 the net assets of Cotton Waste, a division of C.I.H., were sold to a third party for a cash consideration of $12,8 million.

28.3 **Land Acquisition**

Significant tracts of Border Timbers' estates have been listed for compulsory acquisition. In that this is at odds with statements made by Government that agro-industrial enterprises were not subject to this procedure, and that all objections to listing have been lodged, it is considered impossible to provide a meaningful statement of affairs and accordingly no financial effect of this has been recognised in the financial statements.

company balance sheet

at 30 June 2001

	Notes	2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
FUNDS EMPLOYED					
Share capital	C3	**27 709**	27 709	**216**	356
Capital reserve	C4	**36 666**	36 666	**504**	319
Retained income		**50 910**	52 141	**512**	822
		115 285	116 516	**1 232**	1 497
EMPLOYMENT OF FUNDS					
INVESTMENTS AND LOANS	C6	**4 459**	4 459	**34**	58
INTERESTS IN SUBSIDIARY COMPANIES	C7	**111 194**	112 632	**1 202**	1 446
CURRENT ASSETS	C8	**61**	140	**-**	2
CURRENT LIABILITIES	C9	**429**	715	**4**	9
NET CURRENT LIABILITIES		**(368)**	(575)	**(4)**	(7)
		115 285	116 516	**1 232**	1 497

company statement of changes in equity

for the year ended 30 June 2001

	Share capital $'000	Capital reserves $'000	Revenue reserves $'000	Total $'000
Balance at 1 July 1999	27 709	36 666	53 862	118 237
Income for the year after taxation attributable to shareholders			5 483	5 483
Dividends			(7 204)	(7 204)
Balance at 30 June 2000	27 709	36 666	52 141	116 516
Balance at 1 July 2000	**27 709**	**36 666**	**52 141**	**116 516**
Income for the year after taxation attributable to shareholders			**(1 231)**	**(1 231)**
Balance at 30 June 2001	**27 709**	**36 666**	**50 910**	**115 285**

	Share capital US$'000	Capital reserves US$'000	Revenue reserves US$'000	Total US$'000
Balance at 1 July 1999	356	471	831	1 658
Income for the year after taxation attributable to shareholders			84	84
Dividends			(93)	(93)
Exchange rate translation differences		(152)		(152)
Balance at 30 June 2000	356	319	822	1 497
Balance at 1 July 2000	**356**	**319**	**822**	1 497
Income for the year after taxation attributable to shareholders			**(12)**	**(12)**
Exchange rate translation/restatement differences	**(140)**	**185**	**(298)**	**(253)**
Balance at 30 June 2001	**216**	**504**	**512**	**1 232**

notes to the company financial statements

for the year ended 30 June 2001

			2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
C1	**TURNOVER**					
	Turnover comprises dividends received		-	6 697	-	103
C2	**DIVIDENDS**					
	- Final i.r.o. financial year ended 30 June 1999		-	7 204	-	93
C3	**SHARE CAPITAL**	Number Of shares				
	Ordinary shares of 50 cents each					
	- authorised	300 000 000	150 000	150 000	1 926	1 926
	- unissued	244 580 958	122 291	122 291	1 570	1 570
	Issued and fully paid	55 419 042	27 709	27 709	356	356
	Restatement of opening balance				(140)	-
		55 419 042	27 709	27 709	216	356

On 14 January 2000 the company increased its authorised share capital from 65 million to 300 million ordinary shares of 50 cents each.

The unissued shares are under the control of the Directors who may issue them on such terms and conditions as they see fit, subject to the limitation of the Companies Act (Chapter 24:03). The period of this authority is unlimited.

		2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
C4	**CAPITAL RESERVE**				
	At 30 June 2000	36 666	36 666	471	471
	Restatement of opening balance			(185)	
	At 30 June 2001	36 666	36 666	286	471
	Non-distributable reserve arising on currency translation				
	At 30 June 2000			(152)	
	Current year's movement			370	(152)
	At 30 June 20001	-	-	218	(152)
		36 666	36 666	504	319
	Analysis				
	Capital reserves in former subsidiaries	36 666	36 666	286	471
	Non-distributable reserve arising on currency translation	-	-	218	(152)
		36 666	36 666	504	319
C5	**LONG AND MEDIUM TERM LIABILITIES**				
	Interest Free				
	Total taxation payable	220	220	2	3
	Deduct:				
	Taxation due within one year (Note C9)	220	220	2	3
		-	-	-	-

notes to the company financial statements

for the year ended 30 June 2001

		2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
C6	**INVESTMENTS AND LOANS**				
	Shares at cost	**4 418**	4 418	**34**	57
	- unquoted (Directors' valuation $149 000)	**149**	149	**1**	2
	- Balance at 30 June 2000	**149**	149	**2**	2
	- Restatement of opening balance			**(1)**	
	- quoted (market value $184 150 583)	**4 269**	4 269	**33**	55
	- Balance at 30 June 2000	**4 269**	4 269	**55**	55
	- Restatement of opening balance			**(22)**	
	Loans - other	**41**	41	**-**	1
	- Balance at 30 June 2000	**41**	41	**1**	1
	- Restatement of opening balance			**(1)**	-
		4 459	4 459	**34**	58
C7	**INTERESTS IN SUBSIDIARY COMPANIES**				
	(All subsidiaries wholly owned)				
	Shares at cost	**240 825**	220 416	**2 215**	2 830
	Balance at 30 June 2000	**220 416**	220 416	**2 830**	2 830
	Restatement of opening balance			**(789)**	
	Movement	**20 409**	-	**174**	-
	Current Accounts	**(129 631)**	(107 784)	**(1 013)**	(1 384)
		111 194	112 632	**1 202**	1 446
	Market value of quoted subsidiary undertakings	**88 020**	196 366	**688**	2 521

Notes:

1 On 1 March 2000, Radar Holdings Limited acquired from Anglo American Corporation, 54,08% and 39,32% of the issued share capital of Border Timbers Limited and Commercial & Industrial Holdings Limited respectively for a total cash consideration of $220 415 832. This acquisition gave Radar an effective controlling interest at that time of 54,32% in Border and 64,28% in C.I.H. Results of both subsidiaries were incorporated in the consolidated financial statements as from 1 January 2000, the effective date of acquisition.
Following Offers to Minorities, and rationalisation of shareholding levels in C.I.H. and Border, Radar's effective controlling interest at 30 June 2001 is 51,24% in Border and 97,19% in C.I.H.

2 C.I.H. was de-listed from the Zimbabwe Stock Exchange on 23 May 2001 following the completion of the Offer to Minorities.

3 At 30 June 2001 no shares were under pledge to Group Bankers. At 30 June 2000 23 225 108 shares in Border and 44 723 325 shares in C.I.H. having an aggregate market value at 30 June 2000 of $195 686 527 were pledged to the Group's Bankers as security for investment loan facilities of $170 000 000.

notes to the company financial statements

for the year ended 30 June 2001

		2001 $'000	2000 $'000	2001 US$'000	2000 US$'000
C8	**CURRENT ASSETS**				
	Other debtors and prepayments	**61**	12	**-**	-
	Cash resources	**-**	128	**-**	2
		61	140	**-**	2
C9	**SHORT TERM LIABILITIES**				
	Interest Free				
	Other creditors and accruals	**209**	495	**2**	6
	Taxation (Note C5)	**220**	220	**2**	3
		429	715	**4**	9

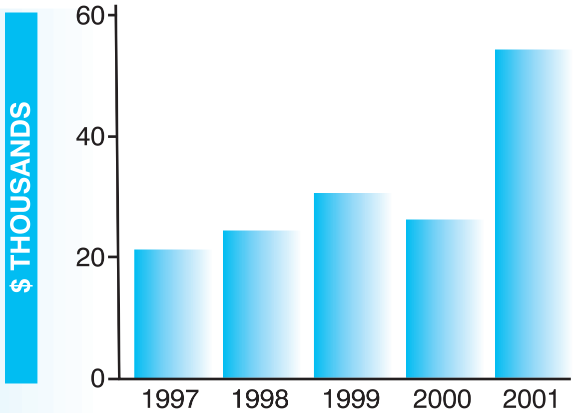
2001

analysis of performance over past five years

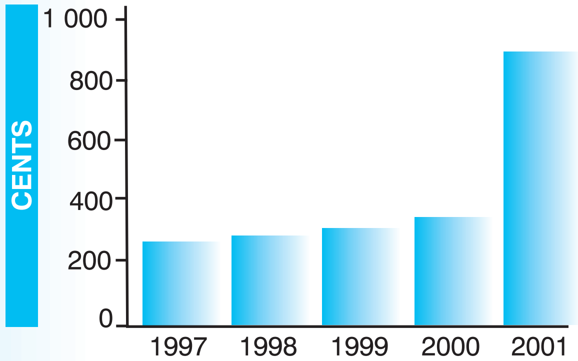
* comparatives adjusted

	2001	2000	1999	1998	1997
Ordinary Share Performance					
Shares in issue at 30 June ('000)	**55 419**	55 419	55 419	9 237	9 237
Weighted shares in issue at 30 June ('000)	**55 419**	55 419	55 419	55 419	55 419
*Basic earnings per share (cents)	**130**	(39)	73	32	17
*Dividends per share (cents)	**-**	13	9	6	4
Dividend cover (times)	**-**	(3.0)	7.9	3.4	3.0
*Net asset value per share (cents)	**894.4**	372.7	316.1	276.6	254.2
*Market price per share at 30 June (cents)	**290**	300	275	127	73
Stock Market Ratios					
*Equity value per share ($)	**8.94**	3.73	3.16	2.77	2.54
*Capital employed value per share ($)	**28.83**	13.90	4.17	3.39	3.04
*Sales per share ($)	**49.48**	24.48	10.47	6.88	5.23
Long term debt to equity (%)	**4.86**	13.36	12.63	12.49	9.58
Price to earnings (times)	**2.24**	(7.73)	3.75	3.97	4.27
Price to equity value (%)	**32.42**	80.50	86.99	45.80	28.85
Market price/sales per share (%)	**5.86**	12.25	26.27	18.42	14.02
Return on equity (%)	**14.48**	(10.42)	23.23	11.52	6.75
Sales to total assets (times)	**1.10**	0.81	1.36	1.31	1.21
Profitability and Asset Management					
Operating margin (%)	**13.2**	7.4	14.4	11.5	9.1
Attributable return on shareholders' funds(%)	**14.5**	(10.4)	23.2	11.5	6.8
Operating income as % of net funds employed (%)	**24.4**	9.9	26.0	19.1	12.6
Operating income as % of total assets (%)	**14.5**	6.0	19.6	15.1	11.0
Attributable income as % of turnover (%)	**2.6**	(1.6)	7.0	4.6	3.3
Net funds employed (times)	**1.8**	1.3	1.8	1.7	1.4
Times stock turned	**7.6**	5.0	5.9	4.8	5.6
Liquidity and Leverage					
Cash flow ($'000)	**129 712**	8 445	47 761	23 164	16 487
Interest cover (times)	**1.42**	0.57	3.42	2.69	2.31
Total interest bearing liabilities to shareholders' funds (%)	**119.69**	303.30	65.87	40.80	37.32
Shareholders' funds to total assets (%)	**19.89**	12.35	41.08	52.55	58.91
Fixed capital ratio (:1)	**0.64**	0.42	1.44	1.23	1.19
Cash flow to total interest bearing liabilities (:1)	**0.22**	0.01	0.41	0.37	0.31
Cash flow to current liabilities (:1)	**0.13**	0.01	0.24	0.22	0.23
Current ratio (:1)	**0.90**	0.72	0.94	1.29	1.34
Acid test ratio (:1)	**0.55**	0.42	0.43	0.52	0.60
Effectiveness					
Number of employees	**4 994**	5 564	1 680	1 795	1 441
Total value added ($'000)	**1 010 305**	486 174	192 130	128 107	86 942
Total employment costs ($'000)	**592 141**	324 056	93 928	73 353	50 596
Employment costs per head ($)	**118 570**	58 242	55 910	40 865	35 112
Sales per employee ($)	**549 136**	243 841	345 274	212 313	201 108
Attributable income per employee ($)	**14 374**	(3 865)	24 220	9 841	6 602
Value added per employee ($)	**202 304**	87 379	114 363	71 369	60 334
Total value added/total employment costs (times)	**1.71**	1.50	2.05	1.75	1.72
Total assets per employee ($)	**499 112**	300 539	253 861	162 506	165 940
Shareholders' funds per employee ($)	**99 253**	37 119	104 282	85 391	97 763

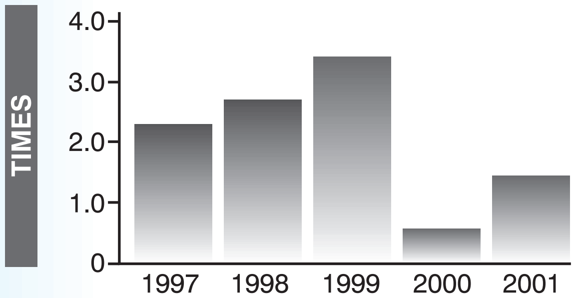
2001 financials



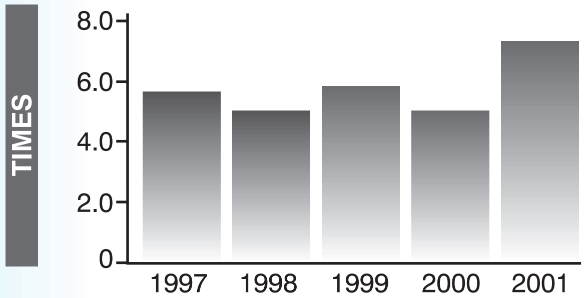
SALES PER EMPLOYEE



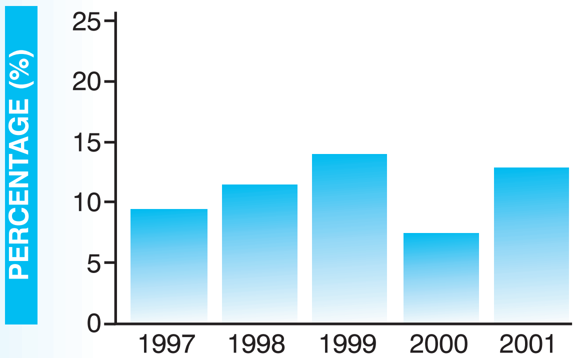
NET ASSETS PER SHARE



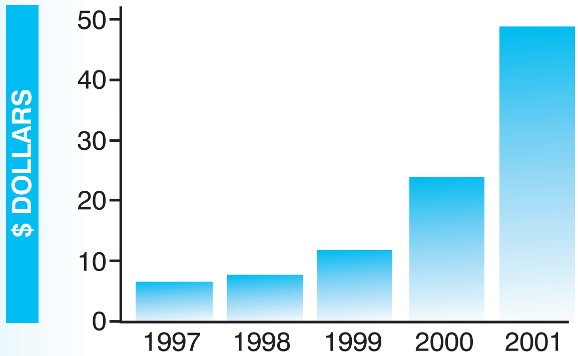
INTEREST COVER



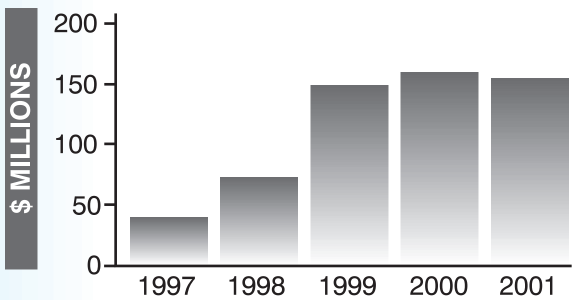
STOCK TURN



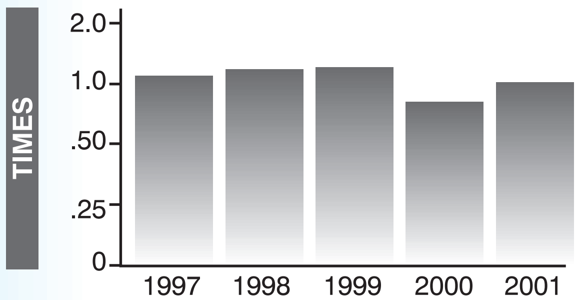
OPERATING MARGIN



SALES PER SHARE



MARKET CAPITALISATION



SALES TO TOTAL ASSETS

definitions

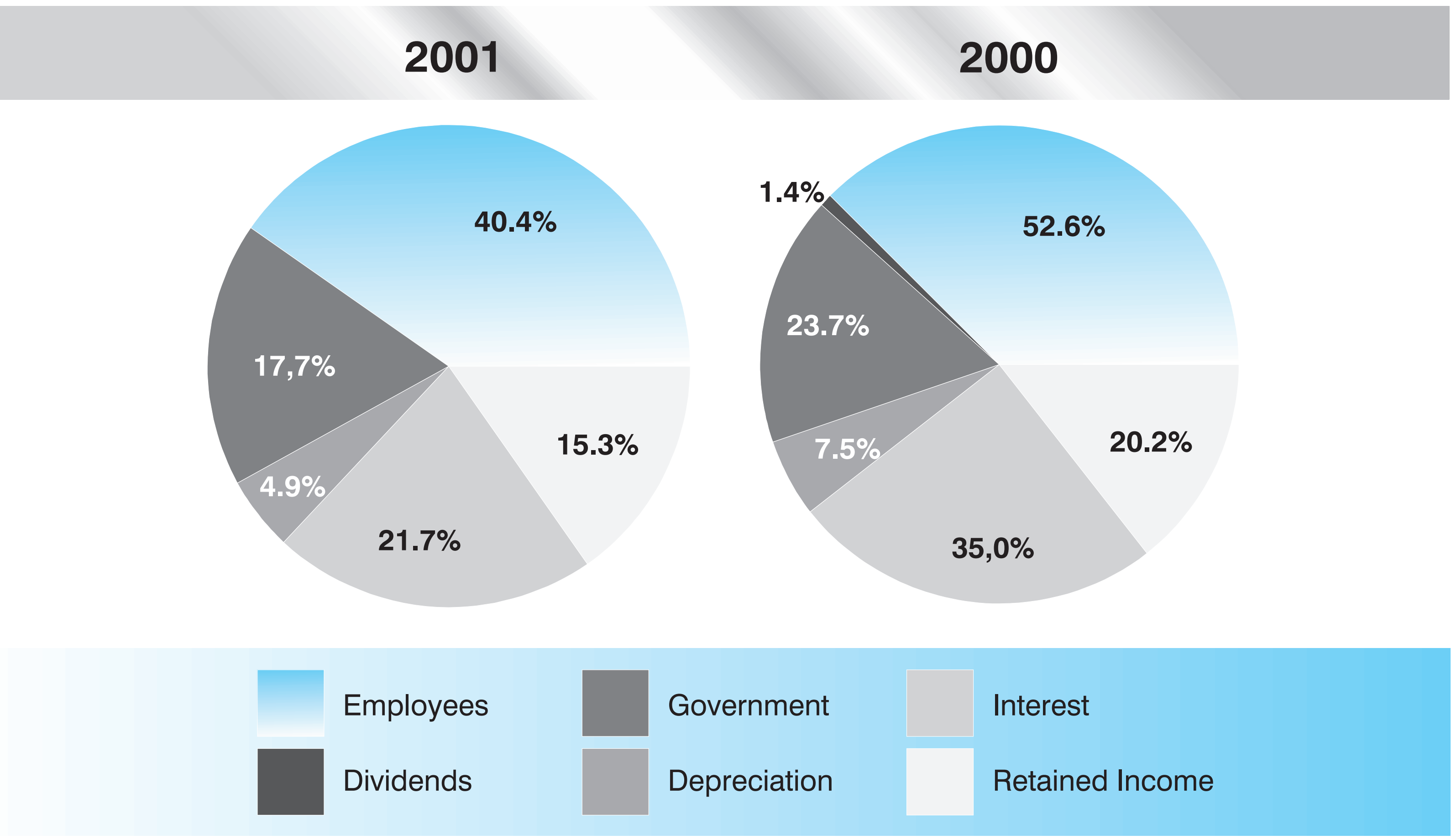
of certain accounting terms and ratios used in this report:

Acid test ratio	Ratio of current assets, less stock, to current liabilities.
Cash flow	Income after taxation less dividends plus depreciation.
Current ratio	Ratio of current assets to current liabilities.
Dividend cover	Income after taxation and extraordinary items divided by dividends.
Fixed capital ratio	Total long and medium term liabilities plus shareholders' funds and deferred tax to fixed assets.
Interest cover	Income before interest divided by net interest paid.
Net asset value/equity value per share	Shareholders' funds divided by the number of shares in issue at the year end.
Net funds employed	Total shareholders' funds, deferred tax, interest bearing liabilities, less positive cash balance.
Net funds employed turn (times)	Turnover divided by net funds employed.
Operating margin	Income before interest as percentage of turnover.
Times stock turned	Turnover divided by stock-on-hand at the year end.
Total assets	Fixed assets, investments and current assets.
Capital employed value	Total funds employed divided by shares in issue.
Free cash flow per share	Free cash flow divided by shares in issue.
Sales per share	Turnover divided by shares in issue.
Long term debt to equity	Ratio of long term debt to shareholders' funds.
Price to earnings (times)	Ratio of the market price per share to earnings per share.
Price to equity value	Ratio of the market price per share to shareholders' funds value per share.
Price to sales	Ratio of the market price per share to the sales value per share in issue.
Return on net assets	Ratio of profit after tax to employment of funds.
Return on equity	Ratio of profit after tax to total funds employed.
Sales to total assets (times)	Turnover divided by gross assets.

group value added statement

for the year ended 30 June 2001

		2001 $'000	2001 %		2000 $'000	2000 %
Gross sales inclusive of sales tax paid		**2 828 465**	**100,0**		1 390 907	100,0
Deduct: Bought-in materials and services		**1 656 500**	**58,6**		892 683	64,2
Total value added		**1 171 965**	**41,4**		498 224	35,8
Distributed to:-						
Employees						
- net salaries, wages, benefits and other staff costs		**473 412**	**40,4**		262 088	52,6
Government and related parties		**207 056**			118 227	
- PAYE	**105 998**		**9,0**	57 053		11,5
- Sales tax	**86 081**		**7,3**	34 178		6,9
- Normal tax for the year	**2 246**		**0,2**	22 081		4,4
- NSSA	**12 731**		**1,1**	4 915		1,0
Providers of capital		**331 114**			158 698	
- interest on loans and other facilities	**253 814**		**21,7**	174 352		35,0
- minority share of profits	**77 300**		**6,6**	(22 858)		(4,6)
- dividends to shareholders	**-**			7 204		1,4
Re-investment in the group:		**160 383**			(40 789)	
- depreciation	**57 926**		**4,9**	37 160		7,5
- deferred tax	**30 671**		**2,6**	(49 238)		(9,9)
- retained income	**71 786**		**6,2**	(28 711)		(5,8)
		1 171 965	**100,0**		498 224	100,0



analysis of shareholders

30 June 2001

	2001				2000			
	Holders	**% of Total**	**Shares**	**% of Total**	Holders	% of Total	Shares (000's)	% of Total
0 - 5 000	**266**	**57,4**	**1 492**	**2,8**	265	55,3	479	0,9
5 001 - 50 000	**143**	**30,9**	**2 162**	**3,9**	155	32,4	2 457	4,4
50 001 - 500 000	**34**	**7,3**	**4 402**	**7,9**	37	7,7	5 664	10,2
500 000 - 1 000 000	**8**	**1,7**	**5 029**	**9,0**	10	2,1	6 759	12,2
Over 1 000 000	**12**	**2,7**	**42 334**	**76,4**	12	2,5	40 060	72,3
	463	**100,0**	**55 419**	**100,00**	479	100,0	55 419	100,0

CLASSIFICATION

	2001				2000			
	Holders	**% of Total**	**Shares (000's)**	**% of Total**	Holders	% of Total	Shares (000's)	% of Total
Resident:								
Banks & Nominee Companies	**17**	**3,67**	**5 067**	**9,14**	19	4,0	4 123	7,4
Insurance Companies	**3**	**0,65**	**10 806**	**19,50**	3	0,6	10 206	18,4
Investment, Trust & Property Companies	**43**	**9,29**	**8 282**	**14,95**	51	10,6	6 722	12,1
Pension Funds	**3**	**0,65**	**3 615**	**6,52**	5	1,0	3 927	7,1
Other Corporate	**47**	**10,15**	**15 157**	**27,35**	52	10,9	19 964	36,0
Individuals	**304**	**65,65**	**7 709**	**13,91**	303	63,3	5 875	10,7
	417	**90,06**	**50 636**	**91,37**	433	90,4	50 817	91,7
Non-Resident:								
Other Corporate	**3**	**0,65**	**4 074**	**7,35**	3	0,6	4 074	7,4
Individuals	**43**	**9,29**	**709**	**1,28**	43	9,0	528	0,9
	463	**100,0**	**55 419**	**100,0**	479	100,0	55 419	100,0

MAJOR SHAREHOLDERS

	2001 Shares	**% of Total**	2000 Shares	% of Total
Old Mutual Investment Corporation (Private) Limited	**9 606 174**	**17,3**	9 606 174	17,3
LTA Trading (Private) Limited	**7 703 314**	**13,9**	7 703 314	13,9
Monomatapa Development Company (Private) Limited	**4 978 520**	**9,0**	4 978 520	9,0
Tradecorp (Private) Limited	**4 188 810**	**7,7**	4 833 552	8,7
Alpha Omega Investments (Private) Limited	**3 000 000**	**5,4**	3 000 000	5,4
Radar Holdings Pension Fund	**2 714 562**	**4,9**	2 714 562	4,9
Regent Trust	**2 178 000**	**3,9**	-	-
Roy Turner	**2 099 479**	**3,8**	-	-
Est Bagneaux	**1 896 000**	**3,4**	-	-
Tonly Investments	**1 627 200**	**2,9**	-	-
Plus Nominees (Private) Limited	**-**	**-**	27 689	0,1
Bard Nominees (Private) Limited	**-**	**-**	2 255 629	4,1
	39 992 059	**72,2**	35 119 440	63,4

DIRECTORS' INTERESTS

At 30 June, the Directors held, directly and indirectly, the following ordinary shares in the Company :

	2001 Shares	2000 Shares	**Change**
P W T Chipudhla	**1 200**	1 200	**-**
Z L Rusike	**20 000**	20 000	**-**
C.J.L. Schofield	**15 681 834**	15 681 834	**-**
K R R Schofield	**5 876 816**	4 833 552	**1 043 264**
J R Sly	**209 200**	189 200	**20 000**
B P South	**1 000**	1 000	**-**
	21 790 050	20 726 786	**1 063 264**

There were no changes in any of the above Directors' holdings between the year end and one month before publication of results.

16 September 2002

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

Our ref: ASB responses
Direct line: 01635 677737

Dear Mr McEwan

FRED 24, "THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES. FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES"

We refer to FRED 24, “The effects of changes in foreign exchange rates. Financial reporting in hyperinflationary economies”, issued by the ASB during May 2002 and on which comments were invited by 16 September 2002.

Vodafone Group Plc is listed on Stock Exchanges in London, Frankfurt and New York, with a significant overseas shareholder base. We presently prepare our published accounts using UK GAAP but with a reconciliation to US GAAP for profit and loss and balance sheet items and prepare a combined Annual Report and Accounts & Form 20-F to cover both our UK and US statutory filing obligations. We believe there is a compelling case for international harmonisation of accounting standards and welcome the ASB’s efforts to assist in the convergence process in the run up to 2005.

There are no specific issues that we wish to bring to your attention on FRED 24 and our responses to the detailed questions on which you and the IASB have collectively invited comment are set out in the attached Appendix.

Yours sincerely

R N Barr
Group Financial Controller

APPENDIX: Responses to questions raised in FRED 24

1) **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?**
Agree.

2) **Do you agree with the proposal not to include the IAS 21 provisions on the recycling of certain exchange gains and losses?**
One of the key aims of FRS3 was to reduce the focus on one key measure of performance, such as profit or earnings, and introduced another performance statement, namely the Statement of Total Recognised Gains and Losses (STRGL). Therefore, we agree that it is inappropriate to recycle gains and losses reported in one such statement to another.

However, we feel strongly that the UK should achieve full convergence with IAS and therefore disagree with the proposal to remove the recycling provisions of IAS21, unless agreement is reached in the ASB / IASB joint project on reporting financial performance that 'recycling' be prohibited.

3) **Do you agree with the proposal not to include any transitional arrangements in these UK standards?**
Agree.

IASB responses

4) **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 paras 7-12 on how to determine what is an entity's functional currency?**
Yes. Of particular importance is para 10 which retains management judgement as a deciding factor. In a large international Group with income and cash flows generated in a number of countries, it may not always be possible to determine a dominant currency.

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

6) **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?**
Yes. Unless presentation is provided for convenience purposes in which case a convenience exchange rate should be used.

7) **Do you agree that the allowed alternatives to capitalise certain exchange differences in para 21 of IAS 21 should be removed?**
Whilst we would prefer to see such items dealt with in the profit and loss account, we feel strongly that the UK should fully converge with IAS. We therefore disagree with the removal of para 21 of IAS21.

8) **Do you agree that goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign operation should be treated as assets and liabilities of the foreign operation and translated at the closing rate?**
Yes.

16 September 2002

The Technical Director
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

Our ref: ASB responses
Direct line: 01635 677737

Dear Sir or Madam

FRED 26, "EARNINGS PER SHARE"

We refer to FRED 26, “Earnings per share”, issued by the ASB during May 2002 and on which comments were invited by 16 September 2002.

Vodafone Group Plc is listed on Stock Exchanges in London, Frankfurt and New York, with a significant overseas shareholder base. We presently prepare our published accounts using UK GAAP but with a reconciliation to US GAAP for profit and loss and balance sheet items and prepare a combined Annual Report and Accounts & Form 20-F to cover both our UK and US statutory filing obligations. We believe there is a compelling case for international harmonisation of accounting standards and welcome the ASB’s efforts to assist in the convergence process in the run up to 2005.

In respect of FRED 26, there are two issues which cause us concern and on which we feel the ASB should request the IASB to review before the FRED becomes an IFRS. The two issues in questions concern the reporting of diluted earnings, and the requirement to present an EPS measure using profit or loss from continuing items.

<u>Reporting diluted earnings</u>

The wording in FRS 14 is not helpful in respect of what a company reporting a statutory loss should disclose for diluted earnings per share as there are two paragraphs, numbers 37 and 56, within the standard that are ambiguous and have lead to companies adopting differing interpretations as to the requirements. FRED 26 has not addressed this matter and the scope for confusion remains. Within the FRED, the two related paragraphs are 37 and 43. In a company reporting a statutory loss, the strict interpretation of para 37 will result in the assumption that out of the money options are exercised, since they will result in an increased loss per share. However, this conflicts with para 43 which states that only in the money options can be dilutive. We feel that the way FRED 26 is currently drafted will continue to lead to inconsistent reporting and would welcome extra clarity on this issue within any future standard on earnings per share.

<u>Reporting EPS using profit or loss from continuing items</u>

We believe that the requirement to present an EPS measure based on profit or loss from continuing items is flawed.

As a large multi-national Group, Vodafone undertakes treasury and taxation planning centrally. This makes it virtually impossible to accurately allocate financing and tax charges to individual entities and hence is unable to accurately distinguish between continuing and discontinued earnings. FRS 14 recognised this difficulty and although its recommendation to apportion such charges on a pro-rata basis was basic at best, FRED 26 includes no such guidance. We would prefer to present just one measure of basic EPS, being based on the all-inclusive net profit or loss attributable to shareholders.

Notwithstanding our views expressed above, we have considered the proposals of FRED 26 and are broadly in favour with its requirements. Our responses to the detailed questions on which you and the IASB have collectively invited comment are set out in the attached Appendix.

Yours sincerely

R N Barr
Group Financial Controller

APPENDIX: Responses to questions raised in FRED 26

1) **Do you agree with the proposal to issue a new UK standard on earnings per share to replace FRS14, as soon as the new IAS 33 is approved by the IASB?**
Yes

2) **Do you believe that the ASB should consider any transitional arrangements?**
No.

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

Yes. The reporting of diluted earnings, and the requirement to present an EPS measure using profit or loss from continuing items.

Reporting diluted loss per share. Clarity is required in respect of the diluted EPS calculations, and disclosures to be made by entities reporting a statutory loss. Similar to FRS14, the FRED states that:

"Potential ordinary shares shall be treated as dilutive when, and only when, their conversion to ordinary shares would decrease earnings per share from continuing operations"; (para 37) and

"Options have a dilutive effect only when the average market price…..exceeds the exercise price (i.e. they are in the money)" (para 43).

In a company reporting a statutory loss, the strict interpretation of para 37 will result in the assumption that out of the money options are exercised, since they will result in an increased loss per share. However, this conflicts with para 43 which states that only in the money options can be dilutive.

Reporting EPS using profit or loss from continuing items

We believe that the requirement to present an EPS measure based on profit or loss from continuing items is flawed and would prefer any future standard to require us to present just one measure of basic EPS, being based on the all-inclusive net profit or loss attributable to shareholders. Alternatively, guidance must be provided as to how to allocate items of income and expense that are generated and managed centrally.

As a large multi-national Group, Vodafone undertakes treasury and taxation planning centrally. This makes it virtually impossible to accurately allocate financing and tax charges to individual entities and hence is unable to accurately distinguish between continuing and discontinued earnings. FRS14 recognised this difficulty and although its recommendation to apportion such charges on a pro-rata basis was basic at best, FRED 26 includes no such guidance.

4) **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. However, there should be scope for the issuer to exclude such shares from the calculation and disclose the reasons why. An example as to when this could be used would be if the issuer was liable to pay deferred consideration in either shares or cash but had subsequently committed to the financial markets that it would not undertake any further share-based payments, then it would be fair to exclude such potential shares from the calculation of EPS.

5) Do you agree with the following approach to the year-to-date calculation of diluted EPS?

-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 (i.e. without regard for the diluted earnings per share information reported during the interim periods)
Agree.

-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.
Agree.

-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 satisified) from the beginning of the year-to-date reporting period (or from the date of the contingent share agreement if later).
Agree.

16 September 2002

Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

Our ref: ASB responses
Direct line: 01635 677737

Dear Mr Nailor

FRED 27, "EVENTS AFTER THE BALANCE SHEET DATE"

We refer to FRED 27, "Events after the balance sheet date", issued by the ASB during May 2002 and on which comments were invited by 16 September 2002.

Vodafone Group Plc is listed on Stock Exchanges in London, Frankfurt and New York, with a significant overseas shareholder base. We presently prepare our published accounts using UK GAAP but with a reconciliation to US GAAP for profit and loss and balance sheet items and prepare a combined Annual Report and Accounts & Form 20-F to cover both our UK and US statutory filing obligations. We believe there is a compelling case for international harmonisation of accounting standards and welcome the ASB's efforts to assist in the convergence process in the run up to 2005.

There are no specific issues that we wish to bring to your attention on FRED 27 and our responses to the detailed questions on which you have invited comment are set out in the attached Appendix.

Yours sincerely

R N Barr
Group Financial Controller

<u>APPENDIX: Responses to questions raised in FRED 27</u>

1) **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?**
   Agree.

2) **Do you believe that the ASB should consider any transitional arrangements?**
   No

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

   The exposure draft remains silent on materiality in respect of adjusting events. Whereas non-adjusting events should be disclosed where material, the text of paras 7 and 8 contain no reference to materiality. Previously, SSAP 17, para 22 stated "A material post balance sheet event requires changes in the amounts to be included in financial statements where it is an adjusting event . We believe the IASB should clarify the applicability to material items only.

16 September 2002

Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray’s Inn Road
London
WC1X 8AL

Our ref: ASB responses
Direct line: 01635 677737

Dear Mr Nailor

FRED 29, “PROPERTY, PLANT AND EQUIPMENT. BORROWING COSTS”

We refer to FRED 29, “Property, plant and equipment. Borrowing costs”, issued by the ASB during May 2002 and on which comments were invited by 16 September 2002.

Vodafone Group Plc is listed on Stock Exchanges in London, Frankfurt and New York, with a significant overseas shareholder base. We presently prepare our published accounts using UK GAAP but with a reconciliation to US GAAP for profit and loss and balance sheet items and prepare a combined Annual Report and Accounts & Form 20-F to cover both our UK and US statutory filing obligations. We believe there is a compelling case for international harmonisation of accounting standards and welcome the ASB's efforts to assist in the convergence process in the run up to 2005.

There are no specific issues that we wish to bring to your attention on FRED 29 and our responses to the detailed questions on which you and the IASB have collectively invited comment are set out in the attached Appendix.

Yours faithfully

R N Barr
Group Financial Controller

The ASB would welcome comments, by 16 September 2002, 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 lAS 16, unless it becomes clear that further changes to lAS 16 are likely by 2005 as a result of the revaluation project?
If the standard is to replace FRS15, it should ensure all aspects are covered in the replacement. Therefore, if it becomes clear that the principles surrounding revaluations are to change, then implementation should be delayed.

(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 agree with the requirement to subject residual values to regular review and to amend in the event of an impairment charge, or reversal of previous impairments. However, we disagree with the notion of adjusting residual values for the effect of inflation as we feel this would result in:

- a hybrid cost / revaluation policy being followed; and
- depreciation charges being affected by incidental holding gains.

(iii) lAS 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?
Renewals accounting does not allow a company to avoid recognising a depreciation charge as it is purely a method by which depreciation is measured. Therefore the use of renewals accounting should be addressed in the proposed standard, although it should not apply to UK entities only if the final issued IFRS does not deal with renewals accounting then UK companies should not be permitted to diverge from lAS.

(iv) What are your views on the differences between the requirements of FRS 15 and lAS 16 concerning revaluations (as described in paragraphs 10 to 17 of the Preface to the FRED)?
We disagree with two of the principles in the proposed IFRS. Firstly, we disagree with the requirement under lAS to revalue to fair value, rather than current value i.e. its value in use for the reasons provided in paragraph 13 (principally that value in use reflects the value most relevant to the economic decision making).

Secondly we disagree with lAS 16 not specifying a maximum period between valuations. Although the requirement is to maintain values to ensure they do not materially differ from fair value, this is not as strict a requirement as per FRS1 5 and would not necessarily prevent company's from retaining inappropriate values in the balance sheet. It would also reduce comparability across companies as they respectively take a different view as to what constitutes a material difference in value.

(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.

(vi) Do you agree with the AS B'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 lAS 16 revised pending the outcome of the IASB's projects on insurance and reporting financial performance?
Not applicable to Vodafone.

(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 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?
Although we agree that the rollover of the transitional arrangements is sensible, if it results in a short-term UK / IAS GAAP difference, we would rather the transitional arrangements were not included in a new UK standard as we feel strongly that the UK should converge fully with the requirements of IAS.

(vii) Do you believe that ASB should consider any other transitional arrangements?
No.

(viii) 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.

(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?
Agree that capitalisation of borrowing costs remain optional, supplemented by the disclosure requirements as specified, expanded to require disclosure of the total amount of interest capitalised at the reporting date.

If faced with a choice between prohibition of capitalisation or mandatory capitalisation, we would prefer the former as it is the most prudent and because determining the cost of borrowing in a complex multinational group with a central treasury function is highly subjective.

(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 can see merit in both approaches however, we feel strongly that the UK should fully converge with IAS and therefore do not agree with the proposed deletion of paragraph 5(e).

(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 agree with the approach required under FRS 15. However, in the interests of achieving full convergence with the requirements of IAS, unless there is a change in IAS to align with FRS15, we agree with the alternative approach as set out in the FRED.

(xiii) Do you have any comments on IAS 23 that you wish the ASB to bring to the IASB's attention?
No.

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 paragraphs 21 and 21A of the [draft] FRS on property, plant and equipment)?
Agree.

(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?
Agree.

(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)?

Agree. Depreciation reflects the measure of cost to the business of holding and or using the asset. Even though the asset is no longer in use, it’s value will likely suffer as a result of other factors, such as through obsolescence.

16 September 2002

Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X SAL

Our ref: ASB responses
Direct line: 01635 677737

Dear Mr Nailor

FRED 25, "RELATED PARTY DISCLOSURES"

We refer to FRED 25, "Related party disclosures", issued by the ASB during May 2002 and on which comments were invited by 16 September 2002.

Vodafone Group Plc is listed on Stock Exchanges in London, Frankfurt and New York, with a significant overseas shareholder base. We presently prepare our published accounts using UK GAAP but with a reconciliation to US GAAP for profit and loss and balance sheet items and prepare a combined Annual Report and Accounts & Form 20-F to cover both our UK and US statutory filing obligations. We believe there is a compelling case for international harmonisation of accounting standards and welcome the IASB's efforts to assist in the convergence process in the run up to 2005.

There are no specific issues that we wish to bring to your attention on FRED 25 and our responses to the detailed questions on which you and the IASB have collectively invited comment are set out in the attached Appendix.

Yours sincerely

R N Barr
Group Financial Controller

APPENDIX Responses to questions raised in FRED 25

1) **Do you agree with the proposal to issue a new standard in the UK on related party disclosures, once the new IAS24 is approved by the IASB?**
   Agree.

2) **Do you believe the ASB should consider any transitional arrangements?**
   No.

3) **Do you believe that an accounting standard should require disclosure of the name of the controlling party and, if different, that of the ultimate controlling party?**
   Yes. However, the requirement to provide such information should align with the IAS requirement and not give rise to an IAS / UK difference.

   If the new IAS24 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?
   No. The UK are progressing towards IAS convergence and so generally should not be recommending differences in proposed standards as an intermediate step.

4) **Do you believe that an accounting standard should require disclosure of the names of transacting related parties?**
   Yes. Non-disclosure will only generate questions from analysts, investors and other interested parties and potentially result in adverse comment on the financial statements as these groups arrive at differing conclusions as to the identity of the related party and purpose of the transaction. Furthermore, as a current requirement of FRS8, these groups are used to receiving such information.

5) **Should the definition of related parties specifically refer to shadow directors? Should it also refer to persons acting in concert?**
   Yes to both. However, these are both terms used in the Companies Act which may not be as widely used and understood in other jurisdictions. Therefore we recommend that definitions have regards to the substance of such relationships.

6) **Do you believe that an accounting standard should specify that disclosure is required of *material* related party transactions and give more guidance on materiality in the context of such transactions?**
   Yes.

7) **Are there any other aspects of the draft standard that the ASB should request the IASB to review when finalising the revised IAS24?**
   No.

IASB responses

1) **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?**
   Agree where other more detailed requirements exist, for example listing rules or Companies Act. If such disclosure is not required then the standard should require disclosure of management compensation in financial statements. However, such disclosure should be an aggregate of total compensation, rather than per individual.

(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')

2) **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?**
   Yes.

Dear Sir

The attached file contains the comments of the Co-operative Accounting Standards Committee (CASC), who are responsible for the recommendations of best practice for accounting and financial reporting standards, as a committee of the Co-operative Union Limited. The Co-operative Union is a trade association which represents the Co-operative Consumer Movement and also a large portion of the worker co-operatives in the UK.

(See attached file: FRED28 NP.doc)

Yours faithfully
Phil Holmes FCCA

Secretary - Co-operative Accounting Standards Committee

Exposure draft: Improvements to International Accounting Standards

The key changes proposed by the International Accounting Board's Improvements Project were highlighted in KPMG's paper to the CASC on 10 July.

This paper addresses the questions included within the exposure draft.

IAS 1 - Presentation of financial statements

Question 1

We generally agree with the proposal but with some reservations. The true and fair override should operate where compliance with International Financial Reporting Standards would not present a fair presentation of the results. The true and fair override should not be conditioned upon the regulatory environment of each country and therefore alternative treatments should not be permitted.

The revised wording should acknowledge the sentiment of the original standard that the true and fair override should only be used in the circumstances where the application of a standard will be misleading and clearly inappropriate. The proposed revised wording may encourage more frequent use of the override provisions.

The previous standard also contained the wording " . . inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used or by explanatory notes to the accounts. This wording also discouraged inappropriate use of the true and fair override.

Question 2

Yes, We agree. The presentation of income and expenses as extraordinary items should be prohibited. Further consideration should also be given to limiting the discretion given to presenting items as exceptional or unusual as this can broaden the practice to present items as arising from outside the ordinary activities of an entity.

Question 3

Yes, We agree. Refinancing or rescheduling payments after the year is a non-adjusting post balance sheet event. All assets and liabilities should be stated as at the balance sheet date unless they are subject to adjusting post balance sheet events.

However a disclosure in note form of any significant post balance sheet events should be made.

Question 4 (a)

Yes, We agree. See answer to question 3.

Question 4 (b)

As stated in the answer to question 3, the liability should be stated at the balance sheet date, unless an adjusting post balance sheet event occurs.

However, IAS 10 (Events After the Balance Sheet Date) could be amended to include rectification of breaches of loan agreement conditions within the period of grace (which is before the financial statement are approved) as an adjusting post balance sheet event. Rectification of Loan breaches as described in this scenario could be an acceptable post balance sheet event as this event provides '....additional evidence to conditions existing at the balance sheet date...'. This would avoid creating confusion about what is and is not an adjusting event under IAS 10.

The reader's key concern regarding loans at year end is to understand whether any events have occurred to change the repayment terms (from a long-term liability to a current liability). If breaches to the conditions of the loan have been corrected before the financial statements have been approved, it would be incorrect to state this loan as a current liability as it will not be repayable within 12 months of the balance sheet date, because the conditions of the loan continue to be satisfied.

Question 5

No, We do not agree. The usefulness of such information may be questionable and limited. The requirement to provide information on the judgements made by management in applying accounting policies could lead to non-specific, standard and meaningless disclosures.

However, it would be useful to know where and bow key judgements and estimates have been made. Disclosure should be encourage for significant balances which would aid the reader of the financial statement's understanding.

Question 6

Yes, We agree. Key assumptions about the future and sources of measurement uncertainty would be useful to the reader of the financial statements.

It would be particularly useful to specify what is expected in the disclosure rather than what should be included (avoid being over prescriptive). Examples of the required disclosure would be helpful.

IAS 2 - Inventories

Question 1

Yes. We generally agree, particularly as tax regimes of certain counties, for example UK do not permit the use of LIFO for tax purposes and the elimination of options in accounting standards improves comparability.

However, there are certain circumstances where the LIFO basis gives a better profit and loss measurement eg. where there is requirement to match current costs with current revenues so that the profit and loss excludes the effects of holding gains.

The impact of the LIFO convention is also understood clearly and disclosures are required to highlight the impact of using the LWO basis compared with the F1FO basis. This allows comparability between the LW 0 and FIFO bases.

In conclusion, whilst it is preferable to remove the LIFO option, there are benefits of retaining the current arrangements.

Question 2

Yes, We agree. If the circumstances of the original write-down no longer exist, the write down should be reversed. This would be consistent with the objective that stock should be stated at the lower of cost and net realisation value.

The write-down should be shown in the profit and loss account as it is appropriate to assume at the time of the write down, that the write down will not be reversible and therefore is a permanent loss.

IAS 8 **-** Accounting policies, changes in accounting estimates and errors

Question 1

Voluntary changes in accounting policies

Yes. We agree. Treatment of voluntary changes in accounting policies should be treated retrospectively as if the accounting policy had always been in place. This would aid comparability.

However, it should be emphasised that voluntary change in accounting policies should only be made where the change will result in a fairer presentation of the results (rather than changing accounting policies to show more favourable results).

Correction of errors

Yes , We agree. Again adjusting the previous year's results for errors would aid comparability. This is in preference to amending prior periods by a cumulative effect by adjusting opening retained earnings.

However, the an amendment of errors as a restatement of financial statements via opening retained earnings does have negative connotations. If errors are to be treated retrospectively we may see more restatements, as this will not be seen as being unusual and having the same negative implication to the financial statements. This may be addressed by way of additional disclosure of the current year's results recognising the full impact of the error.

There may also be instances where expenses are 'deliberately' missed from the profit and loss account to show better results, and then adjusted in the following year as an error. In this case these expenses would never to be shown in the current year's results.

Question 2

Yes, We agree. However, a distinction should be drawn between correction of an error and revision of estimates. It should also be emphasised that correction of an error is necessary only when previous financial statements have been misstated materially.

IAS 16 - Property, plant and equipment

Question 1 and2

No, We do not agree. Recognition of property, plant and equipment at fair value involves recognition of gains and losses (in addition to impairment losses). The issues regarding gain recognition for non-monetary transactions should be dealt with in conjunction with the Board's new project on Revenue Recognition and should cover bartét transactions. Until the Revenue Recognition project is complete, the current position for exchange of assets should be maintained to avoid potentially multiple changes to major cIASses of assets.

Question 3

If an asset is permanently removed from active use it should be measured at the lower of cost and net realisable value. The asset should be subject to impairment tests at the time it ceases to be employed in the business. Depreciation is defined as "the systematic allocation of an asset over its usual life". The useful life is the period of use. Where an asset is temporarily idle, depreciation should cease for that period, but the life of the asset should be revised to recognise the longer period over which the asset should be depreciated.

IAS 17— Leases

Question 1

No, We do not agree. Splitting leases between land and buildings would be difficult. The land element in particular would be difficult to value fairly on a separate basis. This information may not be readily available

The risks and benefits of the land lease should be identical to the building and therefore the land and buildings should be treated as one asset.

Question 2

Yes, We agree. This would aid comparability.

IAS 21 — The effect of changes in exchange rates

Question 1

Yes, We agree with the definition of functional currency.

Question 2

Yes, We agree the reporting entity should be able to report its results in any currency that it choses. Financial statements may need to be presented in a different currency from the parent for a number of reasons, for example

- There may be different users (local tax authority, fmancial lenders etc)
- The parent may be small and be located in country where the currency is not used internationally

However, disclosure of the reasons that a currency has been selected should be given if the currency of the parent has not been used.

Question 3

Yes, We agree The proposal could improve comparability and reliability of financial statements amongst entities.

Question 4

Yes, We agree with the proposal. Again, the elimination of options will improve comparability.

Question 5

Yes, We agree. Goodwill is generated as a result of the acquisition of a company and therefore relates to the acquired entity. The same reason applies to fair values.

IAS 24 - Related party disclosure

Question 1

No, We do not agree. There should be full transparency of compensation payments made to all key management (directors and employees have received compensation payments of say more than £50,000).

To avoid breanches of national privacy laws, compensation payments could be aggregated.

Compensation payments to directors are covered by corporate governance requirements in many countries, but disclosure requirements are inconsistent. Until this inconsistency is eliminated, related party disclosure of compensation payments should remain.

Question 2

No, We do not agree. Information about related party transactions and outstanding balances of the parent and the subsidiary's own financial statements is required to understand the financial position of an entity and therefore this disclosure requirement should be maintained for both the profit and loss account and the balance sheet.

IAS 27 - Consolidation and separate financial statements

Question 1

Yes, We agree, if the all the criteria are satisfied, consolidated financial statements should not be prepared.

Question 2

Yes, We agree. The minority interests represents the remaining interest in net assets of a subsidiary within a group and meets the definition of equity. Therefore the minority interest should be shown as part of equity.

Question 3

Investments in subsidiaries should be at cost in an entity's own financial statements rather than permitting measurement as fair value under IAS 39. The elimination of options in accounting standards assists comparability.

If the focus of a separate company financial statements is on the legal entity alone, measurement at cost is more consistent with that focus, rather than mixing in valuation adjustments relating to other entities.

IAS 28 - Accounting for Investments in Associates

Question 1

Yes, We agree. For venture capital organisations, mutual funds etc IAS 28 and IAS 31 should not apply to investments that would otherwise be associates or joint ventures, if these investments are measured at fair value in accordance with IAS 39. The fair value measurement will provide the most relevant information when the asset is held for investment purposes rather than for use in the business.

Where the fair value basis is being used for valuation of associates and joint ventures, all investments should be valued on this basis rather than a mix of fair value or cost.

Question 2

We do no agree fully. Where a long-term receivable, in substance forms part of an entity's investment in associate, it should be measured in the same way as other elements of the investment.

However, where long term receivables have special conditions associated with repayment, therefore making the recovery of balance likely, it would be inappropriate to write down the receivable in line with the investment. This is particularly the case where collateral is in place to support the recovery of the balance due.

IAS 33 - Earnings per share

Question 1

Yes, We agree. The proposal is consistent with the definition of dilution.

Question 2

The proposed approach would achieve convergence with US GAAP. However the following points require some consideration.

a) The frequency of interim reporting may impact EPS

b) Issuable shares should only be taken into account from the time the conditions have been met or contingent events have occurred. This requires emphasis in the standard.

CO-OPERATWE ACCOUNTING STANDARDS COMMITTEE (CASC)

13th September 2002

FRED 25 RELATED PARTY DISCLOSURES

Question ASB (i)

We agree with the proposal to issue a new standard in the UK on related party disclosures once the new ISA24 is approved by the IASB. This is provided that the two standards should be consistent such that when preparers of the accounts in the UK have to comply with international accounting standards in 2005 there is no need for any further change in published accounts.

Question ASB (ii)

We do not believe there is any need for any transitional arrangements.

Question ASB (iii)

We agree that the disclosure of the name of a controlling party and, if different, that of the ultimate controlling party is appropriate.

Question ASB (iv)

We do not believe that the standard should generally require disclosure of the names of transacting parties. In the majority of circumstances, it is not the specific parties themselves which are important in respect of the impact on the business; it is the nature of the relationship with those parties that is important. The disclosure requirements of paragraph 14 should be adequate.

Question ASB (v)

Shadow directors and persons acting in concert can have precisely the same impact as other related parties. For this reason they should be included in the definition of related parties.

Question ASB (vi)

The consideration of materiality in FRS8 is somewhat unusual in that it refers not only to materiality in relation to a set of financial statements but also in relation to the other related party. There is no reference to materiality in Fred 25.

We consider that more guidance on materiality should be included within Fred 25. My view is that the disclosure of related party transactions should relate to those transactions that are material to the entity. If they are not material to the entity they are unlikely to influence significantly any decisions made by the users of the financial statements.

There are, however, other possible interpretations. If transactions are on completely normal terms they might not have a significant impact on the financial statements in the year in which the transaction is reported. It could, therefore, be considered that they do not require disclosure. However, similar transactions might take place in future years but on different terms. Those different terms might impact significantly on the profitability of the entity. Disclosure of the nature and scale of all related party transactions would warn a user of the accounts of this potential risk.

Question ASB (vii)

The requirement to disclose all related transactions other except where an entity is a wholly subsidiary is unnecessarily onerous. The exemption in FRS8 for subsidiaries that are 90% owned appears quite reasonable.

FRED 25 RELATED PARTY DISCLOSURES

IASB Questions

We agree with both of the IASB questions.

CO-OPERATIVE ACCOUNTING STANDARDS COMMITTEE (CASC)

13th September 2002

FRED 27
EVENTS AFTER THE BALANCE SHEET DATE

Question ASB (1)
In principle We agree with the proposal to issue a new UK standard on events after the balance sheet date, once the new IAS 10 is approved and once the law the amended to permit its application. However, a new UK standard should not be issued if its requirements are different than the new IIAS 10 such that companies will be required to make a change on the implementation of the UK standard and a further change in 2005 when international accounting standards apply.

Question ASB (ii)
We do not believe that transitional arrangements are necessary.

Question ASS (iii)
We concur with the draft standard. There are no aspects that the ASB should request the ISAB to review when finalising the revised IAS 10.

CO-OPERATIVE ACCOUNTING STANDARDS COMMITTEE (CASC)

13th September 2002

FRED 29- PROPERTY, PLANT AND EQUIPMENT. BORROWING COSTS

Question ASB (i)
It is not appropriate for two new standards replacing the current FRS15 to be issued prior to 2005. This would create unnecessary work for the preparers of accounts and unnecessary difficulty for the readers of accounts. It therefore follows that a new standard should only be issued if it is fully in accordance with the expected international accounting standards that will be in existence in 2005. Therefore any UK standard on property, plant and equipment and borrowing costs should not be issued if there are any unresolved differences between that standard and IAS 16. If it is likely that IAS 16 will be changed by 2005, We do not believe it is worthwhile amending FRS 15 until such time. However concerns over the current IAS should be collated for incorporation into any future revision.

Question ASB (ii)
We disagree with the proposed international approach to residual values. It appears technically inconsistent to include what is, essentially, an element of re-evaluation in the residual value when the original cost is historic cost.

In extreme cases the use of the current estimate might lead to no depreciation charge on an asset. This would appear to be inconsistent with the principles of the consumption of benefits arising from the asset.

Question ASB (iii)
The fact that the ASB have asked respondents whether or not they believe that the FRED would permit renewals accounting indicates that the answer is not clear. This is an inadequate position regardless of the responses received because it leaves open the possibility that some preparers of accounts will treat renewals accounting as acceptable under the FRED whereas others will not.

Unfortunately We have little knowledge of businesses where this might be relevant and am unable to comment on the practice.

Question ASB (iv)
We concur with the approach set out in FRS15 with regard to the revaluation of properties to existing use values rather than fair values. Two examples illustrate why the IAS approach is inappropriate:

1. The revaluation of assets to open market value can lead to unnecessary or unfortunate results. It might, for example, require the write down of a property which, although not specialised, has being refurbished to a standard higher than other potential users would require. This could be a deliberate policy by the owner of a property in order to distinguish its properties (such as retail outlets) from competitors. It would be inappropriate to require the write down of such properties to open market value if the owner had no intention of selling.

2. Similarly, but conversely, although the open market value might be higher than the existing use value it would be inappropriate to revalue the property upwards when there is no intention for the property to be sold. Depreciation would be required on the higher amount and this would effectively result in a depreciation charge based on opportunity costs.

FRED 29- PROPERTY, PLANT AND EQUIPMENT. BORROWING COSTS

The detailed requirements for valuations set out in FRS 15 are useful and help increase consistency between different sets of accounts. Not including these guideline increases the risk of revaluations falling into some disrepute.

Question ASB (v)

The treatment of write downs on revalued assets set out on FRS 15 is difficult to understand. In particular it results in write downs of fixed assets appearing in different parts of the accounts even though it may be very difficult to identify the different circumstances applicable. Indeed, it is possible for one set of accounts to write down one asset partly in one place and partly in another. The treatment proposed by IAS 16 is much more straight forward and much more readily understandable to users of the accounts. We consider this treatment much preferable.

Question ASB (vi)

The recognition of revaluation gains and losses in the profit and loss account of insurance companies is wholly appropriate since the gain is part of the day to day operations. It should, therefore, be retained.

Question ASB (vii)

We do not consider that the transitional arrangements for the first time application of FRS15 should be included in a new standard because it has no technical justification. It had no technical justification in FRS15..

Question ASB (Viii)

We do not believe that the ASB should consider any other transitional arrangements.

Question ASB (ix)

There are no other aspects Qf the draft standard that the ASB should request the IASB to review.

Question ASB (x)

Since there is no international agreement on the capitalisation of borrowing costs, We concur that it should, at this stage, remain optional.

If the optional requirement is not a possibility We believe that capitalisation should be mandatory. This is because interest costs are a cost of constructing assets. If an asset is purchased by a reporting entity, interest costs, would, effectively, be included in the purchase price. Capitalising interest costs on assets constructed by the reporting entity would allow a fairer comparison with companies who purchase such assets.

Question ASB (xi)

Where foreign currency borrowings are used specifically to fund a project, exchange differences arising on those borrowing should be capitalised. This is because the exchange difference is a cost that can be directly attributed to the cost of the project in the same way as the interest cost can be directly attributed.

Question ASB (xii)

We concur with the treatment of borrowing costs for captilisation set out in IAS23 Where a loan is obtained specifically to fund a project it will rarely be possible to thaw down the loan at exactly the time the expenditure is incurred on the project. Therefore the costs of acquiring funds to fund the project is equal to the total interest charge on the loan raised less the interest received on any surplus funds invested.

Question ASB (xiii)

We have no comments on IAS23 that We wish the ASB to bring to the IASB's attention.

IASB questions

We agree with all the IASB questions.

CO-OPERATIVE ACCOUNTING STANDARDS COMMITTEE (CASC) 13th September 2002

FRED 28 – INVENTORIES. CONSTUCTION AND SERVICE CONTRACTS

General Comments

The changes in accounting for inventories proposed by FRED 28 appear relatively limited.

The changes in accounting for construction and service contracts are more significant in that they require recognition of revenue and costs from the date work begins on contract rather than when the results of a contract can be reasonably determined. This will more closely reflect the work performed as revenue in the period in which it is performed. The adverse consequence is that the early periods are profitable contract will show no margin whereas the later periods will show a very high margin. Where there are a large number of contracts, one would expect the margins to average out because the contracts will be at different stages. Overall, therefore, We concur with the approach of the draft standard.

Question ASB (i)

It is not appropriate for two new standards replacing the current SSAP 9 to be issued prior to 2005. This would create unnecessary work for the preparers of accounts and unnecessary difficulty for the readers of accounts. It therefore follows that a new standard should only be issued if it is fully in accordance with the expected international accounting standards that will be in existence in 2005. Therefore any UK standard on inventories, construction and service contracts should not be issued if there are any unresolved differences between that standard and IASs.

Question ASB (ii)

We agree with the proposal to incorporate ISA18 in the standard on construction contracts, so that it may also apply to other contracts or services.

Question ASB(iii)

We do not believe any transitional arrangements are required.

Question ASB (iv)

We disagree with disclosure requirements set out in paragraph 34(c), 34(d) and 35(d). The disclosure of the amount of any write down or the amount of any reversal of a write down would not add any value to the accounts unless it was on such materiality or so unusual in nature that the information was required to provide a true and fair view. In such circumstances this information would need to be disclosed anyway. If the information was not so significant its disclosure would simply add unnecessary information to the accounts.

Question ASB (v)

Paragraph 21 refers to costs which are incurred in securing contracts. This paragraph appears less rigid than UITF34. UITF 34 requires that costs must be recognised as an expense up to the point at which the contract is virtually certain to be awarded. The implication of paragraph 21 of the FRED is that costs can be recognised at an earlier date (ie. when it is probable that the contract will obtained) and that any costs incurred in the accounting period in which the contract is awarded (including those costs incurred before it was probable that the contract would be obtained) may be treated as construction costs. Having only just issued the UITF 34 it is strange that the ASB appears to be changing its opinion of this matter.

Question IASB (i)

We agree with the elimination of the last in first out method for determining the cost of inventories.

Question IASB (ii)

We agree with the requirements of paragraphs 30 and 31 that write down should reversed when the circumstances that caused inventories to be written down below costs no longer exist and that the reversal should be recognised in the profit and loss account.

Inventories of agricultural and forest products and minerals

We consider it inappropriate that the standard does not cover agricultural and forest products and minerals. The standard does not make it clear whether or not agricultural products prior to harvesting should be valued in accordance with the standard. It is also simply inappropriate that there is no standard for the valuation of such products and the reference in paragraph 1(c) to "well established practices in certain entities" is too vague. There have been many well established practices for accounting for many items that have been criticised in the past. The lack of clarity leaves the standard open to abuse.

CO-OPERATIVE ACCOUNTING STANDARDS COMMITTEE (CASC)

13th September 2002

Smith & Williamson response - Financial Instruments: The Effects of Changes in Foreign Exchange Rates; Financial Reporting in Hyperinflationary Economies (FRED 24)

The following sets out our responses to the questions raised by the ASB and IASB

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?*

Whilst we fully endorse the ASB's approach to convergence, we would refer you to our response to FRED 23. Our concern relates entirely to the effect that replacement of SSAP 21 has on the loss of guidance with respect to hedge accounting and the resultant proposed standard based on FRED 23. Our view is that this guidance should be subsumed into a standard based on FRED 30 and, therefore, the implementation of standards based on FRED 24 should be delayed to coincide with standards based on FRED 30.

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

We agree that the proposal on recycling of gains and losses should be excluded from the UK standard. We are surprised that the IASB has continued to include this proposal in the revision to IAS 21 given comments made by them on recycling in the development of other standards.

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

We do not consider that there are any necessary transitional arrangements.

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 21:

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 consider that this is sufficient guidance to enable reporting entities to determine functional currency.

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?*

One of the principle aims of the convergence of accounting standards is to create greater comparability between accounts on a global basis. We question, however, whether this is achieved by permitting the use of any currency and would suggest that some restriction be placed upon the currencies in which an entity may prepare its accounts. Restrictions based on the following criteria would appear to be more appropriate.

- Country of incorporation, or
- Functional currency, or
- Currency of the country in which the parent or ultimate parent is incorporated and prepares its accounts.

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)?*

We are in agreement with this approach.

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

We agree with this as it is consistent with the general principles with respect to the recognition of assets and liabilities.

IASB (v) *Do you agree that*

(a) goodwill and
(b) fair value adjustments to assets and liabilities

that arise on 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)?

We agree with this approach in that it produces consistency of accounting treatment.

Smith & Williamson response - Earnings per share (FRED 26)

The following sets out our responses to the questions raised by the ASB and IASB

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?*

We fully support the move towards the international harmonisation of accounting standards and the ASB's intention to 'endorse' new IFRS by issuing revised UK standards at the same time. As the proposals represent only minor amendments to the existing standard, we see no reason for not replacing FRS 14 as soon as the new IAS 33 is approved.

ASB (ii) *Do you believe that ASB should consider any other transitional arrangements?*
No

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?*

No

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?*

This treatment is consistent with requirements elsewhere in existing UK standards, most notably FRS 7 which requires contingent consideration which can be satisfied either by shares or by cash to be accounted for on the basis that the shares will be issued. The approach proposed is therefore appropriate both from the viewpoint of consistency and being one which takes proper account of all potentially dilutive shares.

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)?

- *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 consider that this approach results in both consistency and the most representative figure for diluted earnings per share at the end of each interim period

Smith & Williamson response - Related parties (FRED 25)

The following sets out our responses to the questions raised by the ASB and IASB

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?*

We fully endorse the ASB's work towards convergence. For the reasons discussed below we do have concerns about the possible dilution of existing requirements with respect to the disclosure of related parties.

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

We do not consider that there is any need for transitional provisions.

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 con trolling 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]3B of the [draft] FRS?*

The identity of the controlling party is important information for the users of financial statements and should continue to be included in any accounting standard. Were the new IAS 24 not to require such disclosure, our view is that the UK should continue to include this within the revised FRS.

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

The omission of the requirement to disclose the names of transacting parties will result in a serious dilution of existing UK standards. The international requirement to make disclose by nature of relationship will not, in our opinion, result in information which will be readily understandable to the readers of the accounts. The current 'post- Enron' environment is not the time to potentially weaken disclosure in such an important area. The use of names provides far more clarity.

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

We presume that the omission of shadow directors from the IAS is as a result of this being a term specific to UK legislation. It could be argued that such relationships will be picked up through the fairly wide definition of 'key management'. The most appropriate treatment might, therefore, be for the FRS to include specific reference to shadow directors within the definition.

Persons acting in concert should be added to the definition of related parties.

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 materiality in the context of such transactions?*

The failure to include any reference to materiality could result in excessive disclosure which can result in a loss of value of that disclosure. The standard should therefore only require disclosure of material related party transactions.

Whilst it would be helpful to include guidance on materiality, we do not necessarily think that this should be at the same level as within FRS 8. In particular FRS 8 requires disclosure of transactions which are material to *either* party. Whilst we appreciate the reasoning behind this particular requirement, there is a risk that the inclusion of apparently very small transactions dilutes the perceived value of the disclosure.

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?*

No.

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'.

For UK companies this would have little impact as there is existing disclosure requirements both within legislation and the Listing Rules. There are, however, issues for international comparability going forward. However, we believe that this area is more appropriately addressed through general considerations Of Corporate Governance disclosure.

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)?*

We agree and do not think that disclosure of such transactions would add any value to financial statements.

Smith & Williamson response - Events after the balance sheet date (FRED 27)

The following sets out our responses to the questions raised by the ASB and IASB

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?*

We fully support the move towards the international harmonisation of accounting standards and the ASB's intention to 'endorse' new IFRS by issuing revised UK standards at the same time.

The only significant change proposed between FRED 27 and SSAP 17 is that relating to the treatment of dividends proposed after the end of the year. We are in agreement with the proposed change not least because it will introduce greater consistency between the accounting treatment in the UK and that already adopted by a number of other countries.

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

No.

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

No.

Smith & Williamson response - Property, plant and equipment; Borrowing costs (FRED **29)**

The following sets out our responses to the questions raised by the ASB and IASB

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 £45 16, unless it becomes clear that further changes to IAS 16 are likely by 2005 as a result of the revaluation project?*

We endorse the ASB's approach to convergence and agree in principle with the adoption of the two IAS covered by FRED 29. We also welcome the fact that the ASB have indicated they will not adopt them should it appear that further changes are likely to happen. We comment below on the proposals with respect to valuation.

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 do not think that it is appropriate to review residual balances based on current estimates. Accounting principles do not generally take account of inflation therefore adopting this approach introduces inconsistencies into the reporting of financial performance.

ASB (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?*

We have no experience of the use of renewals accounting and do not therefore feel able to comment on this point.

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 of the Preface to the FRED)?*

Basis of valuation - Our view is that the ‘value in use’ model of FRS 15 is preferable to the ‘fair value’ model of the IAS. The financial statements of an entity should reflect the circumstances of that entity as they are at the balance sheet date. To include assets at fair value is not compatible with this concept as it takes account of possible events in the future and for many entities events that are unlikely to ever happen in practice.

Frequency of valuations - We prefer the approach of the IAS requiring valuations to be carried out as frequently as necessary to maintain valuations close to carrying value. The five year and three year intervals required by FRS 15 are overly prescriptive and potentially unnecessarily burdensome to some reporting entities.

We do not consider that the valuer need be external to the reporting entity, but do agree that they should have a suitable qualification. Where the valuer is a director or shareholder this fact should be clearly disclosed.

The absence of guidance on the method of valuation is an omission, presumably because there is no international equivalent of the RICS guidelines. Such guidance should be included within the standard to ensure consistency of valuation methods.

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?*

No.

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 IASB 's projects on insurance and reporting financial performance?*

We support this proposal as we believe that the progress to convergence should be made as simple as possible for companies and this would avoid the risk of introducing two standards in a short period of time.

ASB (viii) *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 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?*

We consider that this would be an appropriate approach.

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

We cannot i4entify any other transitional provisions that we consider would be appropriate.

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?*

No.

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?*

In general we are not in favour of optional treatments in accounting standards. However, we also accept that in the case of borrowing costs there are certain sectors (for example property) where significant borrowing costs are directly incurred in producing an asset and are an integral part of the cost of the asset. However, to have a requirement that all borrowing costs should be capitalised would be overly burdensome on entities in other sectors. An optional approach is, therefore, appropriate in this case.

Were we to have to choose between mandatory capitalisation or prohibition we would favour mandatory capitalisation. The reason for this being that it would result in a fairer reflection of the true cost of an asset. In addition, the alternative of expensing all borrowing costs directly to the profit and loss would penalise those entities who develop their own assets rather than buying them from third parties where the 'full cost' of the asset, will be included in the purchase price.

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 agree with this proposal as we do not consider that these are appropriate costs to be capitalised.

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 consider that the approach of FRS 15 is the more correct as it includes the true cost of producing the asset. Given that interest rates on borrowings are higher than on deposits, the approach of the IAS could result in higher amounts being capitalised than under FRS *15.*

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

No.

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

This appears to be a reasonable basis for recording such assets. Further guidance on the determination of fair value should however be included.

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?*

Whilst this appears reasonable, we again consider that there should be guidance on the determination of fair values.

IASB (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)?*

We do not agree with this approach. The more appropriate approach would be to determine whether there has been any impairment in the asset, charge the impairment to the profit and loss account and cease depreciation.

DISCLOSURE SOLUTIONS LIMITED
44 Crouch Hall Road, London, N8 8HJ
Telephone 020 8374 2175

The Technical Director,
ACCOUNTING STANDARDS BOARD,
Holborn Hall,
100 Gray's Inn Road
LONDON
WC1X 8AL

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.

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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,

Disclosure Solutions Limited

DISCLOSURE SOLUTIONS LIMITED

44 Crouch Hall Road, London, N8 8HJ

Telephone 020 8374 2175

Hans Nailor,
ACCOUNTING STANDARDS BOARD,
Holborn Hall,
100 Gray's Inn Road
LONDON
WC1X 8AL

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

FRED 25 Related Party Disclosures

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?**
Yes we agree with the proposal.

ASB (ii) **Do you believe that the ASB should consider any transitional arrangements?**
No.

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 believe that the standard should require disclosure of the name of the controlling party and, if different, the name of the ultimate controlling party.

While we support the disclosure of controlling party information, absent any change to the proposed *IAS* 24, the new UK standard should not require this disclosure.

ASB (iv) **Do you believe that an accounting standard should require disclosure of the names of transacting related parties?**
We believe that the disclosure of the names of transacting related parties is not necessary for transactions entered into in the normal course of the business.

Guidance from current listing rules disclosure requirements may be appropriate in determining what level, if any, of related party transactions require the listing of names.

ASB (v) **Should the definition of related parties specifically refer to shadow directors? Should it also refer to persons acting in concert?**
No, we believe that the definition of related parties in the proposed IFRS covers shadow directors and persons acting in concert.

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 materiality in the context of such transactions?**
Materiality is a very difficult matter for the preparer of accounts to come to terms with in the absence of guidance. Yet guidance, if too specific in this standard may not achieve the aim of actually helping preparers of accounts.

Therefore we believe that guidance on materiality would be helpful but would caution against it being too specific.

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?**

Yes - paragraph 3 on page 16 requires clarification. We are unclear as to what is meant by "separate financial statements of a parent or a wholly owned subsidiary that <u>are made available or published</u> with consolidated financial statements". In Ireland, the only time financial statements of non-public companies are made available is when they are filed in the Companies Office which is often well after the date when the consolidated financial statements are published. In addition, filing of financial statements in the Companies Office is not required if the parent (or ultimate parent) guarantees the liabilities of the subsidiary and the parent's (or ultimate parent's) consolidated financial statements are filed in place of the subsidiary's financial statements. This route is taken by many groups. The requirements of paragraph 3 would seem to change the existing practice set out in FRS 8 by requiring the disclosure of related party transactions in the accounts of many subsidiary company financial statements. We believe that the current exemptions set out in FRS 8 are reasonable and should be retained.

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'.**

Yes

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)?**

Yes. See answer to ASB (vii) above.

FRED 27 Events after the balance sheet date

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 IASS and once the law is amended to permit its application?**

We agree with the proposal to issue a new UK standards on events after the balance sheet date once IAS 10 is approved by the IASB and once the law is amended to permit its application.

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

No.

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

We believe that the IASB should review the proposal not to recognise proposed dividends and dividends declared after the balance sheet date in the financial statements. We believe that if dividends are habitually proposed by the directors and accepted by the shareholders, a constructive liability to pay such dividends exists at the balance sheet date and that such a liability should be reflected in the financial statements.

We believe that paragraph 13 et seq on going concern should be left in place. As the ASB does not disagree with the paragraph on going concern, we believe that the omission of the paragraph on the grounds that it is contained elsewhere in ASB standards serves no purpose and introduces an unnecessary difference between the proposed IAS and the proposed IFRS.

FRED 24 The Effects of Changes in Foreign Exchange Rates
Financial Reporting in Hyperinflationary Economies

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?

Yes

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

Yes we agree with this proposal.

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

Yes

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?

Yes

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?

Yes

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)?

Yes

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

Yes

IASB (v) Do you agree that

(a) goodwill and
(b) fair value adjustments to assets and liabilities

that arise on 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)?

(a) In relation to goodwill on acquisitions we believe that goodwill should not be retranslated annually. Our view is that goodwill should be translated at the time of the transaction into the functional currency of the operation and remain at that fixed amount from then on. As it is subject to annual impairment review, its carrying value can be adjusted when appropriate.

(b) We support the treatment of fair value adjustments as foreign currency items.

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*Linking Irish accountants
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Mr Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

04 September 2002

Dear Mr Nailor,

Attached please find our responses to FRED *25* "Related Party Disclosures".

Dear Mr. Naylor

We are writing in response to the invitation to comment on FRED25 "Related party disclosures". We have long advocated the harmonisation of Irish/UK accounting standards with their international equivalent and therefore in general welcome the proposals in this exposure draft. As well as our responses to the specific questions asked we would also make the following comments:

- In our experience FRS8 has proved a problematic standard to fully understand in practise. While the new FRED is adequate, we feel an appendix should be included with examples of various scenarios. This will prove helpful for a fuller understanding of the various issues involved. The Institute is quite happy to provide such examples of frequently asked questions and solutions received by our technical department from our membership.

- We note that throughout the FRED it speaks of UK only and would request for future FREDs issued, that they refer to both the UK and Ireland.

- The extension of the definition of key managers as definite related parties may cause difficulty in practise. Under FRS8 key managers were presumed to be related but this could be rebutted. In our opinion it may be necessary to give more guidance who constitutes a key manager.

9 Ely Place, Dublin 2. Tel + 353 1 676 7353 Fax + 353 1 661 2367 email cpa@cpaireland.ie
Chief Executive: Eamonn Siggins web: www.cpaireland.ie

- In practise, the inclusion of a “domestic partner” within the definition of a related partner may be difficult to define in practise and more guidance should be given in this area.

Yours sincerely,

Mark Butler CPA
Secretary
Financial Reporting Sub-Committee

FRED *25*

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

We are fully supportive of the proposal to issue a new standard in Ireland on related party disclosures in the interests of international convergence and harmonisation.

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

The committee sees no reason for an extended implementation period or for any special transitional arrangements.

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? Of the new IAS 24 does not require disclosures, so you believe that a new UK standard should require this disclosure as set our in paragraphs 13a and 13b of the [draft] FRS?***

In general we do not consider that there should be issues of divergence between LAS and Irish/UK standards. However, we do feel that the disclosure of the controlling party is valuable to readers of the Financial Statements for their understanding of the status of the entity.

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

We feel that the disclosure of the names of transacting related parties is not necessary and in general feel that the scope of the definition of related parties is increased under the standard. This extra disclosure burden is somewhat lessened by the fact that under the standard the name of the transacting party will not have to be disclosed. We also feel that the issue does not warrant a divergence between LAS and Irish/UK standards and in general feel that the exact wording should be used as is in the LAS. Otherwise different interpretations will be attached to the different wording used.

ASB (v) ***1. Should the definition of related parties specifically refer to shadow directors? 2. Should it also refer to persons acting in concert?***

No - we feel that there is no need for the definition to specifically refer to shadow directors as this is already caught by the definition of directors and key managers in paragraph 9 of the FRED.

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 materiality in the context of such transaction?***

No - the concept of materiality is implicit in all financial statement presentation and audit. The concept of materiality in the concept of the related party themselves which currently exists in FRS8 was one which we never fully concurred with. Materiality should only be relevant to the entity itself

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

Yes, as outlined in our letter an appendix to the FRED giving practical examples would be useful.

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

Yes, the current disclosures as required in the Companies Acts suffice and the disclosure of management compensation, expense allowances and similar items are not needed.

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)?***

Yes - we are in agreement with the current position. However, we note that the exposure draft speaks of a wholly owned subsidiary published "with" consolidated financial statements for the group. However, under this jurisdiction a subsidiary's financial statements will not be published "with" consolidated financial statements and therefore the exemption will effectively not be available for the subsidiary. This is something that will require clarification and perhaps amendment in the final exposure draft.

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

11 September 2002

Dear Mr Nailor,

We are writing in response to the invitation to comment on FRED 29 "Property, plant and equipment/Borrowing costs". We have long advocated the harmonisation of Irish/UK accounting standards with their international equivalent and therefore in general welcome the proposals in this exposure draft.

Yours sincerely,

Michael Kavanagh B.Comm CPA
Chairman
Financial Reporting Sub-Committee

<u>FRED 29</u>

The ASB would welcome comments in particular on the following: -

ASB (i) ***Do you agree with the proposal to issue a new UK and <u>Irish</u> standards on property, plant and equipment and borrowing costs when the L4SB issues the revised IAS 16, unless it becomes clear that further changes to IAS 16 are likely by 2005 as a result of the revaluations project?***

We are fully supportive of the proposal to issue a new standard in Ireland on this issue, in the interests of international convergence and harmonisation.

ASB** (ii)* ***As explained in paragraph 7 above, the international exposure draft on property, plant and equipment proposes that residual values used in the calculations of depreciable amount should be reviewed at each balance sheet date and revised to reflect current estimates. FRS 15 generally required prices at the date of acquisition or latest expense on historical cost basis is not reduced to inflation in residual values. Do you agree or disagree with the proposed international approach?

We have no objection to the international proposal that residual values should be reviewed at each balance sheet date and revised to reflect current estimates. We feel that the issue does not warrant a divergence between IAS and Irish/UK standards.

ASB (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 on FRI 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 believe that due to the exclusion of renewals accounting from IAS 16, it could prevent entities from using the method as its exclusion may imply that it is not allowed. We feel that the current guidance on renewal accounting in FRS 15 should remain and a potential solution to this would be to provide such guidance as an appendix to the IAS.

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?***

Our view is that using current value is conceptually more correct as the use of fair values anticipates a use for an asset which is speculative and may not be relevant to the entity, which will continue in it’s current operational existence for the foreseeable future.

ASB (v) ***Are there any other aspects of the differences between the proposed stan4ards and current UK accounting requirements that you wish to comment on?***

No - there is nothing further that has not already been commented on under other questions.

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*** *L4S* ***16 revised pending the outcome of the L4SB 's projects on insurance and performance reporting?***

Yes — we agree with the proposal as it would not make sense for such companies to change their accounting for fixed assets under the new IAS and then potentially change again when the IASB's projects on insurance and performance reporting is completed.

ASB (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 carry amounts reflecting previous revaluations instead of restating the carrying amounts to historical cost (see paragraph 19 above). Do you believe that the transitional arrangements 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, we agree that entities should be allowed to continue to recognise the carrying amounts under the arrangement and we feel that it is a sensible and inevitable outcome of such a convergence.

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

The committee sees no reason for an extended implementation period or for any special transitional arrangements.

ASB (ix) ***Are there any other aspects of the draft standard on property, plant and equipment that the ASB should request the L4SB to review when finalising the revised MS 10?***

Yes, we feel that Foreign Exchange Gains and Losses should not be capitalised and the international standard should be amended to reflect this as foreign exchange gains/losses result from treasury not capital decisions.

ASB (x) ***Do you agree that the capitalization 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 agree that capitalisation of borrowing costs should remain optional. The fact that the policy is clearly explained in the financial statements, means the user can easily identify which policy is being used.

ASB (xi) ***Do you agree that paragraph 5(e) of lAS 23, which allows certain exchange d4fferences to be capitalised, should be deleted in the draft standard on borrowing costs?***

We feel that Foreign Exchange Gains and Losses should not be capitalised and the international standard should be amended to reflect this. Such foreign exchange gains/losses result from a treasury and not a capital purchase decision.

ASB (xii) ***What are you views on the difference between MS 23 and FRS 15 referred to in paragraph 24 above concerning borrowing costs eligible for capitalisation?***

We believe that the rules under FRS 15 are more appropriate as interest can only be capitalised on assets under construction, where IAS 15 allows interest to be capitalised which may have nothing to do with the asset. ASB (xiii) Do you have any comments on L4S 23 that you wish the ASB to bring to the MSB 's attention?

No

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

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

Yes, we feel this is correct.

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?**

Yes, we 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. This is broadly in line with current practice under FRS 10.

IASB (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] FRI on property, plant and equipment)?***

Yes, we believe that depreciation should continue as the issue is one of cost allocation over the useful live of the asset.

The Institute of Certified Public
Accountants in Ireland

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

04 September 2002

Dear Mr Nailor,

Attached please find our responses to FRED 27 "Events after the balance sheet date".

Dear Mr Naylor

We are writing in response to the invitation to comment on FRED 27 "Events after the balance sheet date". We have long advocated the harmonisation of Irish/UK accounting standards with their international equivalent and therefore in general welcome the proposals in this exposure draft.

As well as our responses to the specific questions asked we would also make the following comments:

- We note that dividends declared after the balance sheet date will not be recognised as a liability under the new FRS. We feel that this proposed change is consistent with FRS12 and we are in support of same.

- We are uncomfortable with the omission of paragraph 12-15 of the IAS. We feel that the proposed FRS should at least refer to going concern and reference should be made to the relevant paragraph of FRS18.

Yours sincerely,

Mark Butler CPA
Secretary
Financial Reporting Sub-Committee

FRED 27

16. The ASB would welcome comments in particular on the following: -

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?***

We are fully supportive of the proposal to issue a new standard in Ireland on related party disclosures in the interests of international convergence and harmonisation.

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

The committee sees no reason for an extended implementation period or for any special transitional arrangements.

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?

No

Mr Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X SAL

13 September 2002

Dear Mr Nailor

Financial Reporting Exposure Draft 27
Events After the Balance Sheet Date

The Association of Investment Trust Companies (AITC) welcomes the opportunity to submit its views on the above Exposure Draft.

The AITC is the trade association that represents the interests of investment trust companies (ITCs). ITCs are public limited companies, listed on the London Stock Exchange, whose primary business is investing in a diversified portfolio of shares and securities of other companies. They are therefore one of the main forms of collective investment available in the UK, for both institutional and retail investment, along with authorised unit trusts (AUTs) and open-ended investment companies (OEICs). The AITC currently represents the interests of around 300 members and the industry as a whole has assets under management of approximately £60bn.

In response to paragraph 17(1) the AJTC does not agree with the proposal to issue a new UK accounting standard on events after the balance sheet date in as much as we are most concerned by the main proposal that where an entity declares dividends after the balance sheet date the entity concerned should not recognise those dividends as a liability at the balance sheet date.

The AITC believes that the current position as set out in Schedule 4, paragraph 3(7) of the Companies Act 1985 and SSAP 17 is entirely satisfactory from the perspective of investors, investors usually have an expectation of both capital growth and dividend payments when they purchase shares in an entity. Therefore, when a board recommends a dividend investors have every right to expect that this will be recognised as a liability in the accounts.

THE ASSOCIATION OF INVESTMENT TRUST COMPANIES

Durrant House, 8-13 Chiswell Street, London EC1Y 4YY
Telephone: 020 7282 5555 Fax: 020 7282 5556 e-mail: info@aitc.co.uk Website: www.aitc.co.uk

We believe the key point is that equity dividends are not an expense, but rather an appropriation of profits. It is right that the directors' intentions as far as the profits of the year are concerned are properly set out on the face of the Profit & Loss account for the year in which the profits arise. It is less than helpful, and detracts from the usefulness of the accounts, if the reader has to perform a reconciliation in order to fully appreciate how much of the period's profits have been paid out and how much retained. Therefore, if the dividend payment were not to be shown as a liability in the accounts we believe that it would not reflect the underlying economic reality of the transaction.

In addition to the general point set out above, ITCs, because of their tax and company law position, could be affected by the proposed changes in a unique way and the AITC would need confirmation from the DTI and the Inland Revenue that our Members would not be adversely affected. The particular issue that we have in mind concerns the distribution tests under ICTA 1988 section 842 [1)(e) and Companies Act 1985 section 266 (2) (d). The tests are normally based on the ITC's accounts, which would of course, following an implementation of the proposals, show a different position to that as at present. We would expect to be able to reach a satisfactory conclusion with both parties but until the issue has been fully explored the concern remains. There may also be other issues that will come to light once detailed discussion commences.

We intend to send a copy of this letter to both the DTI and the Inland Revenue for their initial thoughts and comments.

We hope you find our comments of assistance and if you would like any further clarification of our views please feel free to get in contact.

Yours sincerely

Paul Dawson
Technical Manager

cc Mr D Dean
Company Law and Investigations Directorate Department of Trade and Industry

BRITISH AMERICAN TOBACCO

CELEBRATING A CENTURY OF EXCELLENCE

13 September 2002

The Technical Director
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London WC1X 8AL

Globe House
4 Temple Place
London WC2R 2PG

Dear Sir

International Standards Board's Improvements Project

We have reviewed the exposure drafts, FRED23 to FRED29, and the consultation paper which were issued in May this year by the ASB with regard to the above project being undertaken by the IASB.

We have attached as separate appendices our responses to the questions for which comments were requested as well as other issues on each of these eight documents. In the main you will see that we are broadly in agreement with the changes being proposed so far to incorporate international standards into UK GAAP. However we are concerned about the approach that the Board is taking over the timing of the introduction of these changes. We would suggest that a better strategy would be to introduce all the necessary changes at the same time.

Whilst we believe that the Board should continue to publish the necessary exposure drafts for comment in an orderly fashion, we would recommend that the resultant UK standards should all state that their effective date of implementation is 1 January 2005. In addition the Board should consider suspending its current policy of encouraging early adoption of standards to avoid the confusion referred to below.

As interested parties all seem to agree, the 2005 deadline is a tight deadline. It is our opinion that, from a practical viewpoint, requiring reporting entities to change accounting policies every year up to 2005 is not the best option. Some of the current proposals admit that certain aspects of the relevant international standards may change before 2005, leading to further changes in the UK standards. In addition there are changes required in UK Company Law before certain international requirements can be adopted.

We believe that three years of change in published accounts towards what is still a moving target will be confusing for both preparers and all users. It would be more useful and productive to report 2002, 2003 and 2004 on a consistent basis, while companies work towards one change in 2005.

Other considerations include the question of whether transitional arrangements are necessary. Given that the IASB has recently issued an exposure draft specifically dealing with first-time application of IFRSs, deferral of the implementation of the new UK standards will presumably avoid the Board having to address this question. The transition can then be dealt with in 2005 on the basis of the standard resulting from the current IASB exposure draft.

In addition to this concern over the Board's strategy, there are a number of issues pertaining to the individual documents published by the Board which we wish to highlight. These are set out below with reference to the relevant exposure draft.

FRED23 If our view on the approach to the adoption of international standards into UK GAAP is accepted, then we see no need for a standard on hedge accounting at this time. FRED3O has already been published for comment and the resultant standards will cover this accounting area.

FRED24 The Board has apparently ignored UITF9's alternative approaches, in particular the use of a stable currency as the functional currency, in proposing the adoption of IAS29 unchanged as well as the revised IAS21. We believe it is misguided to assume that there is one right and precise answer in the various and volatile environments that are present in high inflationary economies around the world. We believe that the Board should discuss with the TASB the possibility of revising IAS21 and IAS29 before the 2005 deadline.

FRED26 In proposing to replace FRS 14 with the revised IAS33, we note that it will no longer be possible to show additional per share amounts on the face of the profit and loss account; We are most concerned at what we regard to be a retrograde step for users as well as preparers and would ask that the Board discuss with the IASB incorporating FRS 14's approach of allowing such additional amounts into the revised IAS33.

In summary, whilst we fully support the Board's intention to pursue its programme of convergence with IFRSs, we would ask that serious consideration be given to delaying the implementation date of the necessary new UK standards to 1 January 2005. As we have said above, we would not want this to delay the programme of exposing and agreeing these standards as we believe that preparers in the UK should be given as much time as possible to make the necessary changes to be able to produce their financial statements in accordance with IFRSs in 2005.

We hope that you find our comments useful and thank you for giving us the opportunity to comment on the Board's proposals.

Yours faithfully

D C POTTER
Head of Finance and Accounting

Earnings per share (FRED 26)

The ASB would welcome comments in particular on the following:

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?

We do not agree with the proposal. We would prefer that changes to the existing standard (FRS14) should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.

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

If the Board agrees to defer implementation of the proposals, the question of transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

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 are most concerned that the IASB's proposals do not allow for the presentation of additional per share amounts on the face of the profit and loss account, especially as such measures may be what management and users focus on. We would suggest that the IASB should consider adopting FRS14's approach of allowing such additional amounts, having regard to their relevant prominence.

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?

We agree with these proposals.

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)?

- 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 do not agree with the above approach in that we would prefer to compute the number of potential ordinary shares using the average market price during the year-to date period.

BRITISH AMERICAN TOBACCO

CELEBRATING A CENTURY OF EXCELLENCE

13 September 2002

The Technical Director
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London WC1X 8AL

Globe House
4 Temple Place
London WC2R 2PG

Dear Sir

International Standards Board's Improvements Project

We have reviewed the exposure drafts, FRED23 to FRED29, and the consultation paper which were issued in May this year by the ASB with regard to the above project being undertaken by the IASB.

We have attached as separate appendices our responses to the questions for which comments were requested as well as other issues on each of these eight documents. In the main you will see that we are broadly in agreement with the changes being proposed so far to incorporate international standards into UK GAAP. However we are concerned about the approach that the Board is taking over the timing of the introduction of these changes. We would suggest that a better strategy would be to introduce all the necessary changes at the same time.

Whilst we believe that the Board should continue to publish the necessary exposure drafts for comment in an orderly fashion, we would recommend that the resultant UK standards should all state that their effective date of implementation is 1 January 2005. In addition the Board should consider suspending its current policy of encouraging early adoption of standards to avoid the confusion referred to below.

As interested parties all seem to agree, the 2005 deadline is a tight deadline. It is our opinion that, from a practical viewpoint, requiring reporting entities to change accounting policies every year up to 2005 is not the best option. Some of the current proposals admit that certain aspects of the relevant international standards may change before 2005, leading to further changes in the UK standards. In addition there are changes required in UK Company Law before certain international requirements can be adopted.

We believe that three years of change in published accounts towards what is still a moving target will be confusing for both preparers and all users. It would be more useful and productive to report 2002, 2003 and 2004 on a consistent basis, while companies work towards one change in 2005.

Other considerations include the question of whether transitional arrangements are necessary. Given that the IASB has recently issued an exposure draft specifically dealing with first-time application of IFRSs, deferral of the implementation of the new UK standards will presumably avoid the Board having to address this question. The transition can then be dealt with in 2005 on the basis of the standard resulting from the current IASB exposure draft.

In addition to this concern over the Board's strategy, there are a number of issues pertaining to the individual documents published by the Board which we wish to highlight. These are set out below with reference to the relevant exposure draft.

FRED23 If our view on the approach to the adoption of international standards into UK GAAP is accepted, then we see no need for a standard on hedge accounting at this time. FRED3O has already been published for comment and the resultant standards will cover this accounting area.

FRED24 The Board has apparently ignored UITF9's alternative approaches, in particular the use of a stable currency as the functional currency, in proposing the adoption of IAS29 unchanged as well as the revised IAS21. We believe it is misguided to assume that there is one right and precise answer in the various and volatile environments that are present in high inflationary economies around the world. We believe that the Board should discuss with the IASB the possibility of revising IAS2 1 and IAS29 before the 2005 deadline.

FRED26 In proposing to replace FRS 14 with the revised IAS33 we note that it will no longer be possible to show additional per share amounts on the face of the profit and loss account. We are most concerned at what we regard to be a retrograde step for users as well as preparers and would ask that the Board discuss with the IASB incorporating FRS 14's approach of allowing such additional amounts into the revised IAS33.

In summary, whilst we fully support the Board's intention to pursue its programme of convergence with IFRSs, we would ask that serious consideration be given to delaying the implementation date of the necessary new UK standards to 1 January 2005. As we have said above, we would not want this to delay the programme of exposing and agreeing these standards as we believe that preparers in the UK should be given as much time as possible to make the necessary changes to be able to produce their financial statements in accordance with IFRSs in 2005.

We hope that you find our comments useful and thank you for giving us the opportunity to comment on the Board's proposals.

Yours faithfully

D C POTTER
Head of Finance and Accounting

Financial Instruments: Hedge Accounting (FRED 23)

Particular issues on which comments are invited:

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?

The "gap in UK accounting literature" presumably arises if SSAP2O is replaced by the proposals contained in FRED24. In our response to that exposure draft you will see that we do not agree with the implementation timetable proposed in FRED24 which is the only reason for the gap. Also while it may be necessary to improve accounting standards in this area, for the reasons noted in our covering letter we believe this should be part of the total change to IAS in 2005. This is preferable to undertaking a number of changes towards what is a moving target.

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?

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

While it is logical to follow the international standard as part of convergence, we believe this area should be addressed as part of a subsequent consideration of the changes necessary for IAS32 and IAS39 once the IASB has finalised its review of these standards.

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?

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

As in Q2 above.

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 would agree that any subsequent UK standard should include guidance on measuring hedge effectiveness that is consistent with that included in IAS39

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?

Again as in Q2 above.

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)?

(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)?

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

Again as in Q2 above.

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?

As we have stated in our response to question 1 above, we do not believe that the proposed standard is necessary at this time. Our preference is that the subject of hedge accounting should be included in a UK standard that brings the requirements of IAS39 into UK GAAP. This is the subject of FRED30 issued subsequently to FRED23, on which we will be commenting separately in due course.

The Effects of Changes in Foreign Exchange Rates

Financial Reporting in Hyperinflationary Economies (FRED 24)

The ASB would welcome comments in particular on the following:

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?

We do not agree with the proposal. We would prefer that the changes to replace SSAP2O and UITF9 should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.

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

We would suggest that any decision on whether such translation differences should be recycled to the profit and loss account should await the result of the current project on reporting financial performance.

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

If the Board agrees to defer implementation of the proposals, the question of transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

In addition we would make the following comments:

In proposing to introduce UK standards based on IAS21 and IAS29 the Board has not given any explanation as to why it is considered that restatement of financial statements is now the only appropriate method of eliminating the distortions that arise in hyperinflationary economies. In our experience the use of a stable currency as the functional currency is a fairly common approach to the problem. We believe that this approach is often a practical solution, particularly where inflation indices tend to be unreliable or not readily available.

In the light of this, we were somewhat surprised that the IASB did not feel fit to deal with this in IAS21 and re-examine IAS29 as part of its improvements project. We would suggest that the Board should raise with the IASB the possibility of incorporating UITF9' s alternative approaches in IAS21 and IAS29. In our opinion, whilst restatement by indices is sometimes the correct approach, in practice there needs to be pragmatic alternative solutions.

Turning to IAS21, we note that whilst the proposed UK standard does not include IAS2I's requirement to classify certain exchange differences as a separate component of equity, it still retains the requirement for a reconciliation of the changes during the period. We would question the necessity for the reconciliation if separate identification is not to be required under UK GAAP.

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 21:

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 disagree with the statement in paragraph 12 concerning the avoidance of restatement. The use of a hard currency to deal with a high inflationary environment is a fairly common approach to the problem. This has been recognized in the UK through UITF9, as we have referred to above. We believe that the approach being adopted internationally is misguided in assuming that there is one right and precise answer to deal with high inflationary economies and their varied and volatile environments. It is an unnecessary restriction which will cause problems and cost for preparers with no apparent justification.

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 also agree that a reporting entity should be permitted to present its financial statements in any currency that it chooses.

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)?

We agree with the above proposals regarding translation to the presentation currency.

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

We again agree that this allowed alternative should be removed.

IASB (v) Do you agree that

(a) goodwill and
(b) fair value adjustments to assets and liabilities

that arise on 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)?

We are also in agreement with the above proposal that such items are foreign assets and liabilities which should be translated at closing rate.

Related Party Disclosures (FRED 25)

The ASB would welcome comments in particular on the following:

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 L&SB?

We do not agree with the proposal. We would prefer that changes to the existing standard (FRS8) should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.

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

If the Board agrees to defer implementation of the proposals, the question of transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

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 l3A and 13B of the [draft] FRS?

We believe that the name of a controlling party and, if different, that of the ultimate controlling party should be disclosed. If the revised IAS24 does not require such disclosure, we would agree with this requirement being retained in the revised UK standard.

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

Whilst such information is currently required by FRS8, we are not **concerned by its omission from FRED25. We would suggest that the proposals require sufficient information to be disclosed about transactions between related parties.**

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

We believe that the definition of related parties included in FRED25 should be extended to specifically refer to both shadow directors and persons acting in concert.

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

We agree that disclosure should only be required of material related party transactions. In addition we also believe that for this particular standard it would be useful for the standard to give guidance on materiality.

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 would suggest that the wording of paragraph 12 be replaced by the deleted paragraph 32(a) of IAS27. We believe that this would provide a clearer understanding of the information that should be given with regard to subsidiaries.

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 24:

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 agree that disclosure of these items should not be required by the standard.

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)?

Again we agree that such disclosures should not be required.

Earnings per share (FRED 26)

The ASB would welcome comments in particular on the following:

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?

We do not agree with the proposal. We would prefer that changes to the existing standard (FRS14) should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.

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

If the Board agrees to defer implementation of the proposals, the question of transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

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 are most concerned that the IASB's proposals do not allow for the presentation of additional per share amounts on the face of the profit and loss account, especially as such measures may be what management and users focus on. We would suggest that the IASB should consider adopting FRS14's approach of allowing such additional amounts, having regard to their relevant prominence.

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?

We agree with these proposals.

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)?

- 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 do not agree with the above approach in that we would prefer to compute the number of potential ordinary shares using the average market price during the year-to date period.

Events after the balance sheet date (FRED 27)

The ASB would welcome comments in particular on the following:

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?

We do not agree with the proposal. We would prefer that changes to the existing standard (SSAP17) should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its **programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.**

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

If the Board agrees to defer implementation of the proposals, the question of transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

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

No

Inventories; Construction and service contracts (FRED 28)

The ASB would welcome comments in particular on the following:

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?

We do not agree with the proposal. We would prefer that the changes to replace the existing standard should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.

ASB (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 agree with the proposal to incorporate the additional text to deal with contracts for services.

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

If the Board agrees to defer implementation of the proposals, the question of transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

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 are not aware of any such aspects.

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

Again we are not aware of any such aspects.

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

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

We agree that the allowed alternative of using the IAS-in first-out (LIFO) method for determining the cost of inventories should be eliminated.

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).

Do you agree with retaining those requirements?

We are in agreement with retaining both of these requirements.

Property, plant and equipment; Borrowing costs (FRED 29)

The ASB would welcome comments, by 16 September 2002, in particular on the following:

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?

We do not agree with the proposal. We would prefer that the changes to replace the existing standard should apply from 2005, to coincide with the move to international accounting standards required by the European Union. Whilst we fully support the ASB's intention to pursue its programme of convergence with IFRSs, we see no reason for mandatory adoption of these changes to UK GAAP prior to 2005.

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?

It would seem more logical to adopt the FRS15 approach to avoid the depreciation expense on a historical cost basis being reduced by inflation in residual values. However we wonder whether this concern over residual values is likely to cause significant problems in practice.

ASB (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?

Renewals accounting was presumably included in FRS15 to allow certain industries a pragmatic solution to estimating depreciation on certain infrastructure assets. On the assumption that similar industries outside the UK are likely have the same concerns over infrastructure assets, it would appear that the IASB should be requested to look at the question of including similar provisions re renewals accounting in the revised IAS16.

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 of the Preface to the FRED)?

Given the differences that exist between FRS15 and IAS16, we believe that there is a strong case for not introducing IAS16 into the UK at the present time. As there is a joint project looking at a convergence model for revaluations, we would suggest that there is no need to amend FRS15 until there is international agreement on this subject.

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?

We note that, in revising paragraph 60, the statement that comparative information is not required for the reconciliation of the carrying amount at the beginning and end of the period has been deleted. We see no reason for this deletion and would question the need for such comparative information.

With regard to the examples given in paragraph 17 of costs that are not a component of the cost of property, plant and equipment, we would question whether such costs should always be excluded. For example, training costs or relocation expenses could qualify for capitalisation in circumstances where they are necessary to bring the asset into operation or extend its useful life, production capacity or residual value.

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 IASB's projects on insurance and reporting financial performance?

We agree that the present exemption in FRS15 in respect of insurance companies should be retained as a transitional measure.

ASB (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 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?

We believe that entities which adopted FRS15's transitional arrangement should be allowed to continue to recognize the carrying amounts under that arrangement. We understand that the IASB's proposals for first-time application of IFRSs does allow for this type of situation.

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

If the Board agrees to defer implementation of the proposals, the question of any other transitional arrangements will not be relevant. The IASB's recently issued proposals for first-time application of IFRSs will cover this, once the resultant standard is in place.

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

Apart from the two points mentioned above in our response to ASB (v) and the specific points on the ASB questions below, we would also mention paragraph 46. The requirement for an annual review of material residual values imposes an unreasonable burden and we would suggest that such a review should only be necessary where there are indications of impairment.

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 agree that the capitalisation of borrowing costs should remain optional. Whilst we agree that conceptually directly attributable finance costs should be capitalised, such a concept also leads to capitalising notional interest as well as creating practical problems in allocating finance costs. Thus, on balance, if we had to make a choice, we would opt for prohibition of capitalisation.

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?

As the IASB is not proposing to revise IAS23, we are surprised that the ASB is proposing to make this amendment and thus create a difference between UK GAAP and IFRSs. This would seem to be at odds with the policy of convergence.

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?

Whilst we feel that FRS15's approach is probably preferable in this respect, we believe that, in many cases, the approach in IAS23 is not likely to make a significant difference in practice.

ASB (xiii) 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 such comments other than as noted above.

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

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] FRS on property, plant and equipment)?

We do not agree with the changes that are proposed in this respect. We would prefer to keep the wording as set out in the current IAS16. For exchanges of similar assets, the cost of the new asset is the carrying amount of the asset given up.

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 would make a similar comment here to that shown above, i.e. for exchanges of similar assets, the cost of the new asset should be the carrying amount of the asset given up.

IASB (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)?

We do not agree. It may be the case that, in becoming temporarily idle, the useful life is extended and thus the depreciation charge may be lower or possibly even zero. Where an item is being held for disposal , is it right to assume that its service potential is still being consumed? In addition should depreciation continue to be charged if this results in the asset being carried at a value below the expected realizable value?

IASB proposals to amend certain international accounting standards

Presentation of financial statements (IAS1)

Q1 We agree with the proposed approach regarding departure from an IFRS or interpretation thereof to achieve a fair presentation with the proviso that:

(a) the requirement in paragraph 14 (d) is revised to remove the reference to “on each item”. Surely it is only necessary to give the key elements of the financial impact of the departure?

(b) The wording in paragraph 15 (b) is brought into line with that in paragraph 14 (d) as amended above.

Q2 We agree with the prohibition of presenting items of income and expenses as “extraordinary items”.

Q3 We agree with the wording in paragraph 60 regarding the classification of a long-term financial liability due to be settled within twelve months of the balance sheet date.

Q4 We also agree with the classification requirements set out in paragraphs 62 to 64 with regard to long-term financial liabilities that become payable on demand.

Q5 Whilst the examples given in paragraph 109 would seem to make the requirement more reasonable (provided that these examples are indicative ones), the requirement as set out in paragraph 108 appears, on its own, to be onerous and too open ended (see also Q6).

Q6 We are concerned that the requirements in paragraphs 110 to 115 are much too general. We would suggest that such assumptions should be specifically identified and specified in individual accounting standards, as was done for the assumptions referred to in paragraph 115.

In addition we would refer to the revised paragraph 76, which deals with information to be presented on the face of the income statement. The reference to the inclusion of the results of associates and joint ventures now requires share of “after-tax profit or loss” rather than “profits and losses” to be given before the disclosure of tax expense. We would prefer disclosure to be consistent with FRS9, but if “after-tax profit or loss” is to be disclosed, surely it should be shown after tax expense.

Accounting policies, changes in accounting estimates and errors (IAS8)

Q1 We agree that voluntary changes in accounting policies and corrections of errors should be accounted for retrospectively with no allowed alternative.

Q2 We also agree with the elimination of the distinction between fundamental and other errors, providing that there is no change in the interpretation of material. We would be concerned if the concept was extended to cover smaller items which, from a practical viewpoint, could not be seen as influencing the economic decisions of users of financial statements.

In addition we would question the wording of paragraph 19. Our preference would be to retain the existing paragraph 48 but, if this is not possible, then we would strongly object to the inclusion of paragraph (d) regarding a requirement to disclose the financial effect of adoption of a new standard.

Leases (IAS17)

Q1 Theoretically, we agree that when classifying a lease of land and buildings, the lease should be split into two elements - a lease of land and a lease of buildings. However we are concerned that in practice it will often be the case that a reasonable division cannot be achieved.

Q2 We also agree that initial direct costs incurred in negotiating a lease should be capitalised, provided that such costs are incremental and directly attributable to the lease.

Consolidated and separate financial statements (IAS27)

Q3 We agree that a parent need not prepare consolidated financial statements if all the criteria set out in paragraph 8 are met.

Q2 We also agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity.

Q3 With regard to! investments in subsidiaries, jointly controlled entities and associates, we are in agreement with the proposals set out in paragraph 29 and 30.

In addition we would make the following comments:

Paragraph 13 has been reworded to replace "in the near future" with "within twelve months from acquisition". In practice it can be the case that the sale of a subsidiary can take more than twelve months, particularly when regulatory approvals have to be obtained. We would therefore prefer that the phrase "in the near future" is reinstated.

We are concerned about the wording of paragraph 27, in that we would suggest that the relevance should be over whether the Group, rather than the minority, is obliged to make good the losses that may not be recoverable. Therefore it is the minority that has the residual interest in the subsidiary's net assets or liabilities, except to the extent that the Group has an obligation which would determine a different allocation.

The additional disclosure introduced in paragraph 32 (b) appears to us to be unjustified, given that this would apply to subsidiaries that are in the course of disposal and thus carried in the consolidated balance sheet at net realizable value rather than at net asset value.

Accounting for investments in associates (IAS28)

Q1 We agree with the scope exclusions set out in paragraph 1 and that they should also apply to IAS31.

Q2 We also agree with the proposals in paragraph 22 regarding investments in loss-making associates.

In addition we would make the following comments:

As mentioned above with regard to IAS27 we are concerned that the phrase “in the near future” is to be replaced with “within twelve months from acquisition” in paragraph 8.

Paragraph 18A allows for a difference of up to three months in the reporting date of the financial statements of an associate. From a practical point of view we would suggest that a difference of up to six months should be allowed.

The wording of paragraph 28B does not seem to make clear what disclosures are required in accordance with IAS37. We would suggest that it is reworded to clarify the necessary disclosures.

Investment property (IAS4O)

Q1 We agree with the inclusion of a property interest held under an operating lease providing the criteria set out in paragraph 4 are met.

Q2 We also agree that where a property interest held under an operating lease is classified as investment property, it should be accounted for as if it were a finance lease.

Q3 We agree that both the cost and fair value models should remain for the time being pending a further review.

16 Park Crescent
London W1B 1AH

Telephone: 020 7580 4741
Facsimile: 020 7323 1132
E-mail: Info@ICSA.co.uk
Web: http://www.icsa.org.uk

Hans Nailor
Accounting Standards Board
Holbom Hall
100 Gray's Inn Road
London WC1X 8AL

9 September 2002

Dear Sir,

Financial Reporting Exposure Draft 25 - Related Party Disclosures, and 27 - Events After the Balance Sheet Date

The ICSA would like to express its thanks for being given the opportunity to respond to the above consultations.

In compiling its response, the Institute has sought and taken onboard, wherever such a view had been expressed, the views of its Members, who practice in the preparation of accounts to which the accounting standards relate, in positions across industry, the professions and the not-for-profit and local government sectors. We trust that the Accounting Standards Board ("ASB") will find the comments attached hereunder to be of interest and some use.

Related Party Disclosures (FRED 25)

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?

Yes

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

It appears that no special transitional arrangements are anticipated (para 14 of Fred 25). Should any matters come to light as a result of the exposure period, both the IASB and ASB should consider this under its usual procedures.

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 requite 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?

Yes, this would be valuable information for many users that could be provided at little cost by preparers. The requirement in paragraph 13A and 13B should be included in a UK standard if IAS 24 fails to include the requirement. However, the ASB should press the IASB to include the requirement as such information would be of even greater value to international capital markets.

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

Perhaps the proposal is sufficient as it stands, but it suggested that if left as it stands, that the matter is dealt with in a review of the standard after an appropriate period of time to see if the more exacting FRS 8 disclosure is needed by users.

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

We would suggest

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 materiality in the context of such transactions?

Yes, in the light of recent American financial scandals, I think the standard must be firmer on materiality and give appropriate guidance.

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?

No

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 24:

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)?

Yes

'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'.

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)?

Yes

Events after the balance sheet date (FRED 27)

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?

Yes

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

It appears that no special transitional arrangements are anticipated (para 11 of Fred 27. Should any matters come to light as a result of the exposure period, both the IASB and ASB should consider this under its normal procedures.

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

No

We trust that the contents of this submission are self-explanatory, but should you require any further explanation, please contact the under-named on 020 7612 7041.

Yours faithfully

Wai Wong ACIS LLM
Assistant Director
Policy Unit

1902-2002 Charter Centenary
ICSA

16 Park Crescent
London W1B 1AH

Telephone: 020 7580 4741
Facsimile: 020 7323 1132
E-mail: Info@ICSA.co.uk
Web: http://www.icsa.org.uk

The Technical Director
Accounting Standards Board
Holbom Hall
100 Gray's Inn Road
London WC1X SAL

11 September2002

Dear Sir,

FRED 26: Earnings Per Share

The ICSA would like to express its thanks for being given the opportunity to respond to the above consultation.

In compiling its response, the Institute has sought and taken onboard, wherever such a view had been expressed, the views of its Members, who practise in the preparation of accounts to which the accounting standards relate, in positions across industry, the professions and the not-for-profit and local government sectors. We trust that the Accounting Standards Board ("ASB") will find the comments attached hereunder to be of interest and some use.

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 3 is approved by the IASB?

Yes.

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

It appears that there are no special transitional arrangements are necessary (paragraph 18).

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?

No.

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)?

- 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 diluting 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).

Yes.

One response we received from our Members, who is a seasoned accounting practitioner and lecturer, and who is well versed in making the sorts of calculations in the examples set out in Appendix 2 of the FRED, noted that examples 6, 7 and 10 are not easy to follow. For example 12, the calculations on the warrants were not understood for both the second quarter and the full year. We believe that some written descriptions are needed to support the figure work.

We trust that the contents of this submission are self-explanatory, but should you require any further explanation, please contact the under-named on 020 7612 7041.

Yours faithfully

Wai Wong ACIS LLM
Assistant Director
Policy Unit

16 Park Crescent
London W1B 1AH

Telephone: 020 7580 4741
Facsimile: 020 7323 1132
E-mail: Info@ICSA.co.uk
Web: http://www.icsa.org.uk

Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London WC1X 8AL

11 September2002

Dear Sir,

FRED 29: Property, Plant and Equipment - Borrowing Costs

The ICSA would like to express its thanks for being given the opportunity to respond to the above consultation.

In compiling its response, the Institute has sought and taken onboard, wherever such a view had been expressed, the views of its Members, who practise in the preparation of accounts to which the accounting standards relate, in positions across industry, the professions and the not-for-profit and local government sectors. We trust that the Accounting Standards Board ("ASB") will find the comments attached hereunder to be of interest and some use.

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?

Yes.

We are uncertain as to the wisdom of delaying the implementation of IAS 16 should the revaluation project be completed before 2005. The convergence of international accounting standards is causing harmonisation with a "moving target". Why should then IAS 16 be made an exception? Preparers are used to UITF adjustments to new standards and quick reviews of new standards (FRS 1). The revaluation project does not appear to be that major in relation to the issues in these two drafts.

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 do not agree with the international approach.

ASB (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?

We do not believe that we should allow the use of renewals accounting. Its use is presumably limited. It is not as clear as to when it is renewed as the estimate of an asset under the straight line basis of depreciation.

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 of the Preface to the FRED)?

It appears that revaluation to fair value (IAS 16) is far simpler to apply than the FRS 15 method. However, FRS 15 is far better in requiring a maximum period between revaluations. Materiality (IAS 16) relies heavily on judgment and no guidance is provided on assessing materiality. Therefore IAS 16 is open to abuse.

IAS 16 is weak on both requirements and guidance on the basis of valuations. It is thought that an external qualified valuer should be required at appropriate intervals in particular.

Until international accounting standards have the equivalent of FRS 3 (currently under review internationally), then there are bound to be differences as regards paragraph 17 matters. It appears the revised FRS 15 will have differences with the revised IAS 16 for a period of time.

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?

No.

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 IASB'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 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 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?

Should any matters come to light during the exposure period, then the ASB should consider them.

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?

No.

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?

Yes.

I would choose mandatory capitalisation as it would reflect the full capital cost of an asset.

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?

Yes.

Capitalisation in these circumstances would be inappropriate and imprudent.

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 FRS 15 approach.

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

No.

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

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] FRS on property, plant and equipment)?

Yes.

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?

Yes.

IASB (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.

We trust that the contents of this submission are self-explanatory, but should you require any further explanation, please contact the under-named on 020 7612 7041.

Yours faithfully

Wai Wong

Wai Wong ACIS LLM
Assistant Director
Policy Unit

16 Park Crescent
London W1B 1AH

Telephone: 020 7580 4741
Facsimile: 020 7323 1132
E-mail: Info@ICSA.co.uk
Web: http://www.icsa.org.uk

Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London WC1X 8AL

10 September 2002

Dear Sir,

IASB proposals to amend certain international accounting standards

The ICSA would like to express its thanks for being given the opportunity to respond to the above consultations.

In compiling its response, the Institute has sought and taken onboard, wherever such a view had been expressed, the views of its Members, who practise in the preparation of accounts to which the accounting standards relate, in positions across industry, the professions and the not-for-profit and local government sectors. We trust that the Accounting Standards Board ("ASB") will find the comments attached hereunder to be of interest and some use.

IAS 1

Question 1 Yes

We think that paragraphs 13 to 16 do appropriately cover all likely implications of a departure from IFRS or an interpretation of an IFRS in order to achieve a fair presentation of an entity's financial affairs.

Question 2 Yes

We are pleased to note that an outright prohibition of extraordinary items is proposed.

Question 3 Yes

We agree that this should be classified as a current liability because in these circumstances it was so at the end of the financial year.

Question 4 a Yes

This is the same principle as Question 3 above.

Question 4 b Yes

However, we are cautious about situations where the breach has not been rectified, but i the management's opinion it is probable that the breach will be rectified. This is potentially misleading if things do not go to plan. We believe the implications should be spelt out in the financial statements should this eventuality occur.

Question 5 Yes

We regard this as material information to all users of the financial statements.

Question 6 Yes

However, it is considered that such information in the UK would normally form part of the QFR. This information may therefore form part of another IFRS in the future.

IAS 8

Question 1 Yes

We agree that the only method now proposed possesses a qualitative characteristic and provides the most useful information for trend analysis.

Question 2 Yes

We agree that the distinction between fundamental errors and other material errors was too arbitrary.

IAS 17

Question 1 Yes

We agree with the conclusions, paragraphs A3 to A6.

Question 2 Yes

We agree with the elimination of the choice of expressing immediately such costs. We also agree that capitalisation should be strictly restricted to incremental and directly attributable costs.

IAS 27

Question 1 Yes

We broadly agree with the criteria, but we have concern about the interests of the minority interests, particularly where they are not entitled to vote. In a group where corporate governance procedures are less developed, the minority interests could potentially be oppressed to the extent that their interests are overridden.

Question 2 Yes

We agree that this presentation clearly distinguishes a minority from a liability. Question 3 Yes

We agree that this proposal to account for subsidiaries, associates and jointly controlled entities in the same fashion in both the consolidated and separate financial statements will result in less confusion than allowing dissimilar accounting in the respective financial statements.

IAS 28

Question 1 Yes

We agree that it is more appropriate to apply fair value measurements to what would have otherwise been an associate or joint venture when held by venture capital organisations, mutual funds, unit trusts and similar entities.

Question 2 Yes

We agree because the proposal effectively applies going concern principles when the losses are material.

IAS 40

Question 1 Yes

We agree with the conclusions, paragraphs A3 to AS.

Question 2 Yes

The conclusions reached in paragraph A6 are a considerable improvement to IAS 40.

Question 3 Yes

We agree that the economic conditions are not yet appropriate to eliminate the choice here.

We trust that the contents of this submission are self-explanatory, but should you require any further explanation, please contact the under-named on 020 7612 7041.

Yours faithfully

Wai Wong

Wai Wong ACIS LLM
Assistant Director
Policy Unit

RIO
TINTO

5 September 2002

Mr Stephen McEwan
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X8AL

Dear Mr. McEwan

I attach a note commenting on certain points contained in recent exposure drafts.

Yours sincerely

M R Merton

M R Merton
Controller

Rio Tinto plc 6 St James's Square London SW1Y 4LD
Telephone 020 7930 2399 Direct Line 020 7753 Fax 020 7930 3249
REGISTERED OFFICE: 6 St James's Square London SW1Y 4LD Registered in England No. 719885

FRED 24
ASB 28 (ii) We agree that exchange differences arising on an entity's net investment in a foreign operation and recognised in the STRGL should not be recycled to the profit and loss account at the time of disposal of the subsidiary.

FRED 26
ASB 24 (iii) We suggest that the new standard should continue to permit the disclosure of alternative measures of earnings and earnings per share on the face of the profit and loss account in the manner currently provided for under UK accounting standards. We consider that the presentation of an adjusted earnings measure, which excludes exceptional items of such magnitude that such exclusion is necessary to reflect the underlying performance of the Group, is very helpful to readers of the accounts and therefore deserves prominence.

FRED 29
ASB 38 (ix) Where an interest in a fixed asset is exchanged for an interest in a similar asset, we consider that the interest acquired should continue to be carried in the accounts on the basis of the book value of the asset surrendered. This has particular relevance in the mining industry where an interest in one orebody may be swapped for an interest in an adjacent orebody. The transaction may be designed to create a partnership between two proprietors that will enable the two mining properties to be developed with economies of scale. The nature and size of the reporting unit's asset portfolio may be substantially unchanged. Under the historical cost convention, it would appear inappropriate to change the book values of the company's assets where there has been no substantial change in the assets owned.

Paragraph 21 of FRED 29 requires that an item of property, plant and equipment acquired in exchange for another item of property, plant and equipment be accounted for at the fair value of the asset given up. It is not clear from the FRED whether any excess of the fair value of the asset given up over its book value should be credited to the profit and loss account or to the STRGL. Depreciation charges on the uplift in value of fixed assets will be taken to profit and loss account in future years. To be consistent with this approach the uplift in value should itself be credited to profit and loss account.

ASB 38 (x) We consider that the capitalisation of interest costs on borrowings related to construction or development projects is appropriate since this represents a cost of bringing an asset into working condition for its intended use. If it is accepted that capitalisation of such interest is appropriate then it appears logical that this treatment should be mandatory.

FRED 30
ASB 31(v) (b) We agree that recycling of gains and losses on hedging transactions should be avoided by reporting these in the balance sheet until the hedged transaction occurs. We feel that this more fairly reflects the underlying purpose of currency hedging which is to protect shareholders' funds, as well as earnings, from fluctuations in exchange rates. The proposed treatment fully reflects the hedge in the financial statements, but also, in effect, records that aspect of the future transaction that is the subject of the hedge.

The proposed approach also has the benefit of being easier to administer and, provided that full explanation is given, easier for readers of the accounts to understand.

Amendment to FRS 17

We agree that the mandatory full adoption of FRS 17 should be deferred during the period of the international discussions on IAS 19 (revised). This will avoid imposing the necessity for companies to make two fundamental changes to post retirement accounting in a short period of time.

ED - IAS 21 - The Effect of Changes in Foreign Exchange Rates Question 2 - We agree that a reporting entity should be permitted to present its financial statements in any currency (or currencies) that it chooses, which will not necessarily be its functional currency. Legal, tax or investor relations' issues may determine the currency in which an entity must report its results. In the absence of such restrictions, reporting entities should be encouraged to report in the currency that most fairly represents its performance and financial condition. This will not always be the domestic currency.

NATIONAL AUDIT OFFICE

National Audit Office
157-197 Buckingham Palace Road
Victoria
London SW1W 9SP

GTN 3935
Switchboard 020-7798 7000
Facsimile 020-7

The Technical Director
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

Direct Line 020-77987126
Room B352
Reference
Date 13 September 2002

Dear Sir

FRED's 23, 24, 25, 27, 28 and 29

I attach our comments on the exposure drafts above. I hope that you find these comments helpful.

Yours faithfully

P. Morgan

pp. **MIKE SUFFIELD**

Director, Financial Audit Policy and Support

Comments by the National Audit Office

FRED23 - Hedge Accounting General Comments

The National Audit Office has considered how the proposals may be applied, with particular reference to the central government sector. This consideration does not take account of decisions that will be taken by the Treasury on the application of the standard.

The impact on central government will be limited to the small number of bodies that use hedging as part of their risk management strategies.

Specific Comments

Q1 *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?*

Yes in principle. However, a change to the timetable for implementation may be preferable to issuing a standard if that standard will require amendment to achieve convergence (see comments to question 3b).

Q2 *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?*

Yes.

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

The principle appears to be sufficient

Q3 *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*

Yes.

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

The proposed restrictions appear sufficient to implement the principles. However, the proposed standard has fewer restrictions on hedge accounting than IAS 39 and this may have implications for convergence.

Q4 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)?

Yes in principle.

We agree that the proposed standard should make it clear that an effective hedge need not have the expectation of an exact match between the hedged item and hedged instrument but that there should not be very wide divergence. In this respect, the material on what is regarded as highly effective is useful. However, it might be interpreted that if the fair value of a hedge falls within the range given in paragraph 9 that this is a sufficient requirement for the hedge to be considered effective rather than a minimum requirement.

While the range in paragraph 9 reflects IAS 39, the Board might consider whether there is scope for a difference of emphasis between the UK standard and the international standard in this regard; and whether this would be at odds with convergence. The Board has proposed elsewhere in the exposure draft that the UK standard should be slightly different from IAS 39 while adhering to its principles. It would seem consistent with the Board’s stance (and not inconsistent with convergence) that the UK standard makes it clear that a hedge within the range given in paragraph 9 is not sufficient in itself to be considered highly effective but that other factors (such as those in paragraphs 10 to *15)* should be taken into account.

Q5 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?

Yes.

Q6 *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 'proposals on:*

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

Yes.

(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)?*

Yes.

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

Yes.

Q7 *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?*

Yes.

NAO Comments by the National Audit Office

FRED 24 - The Effects of Changes in Foreign Exchange Rates
Financial Reporting in Hyperinflationary Economies

General Comments

The National Audit Office has considered how the proposals may be applied, with particular reference to the central government sector. This consideration does not take account of decisions that will be taken by the Treasury on the application of the standard. However, both SSAP 20 and UITF 9 apply to central government bodies and we see no reason why the standards proposed by FRED 24 should not be adopted.

We support the ASB's view that exchange differences on disposal of foreign operations should not be "recycled" through the Profit and Loss account whereas current proposals for changes to JAS 21 require such treatment. We are also of the view that such gains and losses should be recognised immediately and that recognition should not be deferred until the gain or loss is realised.

This issue is linked to wider discussion on reporting financial performance and we note that the ASB is undertaking a project with the IASB which (amongst other things) may result in "recycling" being prohibited internationally. In order to avoid the possibility that the UK standard will have to be amended further to bring it into line with the international standard, we recommend that the ASB consider whether there is a need to defer implementation until it becomes clear whether or not changes to the international standard are likely in this respect.

Specific Comments - FRED 24

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?

Yes.

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

Yes.

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

Yes.

Specific Comments - IAS 21

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?

Yes.

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?

Yes. We believe it a reasonable presumption that an entity will present its financial statements in its functional currency and that in most cases, this will give the most appropriate view of its results and financial position. However, we accept that there may be reasons why presentation in an alternative currency is preferable. In light of this and the disclosure requirements in paragraphs 51 to *55,* we agree with the approach proposed in the exposure draft.

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)?

Yes.

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

Yes.

IASB (v) Do you agree that

(a) goodwill and
(b) fair value adjustments to assets and liabilities

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

Yes.

FRED 25 - Related Party Disclosures General Comments

The National Audit Office has considered how the proposals may be applied, with particular reference to the central government sector. This consideration does not take account of decisions that will be taken by the Treasury on the application of the standard. However, FRS 8 applies to central government bodies although adapted to circumstances specific to Government such as, the relationship between the different elements of government. We see no reason why the standard proposed by FRED 25 should not be adopted in similar way.

Specific Comments - FRED 25

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?*

Yes.

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

No.

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?*

Yes. We agree with the Board that an accounting standard should require such disclosure, and if not required by IAS 24, this should be ‘included in the UK standard. The disclosure of the identity as well as the existence of a controlling party is relevant information that could allow users to assess properly the nature of the relationship.

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

Yes. While there may be the presumption of an arms length basis in transactions, this presumption may not be justified when related party relationships exist. There is no explicit requirement in FRS 8 to disclose where transactions are not at fair value (although this might be considered implicit); and as such, disclosure of the names of transacting related parties can assist users in making this assessment. This may be the case particularly where the related parties are directors or major shareholders. Similarly, there is no explicit requirement to disclose where a transaction is not at fair value in FRED 25 (although an assertion that a transaction is at arms length can be made only if this can be substantiated). Thus, the disclosure of names as well as the nature of the relationship and information about the transactions is justified in our view.

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

Yes, the standard should refer to shadow directors and to persons acting in concert. A shadow director is a related party by virtue of the influence that can be brought to bear on the entity directly or on the directors of an entity. Persons acting in concert are related parties as they exert influence by acting together whereas they are not able to do so when acting individually.

It might be argued that the definition of a related party given in FRED 25 encompasses such individuals and groups of individuals. FRED 25 states that a related party is one that has an interest that gives significant influence. In principle, this definition might include either individuals that do not have a formal relationship with an entity or groups of individuals. However, we believe that the revised standard should require a clear statement of the extent to which parties are considered to be related and so make specific reference to shadow directors and to those acting in concert.

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 materiality in the context of such transactions?*

We do not think that it is necessary to specify that disclosure is required of material related party transactions only but additional guidance is needed on how materiality should be applied.

It is implicit that accounting standards need not be applied to items or in circumstance where the impact is not be material. The ASB makes this clear by proposing that the standard say that application is necessary for a true and fair view. FRS 8 provides important guidance on materiality that is not included in FRED *25,* specifically that materiality is to be judged, not only in terms of the significance to the reporting entity, but also in relation to the significance to the other related party. In the absence of specific guidance in this respect, it might not be clear that materiality should be interpreted in its wider sense and thus that it should apply in relation to all related parties.

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?*

No.

Specific Comments - IAS 24

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'.*

Yes, although 'management' and 'compensation' might still need to be defined to make it clear what should be excluded from disclosure. The proposed standard says that key management personnel are related parties and thus it would appear unlikely that management personnel who are not key would be related parties. "Key management" is defined in the draft standard already; and the definition of compensation might take account of employee benefits described in IAS 19.

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)? .*

Yes.

NAO Comments by the National Audit Office

FRED 27— Events after the balance sheet date

General Comments

The National Audit Office has considered how the proposals may be applied, with particular reference to the central government sector. This consideration does not take account of decisions that will be taken by the Treasury on the application of the standard. SSAP 17 applies to central government bodies and we see no reason why the standard proposed by FRED 27 should not be adopted in similar way.

Specific Comments

ASB (i) *Do you agree with the proposal to issue a new UK standard on events after the balance sheet date, once the new MS 10 is approved by the IASB and once the law is amended to permit its application?*

Yes.

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

No.

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

No.

Comments by the National Audit Office

FRED 28 - Inventories; Construction and service contracts

General Comments

The National Audit Office has considered how the proposals may be applied, with particular reference to the central government sector. This consideration does not take account of decisions that will be taken by the Treasury on the application of the standard. SSAP 9 applies to central government bodies although in a form adapted to circumstances specific to Government and in particular for types of stock for which the accounting treatment may not be covered adequately by SSAP9. In principle, we see no reason why the standard proposed by FRED 28 should not be adopted in similar way.

Specific Comments - FRED 28

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?*

Yes.

ASB (iii) *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?*

Yes. It seems appropriate that the draft UK standard maintains the scope of SSAP 9 in this respect.

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

No.

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?*

No. We have not identified further aspects that are in need of review.

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

No. We have not identified further aspects that are in need of review.

Specific Comments - IAS 2

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 IAS2?*

Yes. This is appropriate and assists convergence.

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). Do you agree with retaining those requirements?*

Yes, in principle. However, paragraphs 30 and 31 appear to iterate, a similar requirement and it might be better if the requirement is in a single paragraph.

NAO Comments by the National Audit Office

FRED 29 - Property, plant and equipment; Borrowing costs

General Comments

The National Audit Office has considered how the proposals may be applied, with particular reference to the central government sector. This consideration does not take account of decisions that will be taken by the Treasury on the application of the standard. FRS 15 applies to central government bodies although in a form adapted to circumstances specific to Government. In principle, we see no reason why the standard proposed by FRED 29 should not be adopted in similar way.

A standard based on FRED 29 will have a significant impact on the UK public sector not least because a revaluation approach is used widely. In this respect, application of FRS 15 has required interpretation of a deprival value based valuation model in a not for profit environment. How a fair value basis for revaluation will be adopted in the public sector will depend on how fair value is defined and in particular whether it encompasses a valuation of properties based on existing use.

FRED 29's silence on 'renewals accounting' might be taken to imply that renewals accounting cannot be used. If this is the case, there will be implications for bodies in both public and private sectors that have adopted forms of renewals accounting for infrastructure assets.

Specific Comments - FRED 29

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?*

Yes. There would be little benefit in issuing a revised standard that will have a significant impact on the approach to revaluation in the UK if changes to the international standard become likely.

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 disagree with the proposed international approach. The approach outlined in paragraph 46 of the FRED is that, under the historical cost model, the depreciation charge will take account of residual value based on a current estimate whereas the valuation of the asset will not be at a current valuation. This appears inconsistent and in that changes in residual values as a result of a change in price would affect the depreciation charge, whereas the rate at which the asset is consumed (when measured at historical cost) is unchanged.

In our view, the accounting treatment should differ depending on whether a change in residual value is due to price changes or whether it is a consequence of technological change or impairment. In the case of the latter, a change in residual value indicates that the economic benefits of an asset have been consumed (when measured at historical cost). Thus, the residual value should be restated.

ASB (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?*

In our view, silence could be interpreted as not allowing renewals accounting. In common with FRS 15, the proposed standard says that depreciation should reflect consumption; and infrastructure assets are consumed even though there may be expenditure to restate the economic benefits or restore the useful life. Paragraph 43 might be interpreted as allowing renewals accounting in that useful life depends in part on wear and tear which in turn depends on the maintenance programme ie life could be very long if the asset is properly maintained. However, paragraph 51 (in common with FRS *15)* implies that a maintenance programme should be reflected in an extension of life rather than as a “built in” assumption of a long life.

We believe that UK entities should be allowed to use renewals accounting in specified circumstances, such as where an asset is deemed to be maintained to a specific level of service. In principle, charging annual maintenance costs that maintain the economic benefits of an asset can provide a better measure of consumption in a current cost environment than an annual depreciation charge. This would be the case particularly for assets where consumption might vary. An example being in the accounting for roads where consumption of the asset can depend on weather conditions and particularly the severity of the winter.

If renewals accounting were to be allowed, the revised standard might also address circumstances when annual maintenance expenditure does not fully maintain the economic benefits of an asset (or goes beyond what is needed to maintain the asset), and thus where the amount charged is less (or greater) than’ consumption. Where differences are material, an adjustment to the amount changed to profit and loss should be made.

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 of the Preface to the FRED)?*

Revaluation is used widely in the public sector and as such, we agree that it should continue to be an allowed alternative treatment.

A basis of valuation that uses fair value is potentially a significant change from current practice. In principle, fair value if taken as market value for non-specialised assets could lead to more efficient use as it includes a measure of alternative use. However, an objective of financial statements is to reflect the consumption of the economic benefits embodied in an asset and we consider that a deprival value based on the economic benefits forgone may provide a better measure of consumption of an asset in its existing use

While fair value is usually taken to be market value, there would appear to be scope for the proposed standard to provide further interpretation of how fair value may be determined in practice. In particular, there needs to be consideration of whether fair value can be deemed to encompass an existing use value; or whether in practice fair value is sufficiently close to existing use value in most cases. The proposed standard should also provide clearer links to the practices and terminology used by professional valuers, as does FRS *15.* This would enhance understanding between the accountancy and valuation professions of the form of valuation required and how valuations are used.

The proposed standard contains less guidance than FRS 15 on the basis for valuations. In particular, we consider that the standard should specify when an external valuer must be used. In the case of property valuation, the amounts involved could have a significant impact on the financial statements and it is thus particularly important that valuations are seen to be unbiased.

The proposed approach to reporting revaluation gains and losses (set out in paragraph 17 of the Preface) diverts from FRS *15.* In FRS *15,* impairment is always reflected in profit and loss and revaluation losses that are not impairment are reported in the STRGL. In certain circumstances, the proposed approach would result in reductions in value resulting from consumption of economic benefits not being recognised in profit and loss. Thus, we prefer the FRS 15 approach. However, we acknowledge that the IAS treatment is simpler and also that it often reflects how FRS 15 is applied in practice.

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?*

No

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 IASB's projects on insurance and reporting financial performance?*

Yes. The proposed approach is consistent with that in other areas where changes to international standards are likely.

ASB (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 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. In practice, historical costs may not be available and without this transitional arrangement there would appear to be no other option than to adopt a revaluation approach.

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

No.

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?*

As noted above, the proposed international standard does not address renewals accounting. While we understand that there is some opposition to renewals accounting internationally, we suggest that the ASB request the IASB to review its proposals to make it clear that renewals accounting can be used in certain circumstances.

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 agree that capitalisation should remain optional. If we had to choose, we would probably support mandatory capitalisation on grounds of consistency, in that the resulting valuation would match more closely the market price of purchasing a completed asset.

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?*

Yes. In principle, such exchange differences should be treated in a similar way to borrowing costs if there is a presumption that interest rates and exchange rates are linked. However, in practice, it may be difficult to identify reliably the element of exchange differences that relate to changes in interest rates and thus borrowing costs.

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

We believe that the FRS 15 approach is preferable. Borrowing that has yet to be spent on bringing an asset into use cannot be considered to have been embodied in an asset. The interest payable on that borrowing should be treated accordingly.

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

No.

Specific Comments - IAS 16

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 2iA of the [draft] FRS on property, plant and equipment)?

Yes, in principle.

An objective of financial statements is to show the consumption of the economic benefits embodied in an asset. As such, it seems to us that a deprival value based on the economic benefits forgone will provide a measure of the consumption of an asset in its existing use. While fair value is usually taken to be market value, there would seem to be scope for the proposed standard to provide further interpretation on how fair value may be determined in practice. In particular, there needs to be consideration of whether fair value can be deemed to encompass an existing use value; or whether in practice fair value is sufficiently close to existing use value in most cases.

We note that a joint project is underway seeking to converge the approaches to accounting for revaluations. Should it become clear that further changes to IAS 16 are likely as a result of this project, it would seem preferable to wait until revision was complete before issuing a new international standard rather than to issue a standard that may require subsequent amendment.

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?

Yes. We presume that this question relates to exchanges of tangible for intangible assets, or vice versa, rather than exchanges of intangible assets only. The accounting treatment in paragraph 21 of the proposed standard is consistent with the equivalent in IAS 38 *Intangible assets.*

MSB (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 for assets that are temporarily idle although there may be a need to consider whether an asset should be re-lifted following a period of being idle. Retired assets should not be depreciated but written down to residual value.

Further comments - renewals accounting

Renewals accounting is allowed in specific circumstances by existing accounting standards in the UK. The proposed international standard does not address renewals accounting and it is not clearly the case that renewals accounting can be used. While we understand that there is some opposition to renewals accounting internationally, we suggest that the IASB review its proposals to clarify that renewals accounting can be used in certain circumstances.

Bournemouth & West Hampshire WATER

Mr Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
LONDON
WC1X 8AI

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 important issue of renewals accounting raised in paragraph 38 ASB (iii) of the discussion document We currently take advantage of the provisions in FRS 1 5 at paragraphs 97 - 99 to account for our underground infrastructure assets in a cost effective and meaningful way. In addition, infrastructure renewals accounting represents 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 1 5 when the water industry, OFWAT and auditors stressed the importance of retaining this method of "depreciation" for infrastructure networks. The arguments which led to this approach being accepted by the ASB are still as relevant today and are as follows;

- Infrastructure renewals accounting was adopted by the water industry in 1 989 to provide a consistent way in which to account for the underground network of mains and sewers which represents a single system to be 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.

- A significant proportion of infrastructure assets in the water industry were created prior to 1 974 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 as part of the price-selling mechanism. 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.

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 in the water industry.

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 inevitable lack of consistency in treatment between companies would be undesirable.

Prior to the issue of FRS 1 5, 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 should be retained and specific guidance to this effect should be included in the revised accounting standard. The omission of such guidance would present the water industry with major practical difficulties that would inevitably increase costs and affect charges to customers in the long term.

Yours sincerely

Anthony Ferrar

Anthony Ferrar
Finance Director

Continued

UK 15

Stacey & Partners
Chartered Accountants
The Limes
32 Bridge Street
Thetford
Norfolk
IP24 3AG

ASB

(By e mail)

Dear Sirs,

Property, plant and equipment; Borrowing costs (FRED 29)

I am writing on behalf of my firm to set out our responses to FRED 29.

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?

We agree that, if it is likely that further changes will be forthcoming from the IASB, the implementation of FRED 29 should be delayed.

This is because the volume of standards issued by the ASB will be fairly high between now and 2005, and it would be simpler to issue one standard in respect of Fixed Assets rather then issuing one and then amending it at a later date.

We consider that the existing standards cover all matters relating to matters covered by FRED 29.

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 disagree with the international approach. The reconsideration of residual values would create additional work for those preparing accounts and we consider that the extra information given would not be of great value.

Inflation in most industrialized countries is not at large % levels, and therefore any adjustment arising from a revision in residual value is unlikely to have a material effect on the accounts.

ASB (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?

We believe that the UK should be entitled to contour to use renewals accounting in the few circumstances where it gives a true and fair view.

Although we do not consider the FRED as drafted would prevent renewals accounting, FRS 15 defines when it may be used and strict conditions. These are absent from the FRED and we consider this may result in abuse by those preparing accounts. For this reason, we would like to have the guidance from FRS15 incorporated in any standard such as FRED 29.

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

We consider that users of accounts would be able to appreciate revaluations in accounts that are based upon market valuations, rather than the concept of fair valuations. We therefore prefer the IAS principle of revaluation's being based upon market valuations, rather than existing use valuations, as this would simplify the treatment of valuations in the accounts.

We consider that guidance should be incorporated in the FRED to set out the frequency of valuations. As drafted, this is left to the judgment of those preparing accounts, which could be influenced by various factors. By setting out the period over which valuations should be carried out, as in FRS15, those preparing accounts are forced to carry out the valuations or disclose the non-compliance with accounting standards.

We also consider the detailed guidance in FRS15 relating to valuations, and appendix 1 to be useful. A similar appendix and detail should be attached to the FRED.

We believe that the treatment of revaluation losses and surpluses is inconsistent. The current rules should apply, so that a revaluation loss exceeding a previous surplus is recognized in the statement of recognized gains or losses. This assists in producing statements that show the true effect of revaluations.

For the above reason, we also consider that all impairment losses should be shown in the profit and loss account, and not in the Statement f Gain and Losses.

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?

No.

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 IASB's projects on insurance and reporting financial performance?

We agree that the present exemption should be incorporated in the FRED.

ASB (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 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 recognize the carrying amounts under that arrangement?

We agree that the transitional arrangements regarding FRS15 should be maintained.

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

No.

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 finalizing the revised lAS 16?

No.

ASB (x) Do you agree that the capitalization of borrowing costs should remain optional? If you had to choose between mandatory capitalization and prohibition of capitalization, which would you support and why?

We consider that there should be no optional choice between the methods of interest capitalization, so those users of accounts can easily compare one entity with another.

We would support the mandatory capitalization of interest, due to the fact that this would show the "true" cost of brining an asset into existence.

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 believe that all exchange differences should be shown on the profit and loss account. Paragraph *5(e)* should therefore be deleted.

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 consider that it is correct to show the true cost of borrowing within fixed assets. Temporary investment income is a matter of policy of a company, and therefore the effect of the company's money management policy should be shown in the profit and loss account, as currently require in FRS 15.

The treatment of IAS23 in relation to this matter would result in a difference in the capitalised figure, depending on the amount of borrowings received at the start of the project.

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

No.

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

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] FRS on property, plant and equipment)?

We believe this would enable transactions to be reported correctly, showing a true and fair view and agree to the incorporation of such a requirement.

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 believe this would enable transactions to be reported correctly, showing a true and fair view and agree to the incorporation of such a requirement.

IASB (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)?

We believe that when an asset ceases to be used, the asset should be written down immediately to its recoverable value and an impairment review carried out if necessary. Depreciation should therefore cease at that point.

However, if an asset had been temporarily idle, then we suggest that the correct treatment be for deprecation to continue.

Yours truly,

Mark A Wallace ACA
Technical Partner

UK 16

WELSH FEDERATION OF HOUSING ASSOCIATIONS

Response to FRED 29 Property, plant and equipment; Borrowing costs

The Federation welcomes the opportunity **to comment on the Financial Reporting** Exposure Draft 29 Property, plant and equipment; Borrowing costs. The Federation, together with its English and Scottish counterparts, is the recognised SORP-making body for registered social landlords (RSLs) in the United Kingdom.

The Federation represents 92 independent not for profit social landlords registered with the National Assembly for Wales owning over 65,000 properties (at 31 March 2001). These include 30 housing associations funded by a combination of Social Housing Grants payable by the National Assembly and loans raised from the capital markets, banks and building societies. They owned 61,000 properties at March 2001

At 31 March 2001 their global balance sheets were as follows:

Fixed assets	
Housing assets at cost	2,321
less: SHG and other public grants	(1,616)
Depreciation	(8)
Revaluation surplus	82
	779
Long term investments	0
Other fixed assets	31
Total fixed assets	**811**
Current assets	
Rent and service charges receivable	10
less: Provision for bad and doubtful debts	(5)
Investments	16
Cash	40
Other debtors	17
Total current assets	**78**
Current liabilities	
Short term housing loans	6
Bank overdrafts	4
Rent and service charges received in advance	2
Re-cycled capital grant fund	7
Other current liabilities	42
	61
Net current assets	**17**
Total assets less current liabilities	**828**
Creditors: amounts falling due after one year	
Housing loans	570
Non-housing loans	2
Other long term creditors	7
Provisions	0
Total loans and provisions	**579**
Net assets	**249**
Capital and reserves	
Accumulated surplus	82
Major repairs reserve	60
Cyclical maintenance reserve	0
Restricted reserves	12
Other designated reserves	12
Revaluation reserves	82
	249

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?

Response by WFHA: We would prefer that the new UK standard is only issued after the project is completed so as not to have to deal with successive revisions to the standard.

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?

The comparison of the two standards is as follows:

FRS15	FRED29
Review of residual value 95. Where the residual value is material it should be reviewed at the end of each reporting period to take account of reasonably expected technological changes *based on prices prevailing at the date of acquisition (or revaluation).* A change in its estimated residual value should be accounted for prospectively over the asset's remaining useful economic life, except to the extent that the asset has been impaired at the balance sheet date.	Review of residual value 46. The depreciable amount of an asset is determined after deducting the residual value of the asset. In practice, the residual value of an asset is often insignificant and therefore immaterial.. .When the residual value is likely to be material, the residual value is estimated at the date of acquisition and is reviewed as at each balance sheet date. A change in the asset's residual value, other than a change reflected in an impairment loss recognised under FRS 11 is accounted for prospectively as an adjustment to future depreciation. An estimate of an asset's residual value is based on the amount recoverable from disposal, *at the date of the estimate,* of similar assets that have reached the end of their useful lives

Response by WFHA: The review should be based on prices current at the date of the review. Social housing properties typically have very long lives and the residual values will change considerably over time. To maintain residual values at prices which may date back many decades would not be a realistic basis to measure residual values.

ASB (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?

Response by WFHA: Not relevant to housing associations

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 of the Preface to the FRED)?

The main difference relates to the valuation basis as follows:

FRS 15	FRED 29
Valuation Basis 53. The following valuation basis should be used for revalued properties that are not impaired: (a) non-specialised properties should be valued on the basis of existing use value (EUV)…. Where the open market value OMV is materially different from EUV, the OMV and the reasons for the difference should be disclosed in the notes……….. (b) Specialised properties should be depreciated on the basis of depreciated replacement costs (c) Properties surplus to an entity's requirements should be valued on the basis of OMV	**Revaluations** 30. The fair value of land and buildings is usually its market value. This value is determined by appraisal normally undertaken by professionally qualified valuers

Response by WFHA: The conventional basis for valuing social housing properties is the existing use basis. The market value would be the open market basis of valuation, which is not appropriate.

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?

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 IASB's projects on insurance and reporting financial performance?

Response by WFHA: Not relevant to housing associations

ASB (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 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?

Response by WFHA: Not relevant to housing associations

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

Response by WFHA: Not relevant to housing associations

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?.

Response by WFHA: We would like to comment on the following two points:

1. **Initial measurement**

There are differences in the rules for measuring the costs to be capitalised, as follows:

<table>
<tr><td>FRS 15</td><td>FRED 29</td></tr>
<tr><td>Initial Measurement
8. The cost of a tangible fixed asset comprises its purchase price and any costs directly attributable to bringing it into working conditioning …..

9. Directly attributable costs are:
(a) labour costs of own employees arising directly form the construction or acquisition of the specific asset
(b) the incremental costs to the entity that would have been avoided only if the asset had not been constructed or acquired
It follows that administration and other overhead costs would be excluded….
10. Examples include:
(a) Acquisition costs (eg. Stamp duty etc.)
(b) costs of site preperation
(c) initial delivery
(d) installation
(e) professional fees</td><td>Initial Measurement
15. The cost of an item of property, plant and equipment comprises:
(a) its purchase price……
(b) any directly attributable costs to bring the asset to the location and working condition necessary for it to be capable of operating in the manner intended by management after deducting the net proceeds from selling any items produced when bringing the asset to that location and condition.
15A Example of directly attributable costs are:
(a) costs of employee benefits
(b) costs of site preparation
(c) initial delivery
(d) installation and assembly costs
(e) professional fees

17. Examples of costs that are not a component of the cost of the property, plant and equipment:
(a) costs of opening a new facility
(b) costs of introducing a new product
(c) costs of conducting business in a new location
(d) administration and general overhead costs
These costs are excluded because they are not part of the asset's purchase price and cannot be attributed directly to bringing the asset to the location and working condition necessary for it to be capable of operating in the manner intended by management</td></tr>
</table>

FRS 15 includes a key test in the definition of directly attributable costs:

the incremental costs to the entity that would have been avoided only if the asset had not been constructed or acquired

2. Depreciation method

FRED 29 differs somewhat in describing the alternative depreciation methods, as follows:

FRS 15	FRED 29
Depreciation method 81. A variety of methods can be used to allocate the depreciable amount of a tangible fixed asset on a systematic basis over its useful life. The method chosen should result in a depreciation charge throughout the asset's useful life and not just towards the end of its useful economic life. *Two of the more common methods are:* (a) Straight line (b) Reducing balance	**Depreciation method** 47. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. *These methods include* the straight line method, the diminishing balance method and the sum of the units method

We are conscious of the fact that the draft revision to FRS 15 had proposed disallowing the annuity method of depreciation as an acceptable method of calculating depreciation. We also understand that the draft revision is unlikely to be issued. We would therefore prefer FRED 29 to give a clearer steer as to what methods are acceptable.

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?

Response by WFHA: Housing associations capitalise interest on their housing developments. Therefore we are content with the present situation of it being optional. If we had to choose between mandatory capitalisation and prohibition we would choose the former, since it is our current practice to capitalise interest.

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?

Response by WFHA: Not relevant to housing associations

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?

FRS15	FRED29
Finance costs 21. Only finance costs that are directly attributable to the construction of a tangible fixed asset should be capitalised Directly attributable finance costs are those that would have been avoided (for example by avoiding additional borrowings or by using the funds expended for the asset to repay existing borrowings) if there had been no expenditure on the asset 22. Where the entity has borrowed funds specifically for the purpose of financing the construction of a tangible fixed asset, *the amount of finance costs capitalised is limited to the actual costs incurred on the borrowing during the period in respect of expenditures to date on the asset* 23. Where the funds used to finance the construction.. .form part of the entity's general borrowings, the amount of finance costs capitalised is determined by applying a Capitalisation rate to the expenditure on that asset	**Borrowing costs** 11. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalised as part of the cost of that asset. 13. The borrowing costs that are directly attributable to the acquisition of an asset, are those borrowings that would have been avoided if the expenditure on the asset not been made. When an enterprise borrows funds specifically for the purpose of obtaining a particular asset, the borrowing costs that directly relate to that asset can be readily identified. 15. To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined *as the actual borrowing costs incurred on that borrowing less any investment income on the temporary investment of those borrowings.*

Response by WFHA: We are not sure whether the proposed treatment in FRED 29 would give rise to a more precise measurement of interest to be capitalised. Under FRS 15 housing associations capitalise only the interest costs on the borrowings actually used to develop the tangible fixed asset. In practice housing associations rarely borrow dedicated funds for individual specific developments. If they did so, they would generally only draw down the amount required for the development.

We firmly believe therefore that the requirements of FRS 15 should be retained for housing associations.

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

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

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] FRS on property, plant and equipment)?

Response by WFHA: Housing association do occasionally exchange properties between each other. They are usually accounted for at book value, which in the overwhelming majority of cases is historical cost. In those cases where one property is held at valuation by one association and is exchanged for a property which is held at cost by the other, the transferee associations would continue to show the properties at the original book values- cost in the case of one and valuation in the case of the other. We therefore do not agree with the proposal that all exchanges should be measured at fair value.

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?

Response by WFHA: Not relevant to housing associations

IASB (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)?

Response by WFHA: We would generally continue to depreciate the asset, although, as indicated in the last sentence of paragraph 59, the association would test such an asset for impairment under FRS 11 and recognise any impairment accordingly.

FRS15	FRED29
Subsequent expenditure 36. Subsequent expenditure should be capitalised in three circumstances: *(a) where the subsequent expenditure provides an enhancement of the economic benefits of the tangible fixed asset in excess of the previously assessed standard of performance* (b) where a component of the tangible fixed asset that has been treated separately for depreciation purposes and is replaced or Restored (c)………………….	**Subsequent expenditure** 23. Subsequent expenditure relating to an item of property, plant and equipment that has been recognised, other than expenditure incurred in replacing or renewing a component of such an item, shall be added to the carrying amount of the *asset when, and only when, it is probable that the expenditure increases the future economic benefits embodied in the asset in excess of its standard of performance assessed immediately before the expenditure was made.*

The differences between the two standards are minor and are unlikely to change the accounting policies of housing associations.

Charity
COMMISSION
for England and Wales

Woodfield House
Tangier
Taunton
Somerset TA1 4BL

Direct Line: 01823 345096
Fax: 01823 345430
General Enquiries: 0870 3330123 (Voice)
0870 3330125 (Minicom)

Email:

Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

Your Ref: fred29@asb.org.uk
Our Ref: RTJ/Policy (T) -fred29

Date: 11 September 2002

Dear Hans,

FRED 29 (i) Property, plant and equipment (ii) Borrowing costs

We concur that IAS 16 and FRS 15 have much in common in terms of their scope and principles for initial measurement, valuation and depreciation of tangible fixed assets.

A number of issues do however arise in the context of the charities sector that warrants particular consideration.

As identified in the exposure draft, the proposals are silent on the question of initial measurement of donated assets. The existing standard (FRS *15)* is explicit in its requirement for donated tangible fixed assets to be carried at their current value on the date they are received. This accounting treatment is echoed in the Charities SORP and is standard sector practice.

The inclusion of all charity assets in their financial statements at fair value has been a long struggle and we are concerned that the technical underpinning of this work may be lost if the issue is not specifically addressed by the new standard. From the context provided in the preface to the exposure draft, it would appear that ASB have the discretion to modify an international standard for UK purposes. We believe that consideration therefore should be given to the inclusion of a short paragraph to address the issue of initial valuation of donated assets.

Revaluation of tangible fixed assets, whilst not the usual sector practice, is a policy adopted by some charities and the Charities SORP allows some flexibility in valuation approaches where such a policy is adopted. Some charities that currently revalue using EUV may be reluctant to adopt OMY policies for reasons well explained in the preface to the exposure draft. Also a number of charities adopted revaluation policies under FRS 15 without fully appreciating the requirement for ongoing valuations under the standard. Transitional arrangements that allow entities that chose not to adopt revaluation policies under the new standard to continue carrying tangible fixed assets at a previous valuation would be welcomed. These transitional arrangements should apply both to entities that did not adopt revaluation policies under FRS 15 and to those that choose not to adopt revaluation with the introduction of the new standard. This would give charities an opportunity to review current valuation policies before “locking into” a requirement for on-going valuations under a new standard.

We attach a schedule that sets out our responses to the particular questions raised in the exposure draft.

Yours Sincerely

Raymond Jones

Raymond Jones
Policy Accountant

Responses to Exposure Draft 29
Property, Plant and Equipment (IAS 16)
Borrowing Costs (IAS 23)

Reference	Issue	Response
ASB(i)	Do you agree to the proposal to issue new UK standards on property, plant and equipment and borrowing costs when IASB issues the revised IAS 16, unless further changes to the international standard become clear as the result of the revaluation project.	It would be prudent not to issue a new standard until the IASB review of IAS 16 and the outcome of the revaluation project is know with reasonable certainty. (Also see response to ASB (viii) – below).
ASB (ii)	Should residual values used for calculation of depreciation be reviewed annually or at acquisition or revaluation.	Residual values should generally only be reviewed on acquisition or revaluation of tangible fixed assets. To review annually with create additional expense and will only be relevant where residual values are material to annual depreciation. We would therefore prefer to see the need for annual review limited to those assets that have material residual values as under the current standard.
ASB (iii)	Should the new standard allow for renewals accounting for depreciation.	We do not generally encounter such depreciation policies being adopted within the charities sector. We are therefore context with the new standard being silent on this issue.
ASB (iv)	Views on approaches to revaluations: OMV (open market value)- EUV (existing use value) – DRC (depreciated replacement cost).	Whilst the IAS has the attraction of simplicity in its heavy weighting for the use of OMV, we recognise the potential anomalies this approach may create e.g. development potential of land included in valuations or write-downs of specially adapted property despite the value of such additions for existing use. There may therefore be reluctance in parts of the charities sector to use open market values for functional property as this will not reflect the current usage and may create the type of anomaly identified above. There is also significant use of DRC within the charities sector (hospitals, nursing homes, libraries, schools etc.). It will be important that current RICS guidance given within in FRS 15 continues to provide the yardstick as to when DRC approaches are appropriate.
ASB (v)	Any other differences between the two standards you wish to comment on.	No other issues identified.
ASB (vi)	Transitional arrangements for insurance companies.	No comments.

Responses to Exposure Draft 29
Property, Plant and Equipment (IAS 16)
Borrowing Costs (IAS 23)

ASB (vii)	Do you believe that a transitional arrangement should be included in the new UK standard to allow entities that adopted FRS15's transitional arrangements to continue to recognise the carrying amounts under that arrangement.	This exemption would be extremely helpful. The FRS 15 transitional arrangement helped many charities that had revalued as a one – off exercise in the past and did not wish to adopt a policy of on-going revaluation. We therefore feel that the introduction of such an exemption is very important to the sector. Indeed in the context of a move to OMV, it would be appropriate to offer this exemption again to charity's moving to the new standard (not wishing to adopt this policy) but having previously adopted a policy for EUV revaluations under FRS 15. A significant number of charities may also have moved to revaluation approaches under FRS 15 not fully appreciating the on-going valuation requirements. An option to reconsider whether a revaluation policy is still appropriate in the context a move to a new standard is therefore also desirable.
ASB (viii)	Need for other transitional arrangements.	Yes, as mentioned above a move to OMV property values may be inappropriate for some charities. An exemption similar to that granted on the introduction of FRS 15 would be helpful in allowing entities to treat past revaluations as though they were historic costs and not requiring ongoing revaluations in the future. There may also be merit in considering allowing the application of either standard up to 2005. This could allow reporting entities to make a single switch from current UK standards to the proposed new standards rather than a piece-meal transition.
ASB (ix)	Are there any other aspects of IAS 16 that should be reviewed by IASB.	No other issues identified.
ASB (x)	Should capitalisation of borrowing costs be optional? If a choice were mandatory capitalisation or prohibition of capitalisation which would you support.	Within the charities sector there will be a tendency to expense interest costs. We have no difficulties with optional treatment continuing to be allowed.
ASB (xi)	Can foreign exchange differences be regarded as borrowing costs.	It is rare in our experience for charities to enter into foreign exchange loans to fund tangible fixed assets. We can see logic to the international standards approach to this issue as any decision to take a foreign exchange loan will be a factor of both the rate of interest and an assessment of currency movements. However, we have no difficulties in ASB excluding foreign exchange movements from borrowing costs.

Responses to Exposure Draft 29
Property, Plant and Equipment (IAS 16)
Borrowing Costs (IAS 23)

ASB (xii)	Any specific issues to be brought to IASB's attention.	None
IASB (i)	Do you agree that exchange transactions involving property, plant and equipment should be measured at fair value except where fair value of neither exchange assets can be determined reliably.	We concur with this approach.
IASB (ii)	Do you agree that exchange transactions involving intangible assets should be measured at fair value except where fair value of neither exchange assets can be determined reliably.	We concur with this approach.
IASB (iii)	Do you agree that depreciation should apply to temporarily idle or retired assets held for disposal.	We can accept the approach proposed as being pragmatic. Argument could be made that depreciation of idle assets is only relevant where despite the retirement there is still a reduction in the economic life of the asset. Also retired assets pending sale perhaps should in theory be regarded as current assets and written down to net realisable value and depreciation ceased.

Charity
COMMISSION
for England and Wales

Woodfield House
Tangier
Taunton
Somerset TA1 4BL

Direct Line: 01823 345096
Fax: 01823 345430
General Enquiries: 0870 3330123 (Voice)
0870 3330125 (Minicom)

Email:

Hans Nailor
Accounting Standards Board
Holburn Hall
100 Gray's Inn Road
London
WC1X 8AL

Your Ref: fred 25
Our Ref: RTJ/Policy (T)/ED 25

Date: 27 August 2002

Dear Hans,

Related Party Disclosures - FRED 25 Consultation

FRS 8 has been a key standard in charity reporting and has contributed significantly to the sector's accountability and transparency. Transactions with related parties (other than at arms length with subsidiaries) are not regarded as normal or usual in the context of charities. In particular transactions that give rise to a benefit to a charity trustee (a director in company's terminology) require either constitutional authority or in England and Wales an order by the Charity Commission.

In this context the guidance provided by FRS 8 on transactions undertaken directly or indirectly with individuals accountable for stewardship (e.g. trustees) has been particularly valuable. In the context of charities such information may significantly influence the decisions of users of financial statements such as donors. We therefore have particular concerns that this issue of materiality is not addressed in the exposure draft. We fear that without specific guidance that significant transactions with trustees and persons connected with them will fall out of disclosure as being immaterial in the context of the reporting entity or group whilst being significant to the recipient. With current pressures on enhanced disclosure, accountability and transparency we believe this could be seen as a retrograde step and poorly timed.

We also note that FRS 8 deals more comprehensively with the notion of influence and related party status. From the sector viewpoint relationships that might exist which inhibit a charity from pursuing its own independent interest are particularly relevant. Any decision to enter into a transaction ought to be influenced only by the consideration of the charity's own interests. Currently paragraph 2.5 (a) of FRS 8 addresses this point well. Similarly, the concept of two parties being influenced from the same sources and hence being related appears to have been lost. We feel that these considerations could be introduced explicitly into paragraph 5 or 6 of the exposure draft and to some extent built into the definition of "significant interest" provided in paragraph 9.

We also consider that IASB should give wider consideration to the disclosure of "management compensation." The term is loose and undefined at present and one can imagine a variety of transactions being treated as part of management compensation and therefore exempt from disclosure. IASB should in our view be encouraged to consider the exact reasons for the regarding "management compensation" as being exempted from the standard. Users of financial statements are undoubtedly influenced by compensation packages awarded to key management and on occasion such information is relevant to the assessment of governance and risks of aggressive earnings management. The only justification that we can see for the exemption (apart from sensitivities) is that such discloses are also required under company law. We therefore believe this matter and the reasons for the exemption should be re-considered.

Our responses to the specific questions raised with the Exposure Draft are set out in the attached schedule.

Yours Sincerely

Raymond Jones

Raymond Jones
Policy Accountant

Related Party Disclosures
Exposure Draft 25

Reference	Issue	Response
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.	In the context of the Charities Sector we see little advantage to the proposal other than in the context the wider agenda of aligning UK and international standards. FRS 8 appears to be broadly consistent with the requirements of IAS 24 already and much of the more detailed analysis and explanation provided by the UK standard will be missed. It could be argued that FRS 8 creates in substance the same disclosure requirements as the international standard without its revision. (except perhaps in the interpretation of materiality). However, in so far as the two standards are compatible, we believe it is primarily a matter for the ASB to consider the need and merits for the adoption of the text of the international standard.
ASB (ii)	Do you believe that the ASB should consider any transitional arrangements.	The disclosure requirements of the Exposure Draft are not considered significantly different to FRS 8. We would not therefore anticipate a particular need for a significant transitional period. There may however be merit in considering allowing the application of either standard up to 2005. This could allow reporting entities to make a single switch from current UK standards to the new standards proposed rather than a piece-meal transition.
ASB (iii)	Should disclosure of the name of the controlling party and, if different, that of the ultimate controlling party – should the UK standard require such disclosure even if not required by IAS 24.	Yes. We concur with the reasons put forward in paragraph 13B of the exposure draft.
ASB (iv)	Should the standard require disclosure of the names of the transacting related party.	An understanding of the relationship between the parties, amounts, and nature of the transaction are essential to users of the accounts. The names of the parties involved are not perhaps as essential to this understanding. However, we recognise that there may be stakeholder interest in transactions that involve directors (trustees in charities) or their close family members or with entities controlled by them. This information may be relevant to stakeholders and users of accounts in assessing the governance practices of an entity and as such may be relevant to their overall assessment of an entity including risk. On balance therefore we believe that the standard should disclose the names of transacting related parties.

ASB (v)	Should the definition of related parties specifically refer to shadow directors and persons acting in concert.	Yes, we believe that specific reference to shadow directors is desirable in order to remove any ambiguity as to their related party status. Whilst such relationships may already fall within the "significant influence" categories or be seen as " management personnel" we consider it to be desirable to remove any lingering ambiguity. The concept of persons acting in concert to exercise control or influence over a charity is only encountered on rare occasions and in the charity context is seen primarily as a governance issue. In our experience transactions by a charity with such persons is unlikely. In practical terms forming a view as to whether persons are actually acting in concert to influence an entity is extremely problematic. We therefore have no particular concerns should the standard not refer specifically to persons acting in concert as being a related party.
ASB (vi)	Should the standard specify that disclosure is required of material transactions and give more guidance on materiality.	In the context of the charities sector transactions with related parties (other than subsidiaries) are not a normal feature of activities. Such transactions often either require constitutional authority or an order made by the Charity Commission (e.g. - if a trustee or connected person benefits from the transaction or arrangement). In this context the interpretation of materiality may not be the same as for general commercial entities where the standard suggests that related party relationship may be a normal feature of commerce. FRS 8 was particularly helpful in this respect in that significant transactions with trustees/related parties was defined not only in terms of the reporting entity but also in the context of the other related party. We would therefore favour the inclusion of a paragraph 20 of FRS 8
ASB(vii)	Are there other aspects of the draft standard that IASB should be requested to review.	No other specific areas identified where review by IASB is necessary.
IASB (i)	Do you agree that the standard should not require disclosure of management compensation, expense allowances similar items.	Remuneration and other payments made to management are clearly transactions over which the management of an entity has considerable influence if not control. There may be arguments to say that standards based disclosures are unnecessary due to existing legislative requirements for such disclosures. However, standards do not appear to take a general line of not addressing issues already provided for by legislation or regulation. We consider the exemption given to the disclosure of management compensation is difficult to justify.

Related Party Disclosures
Exposure Draft 25

IASB (ii)	Do you agree that the standard should not require disclosure of related party transactions and outstanding balances in separate financial statements of a parent or a wholly-owned subsidiary that are made available or published with consolidated financial statements to which that entity belongs.	In the context of commercial groups we concur with this exemption. Users of accounts are primarily concerned with the potential impact on group results. In the context of the charitable sector certain concerns do arise as transactions between a charitable entity and its subsidiaries could allow for undisclosed subsidy arrangements or in the provision for debt due from non-charitable subsidiaries which may not be readily apparent in the consolidated accounts. We therefore concur with the standard in the context of commercial entities provided the Charities SORP is allowed sufficient flexibility to address additional disclosure needs that may apply to the sector.

Dear Sir or Madam:

FRED29 Property, plant and equipment; borrowing costs Question ASB (iii)

I am writing in response to question ASB (iii) in Exposure Draft No. 29 'Reporting property, plant and equipment; borrowing costs' concerning renewals accounting.
In common with the rest of the water industry United Utilities Water PLC currently accounts for its underground infrastructure assets using renewals accounting as permitted by FRS 15 paragraphs 97—99. This approach allows underground infrastructure assets to be accounted for in a practical and cost effective way and represents an integral part of the economic, regulatory and accounting framework within the water industry.

We strongly believe that the current approach be retained for the following reasons:

- The infrastructure network is treated as a single system - the underground infrastructure network of mains and sewers represents a single system to be maintained at a specified level of service potential. The individual component assets are of no separate economic use and have no determinable asset life, any attempt to estimate these would be subjective.

- Asset records do not exist for pre-1974 assets - many infrastructure assets were acquired/created prior to 1974. Insufficient records exist for these assets to allow depreciation to be calculated on conventional bases. In the absence of these records the use of annual expenditure from an independently certified asset management plan provides a more robust auditable and practical basis of estimating depreciation.

- Consistency with regulatory accounting - OFWAT have indicated that they will continue to require us to account for infrastructure assets in the regulatory accounts using renewals accounting. We would prefer to retain consistency between statutory and regulatory reporting to avoid confusion for users and the need to maintain two sets of assets records. The current presentational differences relating to infrastructure assets between the two sets of accounts are easily reconcilable and result in consistent profit figures.

Renewals accounting per FRS 15 provided a workable solution to the issues outlined above. We believe that this solution should be retained and specific guidance to this effect should be included in the revised accounting standard. In the absence of this, the water industry would face major practical difficulties that would result in increased costs and therefore charges to customers in the long term.

Yours sincerely

Steven Beaumont
Finance Director
United Utilities Water PLC

KeldaGroup

Kelda Group plc
Western House
Halifax Road
Bradford BD6 2SZ
Tel +44 (0)1274 600111
Fax +44 (0)1274 608608
www.keldagroup.com

12 September 2002

Mr Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WCIX 8AL

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

KeldaGroup

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

Yours sincerely

John O'Kane
Group Finance Director

cc Ernst &Young
OFWAT
Water UK

Kelda Group plc
Western House
Halifax Road
Bradford BD6 2SZ
Tel +44 (0)1274 600111
Fax +44 (0)1274 608608
www.keldagroup.com

KeldaGroup

11 September 2002

Mr Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X SAL

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

Anglian Water

Anglian Water Services Ltd
Henderson House
Lancaster Way
Huntingdon Cambs
PE29 6XQ

Tel 01480 323505
Fax 01480 323192

Our ref.

Your ref.

12 September 2002

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

Dear Mr Nailor

Comments on FRED29 - Property, Plant and Equipment

I am writing in response to the FRED29 on the subject of Property, Plant and Equipment and in particular in relation to the important issue of renewals accounting raised in paragraph 38 ASB (iii) of the discussion document. As you are no doubt aware, the water industry currently takes advantage of the provisions in paragraphs 97 - 99 of FRS 15 to account for its infrastructure assets in a practical, cost effective and meaningful way. Furthermore, infrastructure renewals accounting represents an integral part of the economic, regulatory and accounting framework within which water companies operate in the UK.

The framework for accounting for the costs of maintaining the infrastructure in the water industry using infrastructure renewals accounting was established before privatisation in 1989. It covers assets which water companies are required to maintain in perpetuity to agreed levels of service. You will know that detailed discussions took place on the subject of infrastructure renewals accounting prior to the issue of FRS 15 when the water industry, OFWAT and auditors stressed the importance of retaining this method of "depreciation" for infrastructure networks. As a result, paragraphs 97 - 99 were incorporated into the standard and this has proved to be a workable solution which addresses the requirement to depreciate assets whilst still recognising the nature of assets concerned and the manner in which they are maintained.

Registered in England
No 2366656
Registered Office: Anglian House,
Ambury Road, Huntingdon,
Cambridgeshire. PE29 3NZ

The arguments which led to this approach being accepted by the ASB (the key aspects of which are reiterated in summary in the attached Appendix) are still as relevant today and the use of renewals accounting remains the only practical way in which to determine the “depreciation” on 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 in the water industry.

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

I know that you will receive similar comments from many companies within the water sector together with their auditors. This is an issue on which there is a very strong feeling reflecting the amount of work that has gone into developing the existing infrastructure renewals accounting framework. I hope you will recognise this in the finalisation of the Accounting Standard. I look forward to seeing the results of the ASB’s deliberations.

David Hipple
Finance Director

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 network of mains and sewers which represents a single system to be 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.

- A significant proportion of infrastructure assets in the water industry 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 as part of the price-setting mechanism. 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 15, 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 as a method of determining the depreciation charge for infrastructure assets, should be retained and specific guidance to this effect should be included in the revised accounting standard. The omission of such guidance would present the water industry with major practical difficulties that would inevitably increase costs and therefore charges to customers in the long term.

BRITISH AIRWAYS

John Rishton
Chief Financial Officer

Waterside (HBB3)
PO Box 365 Harmondsworth UB7 0GB
Tel +44 (0)20 8738 7612
Fax +44 (0)20 8738 9647

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

16 September 2002

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

John Rishton

John Rishton
Chief Financial Officer

JOHNSTON CARMICHAEL

JW/JWAOO 1/CPL/AMS 17

September 2002

Mr Hans Nailor
Accounting Standards Board
Holburn Hall
100 Gray's Inn Road
London
WC1X 8AL

By e-mail only: fred25@asb.org.uk

Dear Sir

FRED 25 (MAY 2002): RELATED PARTY DISCLOSURES

We refer to the above Exposure Draft and would comment on the questions raised as follows:

ASB (i) We agree in principal with the issue of the new standard in the UK, but as the UK is not adopting IAS 24 we believe that the timetables are mutually exclusive.

ASB (ii) Rather than provide for transitional arrangements in the new standard we believe the current FRS 8 should be followed until the implementation date of the new standard.

ASB (iii) We believe that disclosure of the controlling party or, if different, the ultimate controlling party is an appropriate disclosure.

If the new IAS 24 does not require the disclosure we would still support the disclosures set out in paragraphs 13A and l3B of the (draft) FRS.

ASB (iv) We believe that to provide details of a related party transaction without disclosing the name of the controlling party would be inappropriate. Any stakeholder would be left wanting if the related party were not named.

That is to say we do not believe that common place disclosures such as “During the year transactions took place with company’s directors on commercial terms” address the spirit nor letter of the FRS.

ASB (v) Whilst we support the need to define “Related Parties” certain groupings may be difficult to identify in practice. This could apply to shadow directors and concert parties, but we believe it is appropriate to include these in the definition of related parties.

ASB (vi) We believe that related party disclosures should be restricted to material items. However, as materiality is likely to differ when assessed form the perspective of the related party and the entity we believe it appropriate to provide guidance on materiality.

ASB (vii) We concur with the subsidiary exemption applying only where that subsidiary is a wholly owned entity.

Yours faithfully

JOHNSTON CARMICHAEL

Related Party Disclosures (FRED 25)

The ASB would welcome comments in particular on the following:

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?
Yes, we welcome this move towards harmonisation

ASB (ii) Do you believe that the ASB should consider any transitional arrangements?
No - the requirements do not fundamentally differ from those of FRS 8 therefore we do not see any need for transitional arrangements.

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 l3A and l3H of the [draft] FRS?
We believe the name of the controlling and ultimate controlling party should be disclosed our reasoning behind this is to allow greater transparency for users when reading financial statements.

However, if the new IAS does not require disclosure, then we do not believe that the new UK standard should require disclosure. We believe harmonization is essential to this process.

ASB (iv) Do you believe that an accounting standard should require disclosure of the names of transacting related parties?
Yes, but only if these requirements are included in the new IAS for the reasons mentioned in (iii) above.

ASB (v) Should the definition of related parties specifically refer to shadow directors? Should it also refer to persons acting in concert?
Yes to both of the above as to include them in the definition removes any potential for ambiguous interpretation.

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 materiality in the context of such transactions?
Yes to both the material aspect and the guidance — it makes the standard more definitive and hence less open to misinterpretation. Also there seems little benefit in companies reporting transactions that are not significant both in terms of insight gained by users of accounts and excessive disclosure for preparers.

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?
If standards are to be truly international then surely we should be trying to persuade the JASB to include the items we want to insert into the UK version of IAS 24. We should, therefore, ask them to review the disclosure of names and materiality definition included above.

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 24:

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)?
Yes. These are not items we are looking to capture in preparing this standard

'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'.

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)?
Yes - if the disclosure can be found in published consolidated financial statements then we see no need to disclose them in the individual financial statements.

OFWAT

Office of the Director General of Water Services
Centre City Tower, 7 Hill Street, Birmingham B5 4UA
Switchboard: 0121 625 1300
Direct Tel: 0121 625 1311 Direct Fax: 0121 625 3609

Mr Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1 8AL

20 September 2002

Dear Mr Nailor

Financial Reporting Exposure Draft 29 — Property Plant arid Equipment

This letter sets out Ofwat's comments on the above Exposure Draft, in the context of the water industry. Our comments relate specifically to the issue of renewals accounting raised in paragraph 38 ASB (iii) in the section on Questions for respondents.

The water industry currently applies the provisions in FRS15 Tangible fixed assets (paragraphs 97 to 99) which allow in certain circumstances the use of renewals accounting as a basis for the calculation of depreciation on infrastructure assets.

These provisions were introduced in FRS1 5 following detailed discussions with the industry on its treatment of infrastructure assets and in particular the use of the infrastructure renewals accounting. The arguments which lead to the inclusion of these provisions in the standard are still relevant. I attach a copy of our response to FRED 14 — Provision and contingencies which covered these in detail.

Infrastructure renewals accounting was adopted by the water industry in 1989. Prior to this the industry depreciated its infrastructure assets. This had however become very problematic and was open to manipulation. Infrastructure renewals accounting was introduced to remedy this.

The current provisions of FRS1 5 therefore provide a practical solution to the issue of ‘depreciation’ on infrastructure assets for statutory accounting purposes. They have worked well and ensure consistency in the charges made to the profit and loss account with the regulatory accounts that we require the water companies to submit and which continue to use infrastructure renewals accounting. We continue to have reservations about the differing presentations in the balance sheet. The issue of consistency is particularly important in a regulated environment where such information is of wide interest. Any difference in treatment between statutory and regulatory accounts would undoubtedly make interpretation more difficult for users of accounts and significantly reduce transparency to the information available.

We strongly believe that the inclusion of the provisions on the treatment of infrastructure assets form a key component part of the application of the standard to the water industry. We ask that these are retained. The absence of guidance in FRS15 could be interpreted as a change in view by the Accounting Standard Board on the appropriateness of such an approach. It is therefore conceivable that it would prevent the industry from using renewals accounting as a method of estimating depreciation.

Yours sincerely

Tracy Ander

pp **Keith Mason**
Chief Accounting Adviser

OFWAT
Office of Water Services
Centre City Tower, 7 Hill Street, Birmingham B5 4UA
Switchboard: 0121 625 1300
Direct Tel: 0121-625 Direct Fax: 0121 625

Ms Jackie Callaway
Project Director
Accounting Standards Board
Holborn Hail
100 Gray's Inn Road
London
WCIX 8AL

17 October 1997

Dear Ms Callaway

Financial Reporting Exposure Draft 14 - Provisions and Contingencies

The following letter sets out Ofwat's comments on the above Exposure Draft, in particular in the context of the water industry.

You may not be aware that the water industry uses a long range normative charge when accounting for its infrastructure renewals expenditure. The attached paper 'The Long Range Normative Charge for Infrastructure Renewals' sets out the principles underlying renewals accounting and its application to the water industry.

Under this method, the infrastructure asset network is considered as a single system to be maintained in perpetuity rather than a collection of individual assets each with its own life and maintenance requirements. Capital expenditure on infrastructure renewals is not capitalised and depreciated, rather an infrastructure renewals charge is made to the profit and loss account. It is calculated as the average (over a number of years) of the forecast renewal expenditure required by the entire system of infrastructure assets to maintain serviceability to customers.

This charge takes the place of both depreciation and expenditure on repairs and is calculated so as to maintain the system of infrastructure assets in perpetuity with no loss of value or serviceability to customers. There is therefore no necessity for a depreciation charge for infrastructure assets. Any difference between the infrastructure renewals charge and the expenditure in any year is reflected in the balance sheet as a provision.

This method of accounting for infrastructure renewals expenditure was adopted by the water industry in 1989. Prior to this the industry conventionally depreciated its infrastructure assets. This had however, become very problematic and was open to manipulation infrastructure renewals accounting was introduced to remedy this.

OFFICE OF WATER SERVICES

THE LONG RANGE NORMATIVE CHARGE FOR INFRASTRUCTURE RENEWALS

Contents **Page**

The LRNC is one way of making this estimate, but not the commonest way. However, it is intended to give the same answer in principle as the more usual methods of estimating. Let us look at the ordinary method first.

Route 1 - Ordinary depreciation

The standard method for assessing depreciation involves first forecasting the life of the asset. Although actual physical life is important, the asset's useful economic life may be shorter than that and that is the life over which the fall in the value of the asset, from cost to any scrap **value,** must be charged against profits.

In economic terms, that loss in value (expressed in real terms) must be recovered out of income before the entity has made a profit. Recovery should be made period by period, according to how much of the value is lost in each period, and a second estimate is necessary to decide that.

Mostly, for all practical purposes it can be assumed that the loss occurs evenly over the life and so the expected loss of value is divided up evenly over the life and each period charged with a similar amount of the cost, i.e. depreciation for each period equals cost less residual value divided by total years of life.

What happens if the life is likely to be very long and there is great uncertainty about how long? Is there a better Way of arriving at this estimate of the annual charge to the Profit and Loss Account in such circumstances?

The use of infrastructure renewals accounting and the LRNC is an attempt to formulate a better way. It is important to understand that it is not an attempt to avoid charging depreciation. It is a different method of determining an appropriate annual charge for the phenomenon known as depreciation.

Route 2 Infrastructure renewals accounting

A simple example serves to illustrate the principle.

Imagine a fleet of taxis. The owner runs five identical vehicles, one purchased in each succeeding year, each of which has a useful economic life of five years and (for simplicity only) a nil residual value.

In real terms, i.e. doing our calculations in £s of current value, not £s of the varying values at the time each vehicle was purchased, each year the owner will provide in his accounts for one-fifth of the cost of each vehicle. Each year, one vehicle will reach the end of its useful life and will be retired, to be replaced by a new successor.

EXAMPLE 1 - STEADY STATE - assuming unchanged prices

A taxi fleet consists of five vehicles, each lasting five years, one purchased each year. Cost each time = 100.

Year of Purchase	Cost @ Year 5	Cum Dep'n @ Year 5	Net @ Year 5	Annual Dep'n for Year 6	Cum Dep'n @ Year 6	Net @ Yr 6
Year 1	100	80	20	20	100	-
Year 2	100	60	40	20	80	20
Year 3	100	40	60	20	60	40
Year 4	100	20	80	20	40	60
Year 5	100	-	100	20	20	80
	500	200	300	100*	300	200
Year 6	100*					100
						300

EXAMPLE 2 - STEADY STATE - assuming rising prices

Fleet of vehicles as in Example 1, but costs over 5 years of (say) 100, 120, 130, 160 and 170 respectively. Cost in Year 6 has risen to 180. Shown in current cost terms for Year 6.

Year of Purchase	Repl. Cost Year 5@ Year 6 prices	Cum Dep'n Year 5 @ Year 6 prices	Net Year 5@ Year 6 prices	Annual Dep'n for Year 6	Cum Dep'n @ Year 6	Net @ Yr 6
Year 1	180	144	36	36	180	-
Year 2	180	108	72	36	144	36
Year 3	180	72	108	36	108	72
Year 4	180	36	144	36	72	108
Year 5	180	-	180	36	36	144
	900	360	540	180*	540	360
Year 6	180*					180
						540

PILKINGTON

Ms J Callaway
Project Director
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
LONDON
WC1X 8AL

Date:	22nd October 1997
Reference:	205/GMH/CLJ/let21
Telephone:	01744 692421
Direct fax:	01744 612637

Dear Ms Callaway,

FRED 14

I realise that I am somewhat late responding to FRED 14, however, following discussions with technical people from some of the major accounting firms, there does seem to be a variety of opinions on the transitional requirements arising on the implementation of FRED 14.

It would be most helpful if the resultant standard had a section addressing transitional arrangements covering, specifically, the treatment of pre FRS X provisions no longer permitted.

The options would appear to be:

1. Treat as change in accounting policy. A purist approach which could mean that the profit and loss account s charged twice for the same transaction.

2. Credit 'disallowed' provisions to the profit and loss account.

3. Retain existing provisions until utilised to covet the transaction for which they were originally established. A pragmatic (and preferred approach).

Yours sincerely, - . . .

GM Hall

Pilkington plc

Group Headquarters Prescot Road St Helens WA10 3TT England Tel 01744 28882 Fax 01744 692660 Telex 627441
Registered Office Prescot Road St Helens WA10 3TT Registered in England Company Number 41495

For example, it seems illogical that under the proposed standard the cost of a relocation would not be recognised but the cost of a related lease termination would be. I

In conclusion, we have serious concerns that this proposed standard undermines the fundamental accounting concept of prudence.

Yours sincerely

P K Wood
Deputy Finance Director

With the development of the regulatory regime and the Asset Management Plan, it was necessary to develop a more far-sighted view of future renewals expenditure anyway. While clearly that process is subject to all the uncertainties of any process of estimation, it is a process that takes full account of current knowledge and experience and one with which engineers are familiar and in which they have some confidence. The attractions of satisfying both reporting requirements and the industry's concerns over estimates with no grounding in real experience proved sufficient reason to encourage the adoption of the alternative of renewals accounting.

What remained was the need to codify and systematise the measurement of the necessary charge to the Profit & Loss Account, i.e. the depreciation substitute. Although some work has been done on this, the wide diversity of the charges that have emerged suggests that not everyone understands the basis on which the charge needs to be determined, or perhaps the criteria which it needs to meet, in order to be credible and satisfy the requirements of a renewals accounting system (assuming that there is no strong wish to return to trying to estimate depreciation by the adoption of arbitrary asset lives).

The charge for each period is not intended to be precisely what is actually spent. The actual timing of spend can be unpredictable, not least because the point at which any individual part of the segment fails and requires replacing is generally reckoned to be random. Over an entire system, the number of such random incidences of breakdown in any period is a more predictable figure, but still subject to external vagaries, for example extreme weather conditions. Any difference between actual spend and the long range charge, over or under, is included in the balance sheet as either a prepayment or an accrual.

4. BACKLOG

Some confusion tends to arise because of similarities between the LRNC and what is known throughout the industry as Initial Backlog.

The process of regulating the industry has been complicated by certain of the mechanisms inherited as a result of the privatisation process. One of these was the determination of an amount entitled Initial Backlog as at the start of the first period of regulation. It has proved a source of confusion, complicating the understanding of the LRNC - with good reason, because the expenditure involved in reducing Initial Backlog may be identical in kind to that involved in the LRNC. It is worth spending a moment on explaining the difference and how it works.

There are two reasons why this is important: first, because the continuing size of Initial Backlog remains an uncomfortable reminder of the original heroic assumption and a potential political stick with which to beat members of the industry for demonstrably not having their infrastructure assets up to new standards; and secondly, because any confusion between the two will distort the size of any LRNC accrual (or prepayment) and risk creating confusion when attempting to review forecasts of the necessary level of the LRNC at each Periodic Review.

5. PRACTICAL IMPLICATIONS FOR MEASURING LRNC

We have looked at the underlying theory of renewals accounting and the focal role played by the LRNC in that theory. This section looks at what this means for the industry in practical terms when accounting for the LRNC, based both on the requirements of the theory and on the experience of the industry to date in operating renewals accounting.

5.1 Practical requirements for a credible LRNC

The basic requirements for a credible renewals charge, the LRNC, may at this point be summarised as follows:

> i) it must be at broadly the same level of cost each successive year, in real terms; or, if there has been any material change in the size of the system from year to year, the renewals charge for subsequent years should continue to be broadly the same proportion of the carrying value of the system (in current cost terms). *
>
> Other possible reasons for variation would include technological change and the imposition of new standards of service. The former may presently be discounted, because technological change is not predicted to have any noticeable impact on the infrastructure assets of this industry in the foreseeable future. The latter, new standards of service, will impose new levels of maintenance from time to time, and the charge for maintaining them will need to be forecast separately as a discrete element of the renewals charge and, like the basic charge, might be expected to remain a constant in real terms, for the same reasons.

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* Conceptually, there might also be an expectation that proportions would be broadly similar across the industry, but it is possible that differences of approach to planning renewals might be capable of accounting for consistent differences between companies.

Critical to the determination of the LRNC is the categorisation of renewals and maintenance expenditure described in RAG 2, which focuses particularly on the REVENGE classification, distinguishing between the REV (Revenue) element and the ENGE (enhancement, growth and efficiency, i.e. capitalisable) elements. Some points which impact upon the measurement of the LRNC include:

i) operating costs described in RAG 2 as 'routine maintenance expenditure which is not in the AMP and which arises in a reactive way on a day to day basis'. It has tended to be assumed that, because this does not form a part of REV, it does not form part of the LRNC.

This is not logical as it is bound to constitute expenditure intended to restore infrastructure assets to full operational condition. To the extent that provision is made in the Asset Management Plan, and hence in price limits, for a certain quantity of repair work of random incidence (eg bursts), it is planned. To the extent that more of such work has to be undertaken in a period than had been budgeted for, it is unplanned i.e. has occurred Sooner than expected.

By definition, it will therefore have been anticipated in principle as a part of a future year's LRNC. Occurring now, it reflects only a timing difference in the LRNC, a prepayment. In the event that such expenditure happened to vary widely from year to year, failing to include it in the LRNC could either account for the LRNC varying in size or, where the LRNC is correctly provided for as a constant, distorting the accrual or prepayment by effectively double-counting this expenditure.

ii) proportional allocation. Some expenditure designed to enhance the system necessarily involves the early replacement of parts of the existing system, and guidance is given in RAG 2 on how to allocate the overall cost between REV and ENGE, i.e. LRNC and capital cost.

Where this occurs, the REV element is again merely a bringing forward of replacement expenditure anticipated at some future point in the LRNC. This will be a recurring feature every year, and will therefore be a normal element of the LRNC for as far into the future as we can see. Unless this element of REV cost is expected to be quite abnormally large in any year or over several years, it should not distort the constant nature of the LRNC.

There may be practical distortions occurring if there is any doubt over consistent application of proportional allocation between the planning stage and accounting for the actual expenditure. Unless there are safeguards in place in each company's system to check that planned schemes involving proportional allocation are in fact accounted for in the event in the same way as they were included in the LRNC, it is possible that an accumulation of non-reversing differences could build up, which would be a source of concern.

There is no guarantee that twenty years is necessarily long enough for a wholly confident prediction of an LRNC. If engineers' experience of their system leaves them concerned that a twenty-year forecast of renewals and maintenance expenditure is inadequate, particularly if they confidently anticipate a heavy peak of expenditure in subsequent years, then it is necessary to improve the quality of the forecast. This would be achieved by extending the time-frame of forecasting the
LRNC.

In extremis, theory would be satisfied by reverting to the more primitive method of predicting a physical life for the system and calculating the size of the arithmetic depreciation charge that would result - but this would be adopted if, but only if, that was the only method in which the engineers felt they could have confidence, the opposite of the view which led to the adoption of renewals accounting in the first place. (Physical life would be the critical determinant because nobody questions the idea that the economic useful life of the water and sewerage systems is indefinite. The physical life that one would be seeking would be the length of the life-cycle over which the major part of the system will need to be replaced.)

5.4 How is indention for price change handled?

As we have seen, the LRNC should in principle be the same in real terms every period, for an unchanged system and unchanged service standards. In money terms of course it will vary as prices change. In the current cost accounts, opening balances expressed at last year's prices must be re-expressed in terms of this year's prices to be meaningful, hence the indexing forward, using the Retail Price Index (RPI), of all fixed asset gross values and, for non-infrastructure assets, aggregate depreciation brought forward.

Any LRNC accrual (the provision for renewals expenditure not yet spent) or prepayment is similarly re-expressed into *L's* of that year's spending power as it is brought forward each year as part of working capital.

The re-expression of all these items (gross asset values, accumulated depreciation and accrued provisions for both LRNC and Initial Backlog) into *L's* reflecting the current year's price levels using the RPI produces a total increase in net assets which is taken to reserves in the current cost regulatory accounts. No part of it is credited or debited to the Profit & Loss Account because it does not represent any gain or loss to either members or customers. (It is similar to the translation of items from one currency to another, but without any commission on the transaction!).

ScottishPower

David T Nish
Finance Director

Messrs. Paul Ebling, Stephen McEwan, Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
LONDON
WC1X 8AL

Your ref

Our ref

Date

27 September 2002

Contact/Extension

Dear Sirs

FINANCIAL REPORTING EXPOSURE DRAFTS 23 TO 29

We welcome the opportunity to comment on the above exposure drafts issued by the Accounting Standards Board (ASB).

Our overall comments are set out below. We have also commented specifically on the various exposure drafts but have limited our comments to those areas which believe are the key issues.

In terms of the overall process, we welcome the fact that the ASB has issued the above exposure drafts (FREDs). This has helped to improve the focus on the scale of change that is likely over the next few years as UK GAAP converges with International Accounting Standards (IAS). These FREDs have been developed based on, but not identical to, the recent exposure drafts issued by the International Accounting Standards Board (IASB). While we understand the ASB's reasons for wishing to argue for "better" standards, we strongly believe that it would be inappropriate for the ASB to issue standards which are different from the standards eventually issued by the IASB. The prospect for UK listed companies, of being required to implement new standards under UK GAAP and then having to adopt similar but different standards under IAS one or two years thereafter, is not attractive.

We would welcome the ASB issuing standards on a phased basis but these should not be mandatory until IAS are required to be implemented by UK companies.

We would strongly urge the ASB to lobby the JASB and the EU on behalf of UK listed companies so that the body of accounting standards that are required to be implemented on transition to IAS are published no later than summer 2003. This will enable companies to have sufficient time to implement properly the raft of new standards. The standard setting bodies ought to be fully aware of the time involved in educating and training, changing systems, processes and procedures and communicating with users. We are concerned that the transition to IAS will not be immediately understood by all users and we doubt whether the accounting profession should be self-imposing the risk of further confusion given recent well publicised corporate scandals. We appreciate that the ASB has recognised this with its original transitional approach to implementing FRS 17 ‘Retirement benefits’. This sensible timeline approach should be a feature of the developing financial reporting environment for the benefit of all parties concerned and for financial markets in general.

Our detailed comments on the individual FREDs are included in the attached Appendix.

Should you wish to discuss any of these issues, please contact Stuart MacDonald, Head of Group Financial Reporting, Scottish Power plc, 1 Atlantic Quay, Glasgow G2 8SP (telephone 0141 *566* 4721).

Yours sincerely

DAVID NISH
Finance Director

Appendix

FRED 23 ‘Financial Instruments: Hedge Accounting’

- We do not believe that the ASB should issue a new standard on hedge accounting until the JASB has completed its review of IAS 39.

- In our view, to implement a standard on hedge accounting, a UK standard on the treatment of financial instruments more generally would be necessary. We recognise that the ASB has issued FRED 30 and we will comment on that FRED in due course.

- In our view, there should also be a requirement for the consistent application of methodologies for testing hedge effectiveness both over lime and across similar hedge relationships.

- We believe the ASB should publish a standard which contain rules on how hedge accounting should be performed, not merely setting out the conditions which need to be complied with in order that some (undefined) basis of hedge accounting should be applied.

- We agree with the principle that gains and losses should not be recycled. We request that the ASB argues strongly for this point in the international debate.

- We would encourage the ASB to consider the significant implementation issues that have arisen in the US with respect to SFAS 133 ‘Accounting for Derivative Instruments and Hedging Activities’. In particular, the fact that over 150 DIG interpretations have been issued to provide guidance on applying the requirements of the standard.

FRED 24 ‘The Effects of Changes in Foreign Exchange Rates; Financial Reporting in Hyperinflationary Economies’

- As discussed above, we strongly agree that gains and losses should not be recycled.

- We 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.

- We agree with the proposal that the current allowed treatment of translating profits at closing rate should be removed.

- We agree that goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign operation should be required to be treated as assets and liabilities of the foreign operation and translated at the closing rate.

FRED 25 ‘Related Party Disclosures’

- We believe that an accounting standard should require disclosure of the name of a controlling party and, if different, that of the ultimate controlling party. However, if the eventual IAS does not include such a requirement, then the ASB should not require this disclosure on the grounds of international harmonisation. Please refer to the comments made in our covering letter.

- It is our view that an accounting standard should require disclosure of the names of the transacting related parties where this is material to the user of the accounts. So for example, it would be appropriate to group, for disclosure purposes, all trading transactions with associates. However, if the related parties were, say, directors, then the disclosure of the individual directors’ names would be, in our view, material to the reader of the accounts.

- We believe that any exemptions for subsidiary companies should be only for transactions with fellow group companies, not an exemption from all related party disclosures.

- It is our opinion that the ASB should lobby the IASB to ensure that its eventual standard does not contain an exemption for disclosure of management’s remuneration. This is perhaps the most common related party disclosure of relevance to shareholders. The fact that many countries impose detailed disclosure requirements in this area is no reason for this exemption in accounting standards.

- We believe that the current FRS S application of the materiality concept to transactions with individuals, while logical, is not really practical and should be excluded from any future standards on this topic.

FRED 26 ‘Earnings per Share’

- We see no reason why additional earnings per share figures should be prohibited from the face of the profit and loss account, and would be happy for such additional figures to be disclosed on the face of the profit and loss account provided that they are not given more prominence than the earnings per share figures required by the standard and an explanation of these additional figures is given in the notes to the accounts.

- For companies which prepare interim accounts, we believe that their annual earnings per share figures should be based on cumulative year to date information, not on the basis of previously published interim figures.

FRED 27 ‘Events after the Balance Sheet Date’

- We agree that it would be preferable for the Companies Act to be amended to cater for the intended change in treatment of proposed dividends.

FRED 28 ‘Inventories; Construction and Service Contracts’

- We encourage the ASB to lobby the JASB to encourage the removal of the option to value inventories on a LIFO basis.

FRED 29 ‘Property, Plant and Equipment; Borrowing Costs’

- We believe that residual values should only be based on current estimates where the assets are revalued annually.

- We agree that the proposed standard may prevent entities from using renewals accounting and suggest that it be made clear in the standard that renewals accounting is still permitted. Also, further guidance should be provided as to when infrastructure accounting should be applied and how it would operate. We would recommend the inclusion of the current text in FRS 15 ‘Tangible fixed assets’ on this particular area.

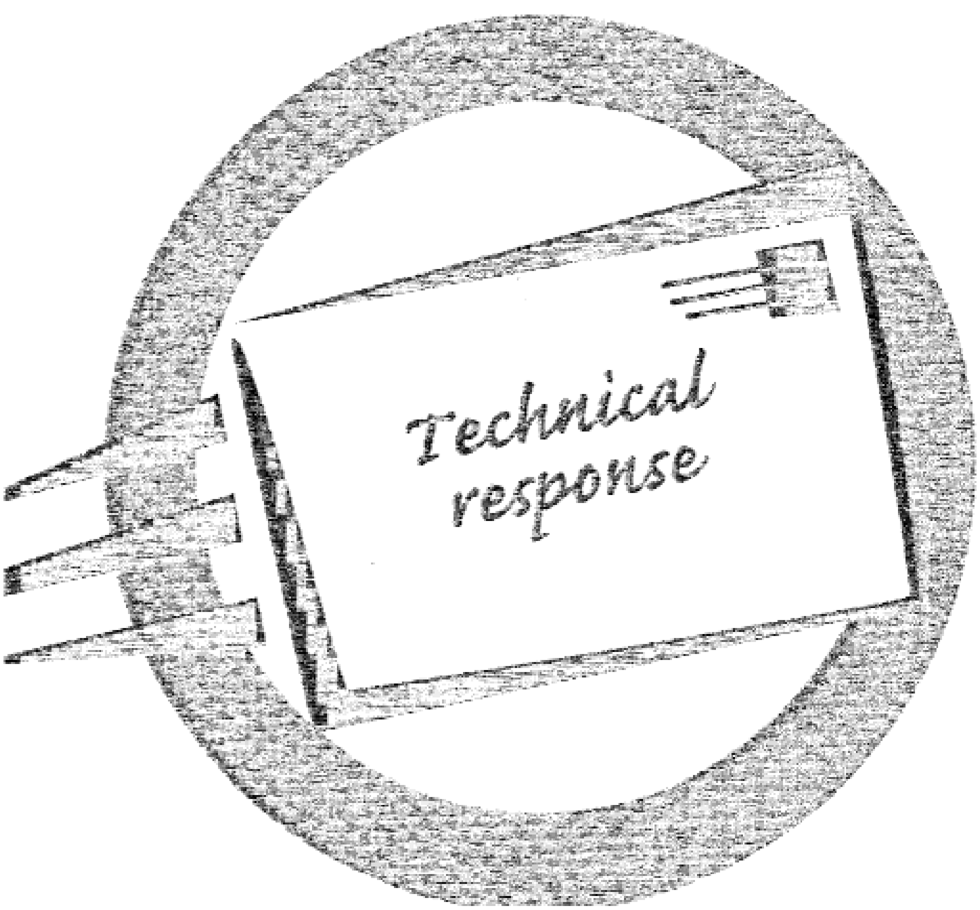
- We believe strongly that the existing use methodology for valuing assets in the UK be applied and would encourage the ASB to lobby for this in the international debate. While market value (exit values) may be appropriate for valuing financial instruments we do not believe they are best suited to valuing tangible fixed assets.

- We 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.

- Capitalisation of borrowing costs should remain optional, subject to disclosure of the policy and the amounts capitalised in each period.

- We do not 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.

technical response



IASB proposals to amend certain International Accounting Standards

Audit Commission submission to the Accounting Standards Board

audit commission

Public audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services. The Audit Commission (the Commission) was established as an independent body in 1983 and has statutory responsibilities, amongst other things, for:

- **appointing auditors to local government and NHS bodies that spend some £120 billion of public money annually;**
- **setting the required standards for its appointed auditors, and regulating the quality of audits;**
- **making arrangements for certifying government grant claims and returns;**
- **undertaking or promoting comparative and other studies to promote the economy, efficiency and effectiveness of local government and NHS services;**
- **defining local government performance indicators;**
- **receiving and, where appropriate, following up information received from 'whistleblowers' in local government and NHS bodies under the Public Interest Disclosure Act 1998; and**
- **carrying out best value inspections of certain local government services and functions.**

The Commission appoints auditors to local government and NHS bodies from District Audit (the Commission's own arms-length audit agency) and from private firms of auditors. Once appointed, auditors carry out their statutory and other responsibilities, and exercise their professional judgement, independently of the Commission.

A summary of the key proposals contained the IASB Consultation Paper can be viewed on the ASB web site (www.asb.org.uk). Any comments on the issues raised by this response should be addressed to:

Paul King
Senior Manager, Accounting and Financial Reporting
Audit Policy and Appointments Directorate
The Audit Commission
1 Vincent Square
London SW1P 2PN

Telephone: 020 7396 1305
Fax: 020 7396 1369
Email: paul-king@audit-commission.gov.uk

CONTENTS

INTRODUCTION

1. The Audit Commission (the Commission) is responsible for appointing auditors to local authorities, police and fire authorities and National Health Service bodies in England and Wales. As such, it is primarily concerned with the potential impact of the proposals contained in the IASs on public sector entities indirectly through the alignment of UK accounting standards with international standards. In this context the Commission supports the UK Accounting Standards Board's strategy of moving towards international standards through its programme of work to align UK accounting standards with International Financial Reporting Standards (IFRPs) and the phased replacement of existing UK standards with new UK standards based on the equivalent WRSs.

2. The ASB issued the Consultation Paper *IASB proposals to amend certain accounting standards* in May 2002 as part of the former's programme of alignment, and which is the subject of this response from the Commission. The ASB has separately published proposals to issue UK standards based on six exposure drafts of revised IASB standards. Accordingly the Commission has separately responded to this proposal.

3. This response makes a number of general observations about the proposals in the IASs where the Commission believes it can add value to the debate. The Commission's responses to the specific issues and questions contained in the Prefaces to the IASs are contained in individual annexes to this response.

GENERAL OBSERVATIONS

IAS 1 PRESENTATION OF FINANCIAL STATEMENTS

4. The proposed amendments to the IAS mainly relate to:

    - limitation of the circumstances in which an entity could depart from a requirement in an]FRS or interpretation of a Standard;
    - elimination of the concept of "extraordinary items" and prohibition of the presentation of items of income or expense as "extraordinary items" in the income statement or notes;
    - limitation on the classification of a long-term financial liabilities in certain circumstances as a non-current liability where circumstances change after the balance sheet date but before the financial statements are authorised for issue; and
    - additional disclosure requirements relating to the judgements made by management and key assumptions about sources of measurement uncertainty.

5. The Commission agrees with the broad thrust of the proposals in the IAS although with some concerns on matters of detail as set out in the responses to the specific questions raised by the IASB in Annex A to this response.

IAS 8 ACCOUNTING POLICIES, CHANGES IN ACCOUNTING EXTIMATES AND ERRORS

6. The proposed amendments to the IAS mainly relate to:

    - removal of the allowed alternative treatments for changes in accounting policies and corrections of errors; and
    - elimination of the distinction between fundamental errors and other material errors.

7. The Commission notes the proposed treatment of errors (paragraphs 31 to 35 of the revised IAS 8) but is concerned that there is no reference at all to the concept of materiality, with the consequent implication that any error should be corrected, no matter how small it might be. It is generally accepted that by their nature financial statements are unlikely to be absolutely correct, in the same way that an audit of those financial statements can normally only provide reasonable assurance and not absolute assurance. The Commission does not believe that the criteria of "undue cost or effort" is an effective alternative to the generally understood concept of materiality.

8. Another issue concerns the proposal to amend paragraph 34 of IAS 8 so that when accounting retrospectively for a correction of an error, the basis for exemption from restating comparative information for a particular prior period changes from "impracticality" to "undue cost or effort". It is not clear whether the new criteria are intended to be more stringent than the old - if this is the intention then the

Commission is not convinced that it will be interpreted as such. There is a risk that entities will be inclined to cite “undue cost and effort” in more instances than is appropriate.

9. The same concern applies to the similar change proposed when there is a voluntary change in accounting policy (paragraph 49 of IAS 8).

10. The Commission also does not support the proposal in paragraph 19 of the IAS to require rather than encourage disclosure of the nature of a future change in an accounting policy when an entity has yet to implement a new Standard that has been issued but not yet come into effect. This seems unnecessary and contradictory to the concept of an effective date within a new standard. In addition, the Commission’s concern expressed above about the concept of “undue cost or effort” extends to the risk that entities will also resort to the exemption provided by the proposed paragraph 19(d)(ii) which states that an estimate does not have to be provided if it cannot be made without undue cost or effort.

11. The Commission would also suggest that the circumstances in which changes to an accounting estimate should be made (paragraph 25) would benefit from being expressed as a bold letter requirement.

IAS 17 LEASES

12. The proposed amendments mainly relate to:

- the inclusion of additional guidance on the treatment of leases of land and buildings; and
- elimination of the choice in IAS 17 on the treatment of initial direct costs i.e. expensing of such costs will no longer be permitted.

13. The Commission agrees with the proposed amendments.

IAS 27 CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

14. The proposed amendments mainly relate to:

- extensions to the exemption to prepare consolidated financial statements;
- the requirement to present minority interest as part of equity, but separately from the parent shareholders’ equity; and
- the measurement of investments in subsidiaries, associates and jointly controlled entities in the investor’s separate financial statements.

15. The Commission agrees with the proposed amendments. But in the public sector, both generally and the UK specifically, there are circumstances in which entities can be required (or specifically not required) to prepare consolidated financial statements. These requirements are set out in legislation, or through powers

exercised under legislative provisions and govern the exact financial reporting requirements of an entity, or a group of entities.

IAS 28 ACCOUNTING FOR INVESTMENTS IN ASSOCIATES

16. The proposed amendments mainly relate to:

- the exclusion of investments by venture capital organisations, mutual funds, unit trusts and similar entities from the scopes of IAS 28 and IAS 31 *Financial Reporting of Interest in Joint Ventures* when they are measured at fair value in accordance with IAS 39 *Financial instruments: Recognition and Measurement,* when such measurement is well-established practice in the industries involved; and
- the expansion of the base available for offsetting of an investor's share of losses from an associate to include the carrying amount of an investment in equity shares plus other interests such as long-term receivables.

17. This is not likely to have a significant impact on public sector entities.

IAS 40 INVESTMENT PROPERTY

18. The proposed amendments mainly relate to the expansion of the definition of investment property. The amended definition will allow, but not require, a lessee that has an interest in property under an operating lease to classify that property interest as an investment property (provided the rest of the definition of investment property is met), on a property-by-property basis. This option is limited to entities that use the fair value model in IAS 40.

19. The Commission supports the proposed approach to the IAS.

ANNEX A

IAS 1 PRESENTATION OF FINANCIAL STATEMENTS

RESPONSES TO SPECIFIC QUESTIONS RAISED BY IASB

Q.	Particular Issue	Comment
1.	Do you agree with the proposed approach regarding departure from a requirement of an International Financial Reporting Standard or an Interpretation of an International Financial Reporting Standard to achieve a fair presentation (see proposed paragraphs 13-16)?	Yes, the tightening of such circumstances is supported.
2.	Do you agree with prohibiting the presentation of items of income and expense as 'extraordinary items' in the income statement and the notes (see proposed paragraphs 78 and 79)?	In principle, yes. But consideration should be given by the IASB as to whether additional disclosure of the circumstances of the items (for example in the notes to the accounts) would provide a more meaningful view of performance of the entity.
3.	Do you agree that a long-term financial liability due to be settled within twelve months of the balance sheet date should be classified as a current liability, even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue (see proposed paragraph 60)?	No. The classification of the liability as current in such circumstances would be misleading. Although current at the balance sheet date, the agreement to refinance or reschedule is properly viewed as an adjusting Post Balance Sheet Event. It would be useful to consider the disclosure of such items to provide better information to users.
4.	Do you agree that: a. a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date, even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach (see proposed paragraph 62)? b. if a lender was entitled to demand	No to paragraph 62, for the same reasons given in answer to question 3 above. Yes to paragraphs 63 and 64.

	immediate repayment of a loan because the entity breached a condition of its loan agreement, but agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and: (i) the entity rectifies the breach within the period of grace; or (ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified (see proposed paragraphs 63 and 64)?	
5.	Do you agree that an entity should disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements (see proposed paragraphs 108 and 109)?	Yes.
6.	Do you agree that an entity should disclose key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year (see proposed paragraphs 110-115)?	Yes.

ANNEX B

IAS 8 ACCOUNTING POLICIES, CHANGES IN ACCOUNTING EXTIMATES AND ERRORS

RESPONSES TO SPECIFIC QUESTIONS RAISED BY IASB

Q.	Particular Issue	Comment
1.	Do you agree that the allowed alternative treatment should be eliminated for voluntary changes in accounting policies and corrections of errors, meaning that those changes and corrections should be accounted for retrospectively as if the new accounting policy had always been in use or the error had never occurred (see paragraphs 20, 21, 32 and 33)?	Yes.
2.	Do you agree with eliminating the distinction between fundamental errors and other material errors (see paragraphs 32 and 33)?	No – the paragraphs make no distinction between any kind of error, and the concept of materiality is not referred to. The Commission believes that it should be (see observation in the main part of this response)

ANNEX C

IAS 17 LEASES

RESPONSES TO SPECIFIC QUESTIONS RAISED BY IASB

Q.	Particular Issue	Comment
1.	Do you agree that when classifying a lease of land and buildings, the lease should be split into two elements – a lease of land and a lease of buildings? The land element is generally classified as an operating lease under paragraph 11 of IAS 17, *Leases* and the buildings element is classified as an operating or finance lease by applying the conditions in paragraphs 3-10 of IAS 17.	Yes.
2.	Do you agree that when a lessor incurs initial direct costs in negotiating a lease, those costs should be capitalised and allocated over the lease term? Do you agree that only incremental costs that are directly attributable to the lease transaction should be capitalised in this way and that they should include those internal costs that are incremental and directly attributable?	Yes, the Commission agrees that the direct costs incurred in negotiating a lease should be capitalised and allocated over the lease term – subject to an impairment test. The Commission also agrees that only the incremental costs, including internal costs, that are directly attributable to the lease transaction should be capitalised as proposed.

ANNEX D

IAS 27 CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

RESPONSES TO SPECIFIC QUESTIONS RAISED BY IASB

Q.	Particular Issue	Comment
1.	Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met? [paragraph 8: A parent need not present consolidated financial statements to comply with International Financial Reporting Standards if and only if: (a) it is a wholly-owned subsidiary or the owners of the minority interests, including those not otherwise entitled to vote, unanimously agree that the parent need not present consolidated financial Statements; (b) its securities are not publicly traded (c) it is not in the process of issuing securities in public securities market; and (d) the immediate or ultimate parent publishes consolidated financial statements that comply with International Financial Reporting Standards. Such a parent shall prepare financial statements in accordance with the requirements in paragraph 29, 30, and 33 of this Standard for separate financial statements.]	Yes, the proposed amendments are acceptable.
2.	Do you agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity (see paragraph 26)?	Yes. The Commission agrees with the proposed presentation of minority interests.
3.	Do you agree that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method	Yes, the proposed amendments are acceptable.

	in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, in the investor's separate financial statements (paragraph 29)? Do you agree that if investments in subsidiaries, jointly controlled entities and associates that are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments should be accounted for in the same way in the investor's separate financial statements (paragraph 30)?	

ANNEX E

IAS 28 ACCOUNTING FOR INVESTMENTS IN ASSOCIATES

RESPONSES TO SPECIFIC QUESTIONS RAISED BY IASB

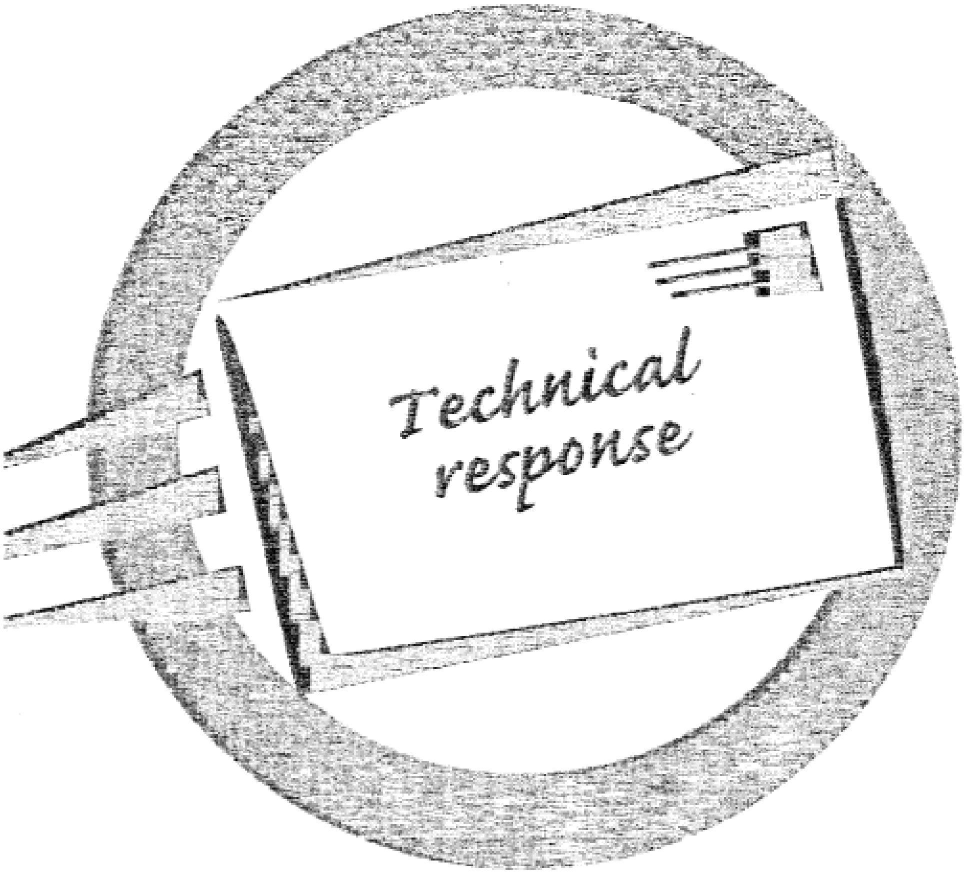
Q.	Particular Issue	Comment
1.	Do you agree that IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, should not apply to investments that otherwise would be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries (see paragraph 1)?	Yes.
2.	Do you agree that the amount to be reduced to nil when an associate incurs losses should include not only investments in the equity of the associate but also other interests such as long-term receivables (paragraph 22)?	Yes.

ANNEX F

IAS 40 INVESTMENT PROPERTY

RESPONSES TO SPECIFIC QUESTIONS RAISED BY IASB

Q.	**Particular Issue**	**Comment**
1.	Do you agree that the definition of investment property should be changed to permit the inclusion of a property interest held under an operating lease provided that: (a) the rest of the definition of investment property is met; and (b) the lessee uses the fair value model set out in IAS 40, paragraphs 27-49?	Yes. The Commission agrees with the proposed amendment to the definition of investment property.
2.	Do you agree that a lessee that classifies a property interest held under an operating lease as investment property should account for the lease as if it were a finance lease?	Yes. The Commission agrees with the proposal that a lessee that classifies a property interest held under an operating lease as investment property should account for the lease as if it were a finance lease.
3.	Do you agree that the Board should not eliminate the choice between the cost model and the fair value model in the Improvements project, but should keep the matter under review with a view to reconsidering the option to use the cost model in due course?	Yes. The Commission agrees with the approach proposed.



Financial Reporting Exposure Drafts 23 to 29

Audit Commission submission to the Accounting Standards Board

audit commission

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A summary of the key proposals contained in FREDs 23 to 29 can be viewed on the ASB web site (www.asb.org.uk). Any comments on the issues raised by this response should be addressed to:

Paul King
Senior Manager, Accounting and Financial Reporting
Audit Policy and Appointments Directorate
The Audit Commission
1 Vincent Square
London SW1P 2PN

Telephone: 020 7396 1305
Fax: 020 7396 1369
Email: paul-king@audit-commission.gov.uk

CONTENTS

INTRODUCTION

1. The adoption and revision of appropriate accounting standards is fundamental to the presentation, within the financial statements, of meaningful information on an entity's performance and financial position. The Audit Commission (the Commission) supports the ASB s strategy of moving towards international standards through its programme of work to align UK accounting standards with International Financial Reporting Standards (IFRPs) and the phased replacement of existing UK standards with new UK standards based on the equivalent IFRSs. The Commission also welcomes the opportunity to comment on the ASB's implementation of this strategy through the issue of FREDs 23 to 29.

2. The Commission notes that FREDs 23 to 29 are based on six exposure drafts of revised IASB standards. The ASB has separately issued the Consultation Paper IASB proposals to amend certain accounting standards as part of the former's programme of alignment, containing revised IASs that the ASB does not at this time propose to use as the basis for issuing equivalent UK standards. The Commission has separately responded to the ASB on this proposal.

3. The Commission is responsible for appointing auditors to local authorities, police and fire authorities and NHS bodies in England and Wales. As such, it is primarily concerned with the potential impact of the proposals contained in the FREDs on public sector entities. The subject matter of the FREDs is such that some of them are clearly of more relevance to the public sector and those parts of the public sector audited by the Commission's auditors, whilst others are much less relevant.

4. Accordingly, this response makes a number of general observations about the proposals in the FREDs where the Commission believes it can add value to the debate. The Commission's responses to the specific issues and questions contained in the Prefaces to the FREDs are contained in individual annexes to this response.

GENERAL OBSERVATIONS

FRED 23 FINANCIAL INSTRUMENTS: HEDGE ACCOUNTING

5. The FRED proposes a principles-based approach to restricting hedge accounting, but does not place restrictions on the type of hedge accounting to be used. Essentially, it will only be permitted to hedge account if the 'hedging relationship' and 'hedging-effectiveness' criteria are fulfilled. These are not excessively rigorous requirements and the FRED notes that it is less prescriptive than the IAS equivalent which specifies certain situations where hedge accounting cannot be used.

6. Hedge accounting is not a widely-used technique in the public sector, and in particular local authorities are prohibited from using hedging. Therefore the proposed standard will have little direct relevance to the majority of public sector bodies.

7. Notwithstanding this, the Commission believes that the proposed standard is clear in its requirements and has the virtue of a straightforward, principles-based approach. It also represents a good means of both implementing IAS practice in the UK and allowing the ASB to influence the development of a revised IAS 39.

FRED 24 THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES; FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOM1ES

8. Again, the proposed standard is likely to be of limited direct relevance to most public sector entities, most of whose activities are undertaken within the UK, although some entities with significant overseas activities will be affected.

9. The Commission notes that the FRED is based primarily on the consultation draft of IAS 21 'The Effects of Changes in Foreign Exchange Rates', and that the ASB intend to issue an FRS reflecting the contents of this revised IAS as a replacement for the current SSAP 20. The IASB has also issued an ED based on IAS 29 'Financial Reporting in Hyperinflationary Economies' and the ASB has the same plan in respect of this proposed FRS, replacing the current UTTF 9 and elements of SSAP 20.

10. The Commission notes that the ASB does not agree with the IASB proposals for 'recycling' all foreign exchange gains on disposal of a foreign operation through the P&L (as opposed to being recognised in the STROL). The ASB notes that it is working on a project with the IASB to address this in the longer term.

11. The Commission would also support the change whereby, in the closing rate method of accounting for foreign currency transactions, the closing rate is no longer an option for the translation of P&L items. It is now the rate on the date of transaction or an average.

12. The Commission also supports the proposal in FRED 24 to prevent the deferral of exchange gains or losses on long term monetary items where there is doubt about the convertibility or marketability of the foreign currency.

FRED 25 RELATED PARTY DISCLOSURES

13. The Commission notes that this FRED contains the draft IAS on related party transactions, coupled with ASB discussion of the impacts and proposals for change. There are some significant differences between the IAS and the FRED and, in response, the ASB has raised several potential additions within the UK context. However, the standard is not seen as contentious enough to warrant a delay on implementation.

14. Related party disclosures have a particular significance for the public sector given the greater prominence to issues around propriety and the conduct of public business, and this significance has become more important over recent years. Moreover, the growth of 'Special Purpose Vehicles', 'Arms Length Management Organisations' and other forms of partnership is likely to increase this prominence further. The Commission believes that this greater significance could usefully be referred to in any new standard.

15. The standard adopts a much simpler approach than FRS 8. Related parties are defined more widely than in FRS S which is useful. This is likely to increase the number of related parties to be disclosed. The disclosure of transactions is slightly narrower than the current FRS and the ASB has suggested an additional UK proposal to report the names of both the controlling party and also the names of transacting parties as it believes the IAS is deficient in this regard. The Commission supports this line.

16. Another key difference is that the IAS defines 'significant influence' more narrowly than the FRS (power to participate in the operating and financial policy decisions of the entity rather than the more negative inhibition from pursing interests). This is useful, but arguably too narrow. The Commission is also concerned that the IAS does not specifically address the concept of materiality in considering the need to disclose - which may lead to excessive detail being produced. The Commission also believes that the definition of 'significant influence' should be revisited.

FRED 26 EARNINGS PER SHARE

17. Earnings per share is also an issue that will not be applicable to the vast majority of public sector entities, and the FRED notes that the FRS to be produced at the end of the development process will only apply to listed companies.

18. Whilst the issue of earnings per share is not directly relevant to the public sector, the clear specification of performance measures (especially those involving accounting information) is of critical importance. Notwithstanding the fact that

financial commentators use a variety of other ‘home-grown’ measures to assess performance, the earnings per share issue is a key published statistic for listed companies and a vital tool in the evaluation of the other types of entity. Therefore, the Commission supports the requirement in the FRED to publish more earnings per share information (basic and diluted). Similarly, where entities produce additional information on earnings per share then there is merit in the proposals for a reconciliation to be published.

FRED 27 EVENTS AFTER THE BALANCE SHEET DATE

19. This FRED only has a few major differences to extant UK GAAP. The main one is that the SSAP 17 definition of adjusting events includes ‘events which because of statutory or conventional requirements are reflected in financial statements’ is no longer appropriate. This means that dividends are no longer a liability at the year end and this will require a change in the law, which is currently being discussed with DTI.
20. This is not likely to have a significant impact on public sector entities. A similar implication arises with the accounting treatment of dividends declared by subsidiaries in respect of previous periods.

21. The Commission also notes that the draft FRS is more rigid than the current SSAP 17 in that it does not allow for exceptional cases of non-adjusting events becoming adjusting.

22. In the context of the public sector, the reference in paragraph 16 of the FRED to a requirement that an entity should “disclose the date when the financial statements were authorised for issue and who gave that authorisation” will need clarification or interpretation. For example, in the case of NTIS bodies, the financial statements must be adopted (approved) by the Board of Directors, but they are then signed by the chief executive and finance director by order of the Board. In theory, the date of adoption and signature could be different.

FRED 28 INVENTORIES; CONSTRUCTION & SERV1CE CONTRACTS

23. The Commission notes that there are no major changes to UK requirements. The FRED indicates that the IAS-based requirement for ‘reliable estimation’ of contract profits, rather than the SSAP 2 ‘prudently calculated attributable profit’ is closer to the Statement of Principles emphasis on reliability rather than prudence.

24. The draft standard reduces the amount of prescribed guidance on disclosure of contract balances requiring them to be presented as a single line item rather than a collection of elements - ‘gross amounts due from/to customers for contract work.’(SSAP 9 has elements for stock, debtors, creditors, etc.).

25. Finally, the draft standard more explicitly states that the requirements ban be applied to separately identifiable components of a contract or group of contracts if

that would reflect the substance. The ASB comments seem to suggest that this is reasonable if SSAP 9 is interpreted in the light of FRS *5*.

26. This is an important standard for public sector organisations, who are involved in a very wide range of contract arrangements (although not typically as the contractor). The Commission's view is that there are no significant changes to the treatment and the proposals are reasonable. The only issue to raise is that the ASB could perhaps consider the treatment of the outstanding balances at the year-end whether there is a case for retaining the SSAP 9 approach.

FRED 29 PROPERTY, PLANT AND EQUIPMENT

27. The Commission believes that this FRED is likely to have a significant impact on public sector entities. In particular, the following issues are of particular interest in this respect:

28. Whilst the IAS uses the term 'fair value', the definition of the term does not appear to encompass the concept of 'value in use', which is of particular importance to the UK Public Sector.

29. The issue of donated assets is not covered in the IAS. This is also of particular relevance and importance to UK public sector entities, and the Commission's view is that they should be recognised at their fair value by an entity when the asset is donated.

30. There is also no mention of renewals accounting in the FRED. Local Government entities in the UK, in particular, use renewals accounting as an estimate of depreciation in certain circumstances. The Commission supports this approach and its availability as an acceptable accounting treatment within the relevant accounting standards.

31. Further detail on these issues, together with other comments and observations, are contained at Annex G in response to the specific questions raised by the ASB and IASB.

ANNEX A

FRED 23 FINANCIAL INSTRUMENTS: HEDGE ACCOUNTING

Q.	Particular Issue	Comment
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?	Yes. The possible implications of deferred charges to the profit and loss account are very significant.
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 on 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?	Yes. This supports both the convergence process and continues the tradition in the UK of principles-based reporting.
	(b) Does the principle need to be supplemented with any other principles?	At this stage, no.
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	Yes. These appear to be the bare minimum for the implementation of the standard.

	necessary to implement the aforementioned principle? (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?	 Yes. This is particularly important as the purpose of the standard appears to be a 'starting point' for addressing the hedge accounting issues.
4.	Do you agree with the material in the FRED on measuring hedge effectiveness (see paragraphs 9-15)? 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)?	Yes, the measures appear reasonable. One concern would be the 80-125% range in paragraph 9. Insofar as this 'corridor' appears arbitrary then this may lead to a compliance culture where a figure is this range implies that a hedging arrangement must be one of high effectiveness. Such a 'corridor' also seems to be inconsistent with the statement in paragraph 15 that 'this standard does not specify a single method of assessing hedge effectiveness'. It would be more appropriate to view such a 'corridor' as a minimum requirement of high effectiveness, rather than the sole requirement. Although identical provisions are to be found in IAS 39, as the FRED is to lead to a UK standard with no direct IAS equivalent, such a divergence would not be inappropriate.
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?	Yes, for the practical reasons outlined above (i.e. starting to set standards on hedge accounting). However, the ASB should be considering if this will be necessary in the longer term.
6.	The ASB has nevertheless decided that the FRED should contain 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 of the FRED)? (b) the treatment of the ineffective portion of a gain or a loss on the hedge that is not a hedge of a net	 Yes. Yes.

	investment in a foreign operation (see paragraph 16 (b) of the FRED)? (c) The treatment of hedging instruments that cease to qualify for hedge accounting (see paragraphs 17 and 18 of the FRED)?	 Yes.
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?	Yes.

ANNEX B

FRED 24 THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES; FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES

Q.	Particular Issue	Comment
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?	Yes. This seems pragmatic.
ASB (ii)	Do you agree with the proposal not to include the IAS 21 provisions on the recycling of certain exchange gains and losses?	Yes. The IAS provisions would make for increased complexity on the disposal of foreign currency operations. In addition, they would conflict with the treatment of revaluation gains on the disposal of fixed assets.
ASB (iii)	Do you agree with the proposal not to include any transitional arrangements in these UK standards?	Yes. The standard is not contentious.
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?	Yes. The two new 'notions' appear to be a sensible approach to dealing with the closing rate/temporal method dilemma.
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?	Yes. The alternative would be too difficult to police.
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)?	Yes, this seems a sensible suggestion.
IASB (iv)	Do you agree that the allowed alternative to capitalise certain	Yes.

	exchange differences in paragraph 21 of IAS 21 should be removed?	
IASB (v)	Do you agree that (a) goodwill and (b) fair value adjustments to assets and liabilities that arise on 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)?	Yes, this seems sensible.

ANNEX C

FRED 25 RELATED PARTY DISCLOSURES

Q.	Particular Issue	Comment
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?	Yes.
ASB (ii)	Do you believe that the ASB should consider any transitional arrangements?	No, the proposed standard is not onerous.
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 does not require disclosure, do you believe that a new UK standard should require the disclosure as set out in paragraphs 13A and 13B of the draft FRS?	Yes, disclosure of the name of the controlling party and the ultimate controlling party if different should be required. In the public sector, the growth of 'arms length' organisations and special purpose vehicles (among others) makes the public availability of this information desirable. From a more principles-based approach, it is hard to see what benefits to users of financial statements might accrue from removing this disclosure requirement. If the IAS did not require disclosure then a new UK standard should require the disclosure set out in paragraphs 13A and 13B of the draft FRS.
ASB (iv)	Do you believe that an accounting standard should require disclosure of the names of the transacting related parties?	Yes, for the reasons set out in answer to ASB (iii) above. In particular, standards of probity in the public sector would be improved through this requirement.
ASB (v)	Should the definition of related parties specifically refer to shadow directors? Should it also refer to persons acting in concert?	Yes, to both questions.
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 materiality in the context of such transactions?	Yes, the concept of materiality is an important one in this concept and guidance would be valuable in interpreting the requirement.

ASB (vii)	Are there are any other aspects of the draft standard that the ASB should request the IASB to review when finalising the revised IAS 24?	Yes. The FRS 8 definition of significant influence, albeit more ambiguous than the IAS definition, is a wide-ranging one. It is therefore arguably closer to the reality of transactions between entities. There is significant scope for transacting entities to arrange their affairs under the draft IAS in such a way that they will avoid reporting related party transactions. Again, there is scope here for the ASB to influence the work of the IASB in a positive way – the highest common denominator approach.
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'.	The Commission <u>does not agree</u> with the requirement not to disclose management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations. Full and open disclosure of management remuneration in all its forms is a key principle for public sector entities in the UK, and is seen to be an important element in the overall accountability and performance framework. It is also seen as an area of specific interest to readers of the accounts. It is difficult to be prescriptive in seeking to define both 'management' and 'compensation', as both will vary according to the organisational nature and structure of any particular entity. But 'management' would normally include the directors or members of the board or equivalent governing body of the entity, together with others having the authority and responsibility for planning, directing and controlling the activities of the entity. 'Compensation' would include all cash and non-cash benefits derived both directly and indirectly from services provided by 'management' in their capacity as directors, members of the board or equivalent governing body or as employees of the entity.
IASB (ii)	Do you agree that the Standard should not require disclosure of related party	The Commission <u>does not agree</u> with this proposal. The argument for full and open disclosure to satisfy the need for

	transactions and outstanding balances in the separate financial statements of a parent or wholly-owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs (see paragraph 3)?	accountability referred to above also means that an appropriate level of disclosure should be made in respect of each individual entity, rather than solely at the group level. In the public sector in the UK, such disclosure is often prescribed in the requirements governing the preparation of financial statements of the entity.

ANNEX D

FRED 26 EARNINGS PER SHARE

Q.	Particular Issue	Comment
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?	Yes. This is in accordance with the convergence programme.
ASB (ii)	Do you believe that the ASB should consider any transitional agreements?	No.
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?	Earnings per share is not a subject that is directly relevant to the Commission's areas of activity, so the Commission is not in a position to respond on this point.
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?	As above, the Commission is not in a position to respond on this point.
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 & 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 (i.e.	As above, the Commission is not in a position to respond on this point.

	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).	

ANNEX E

FRED 27 EVENTS AFTER THE BALANCE SHEET DATE

Q.	Particular Issue	Comment
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?	Yes.
ASB (ii)	Do you believe that ASB should consider any other transitional arrangements?	No.
ASB (iii)	Are there any aspects of the draft standard that ASB should request IASB to review when finalising the revised IAS 10?	No.

ANNEX F

FRED 28 INVENTORIES; CONSTRUCTION & SERVICE CONTRACTS

Q.	Particular Issue	Comment
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?	Yes.
ASB (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?	Yes. The Commission believes that the incorporation of part of IAS 18 is useful in providing guidance on an area where it has previously been absent. But once the work of the ASB and other standard setters on revenue recognition is completed then any new guidance arising from that work will need to be reflected in the FRS that emerges from FRED 28.
ASB (iii)	Do you believe that the ASB should consider any transitional arrangements?	No.
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?	No.
ASB (v)	Are there any aspects of the standard on construction contracts that the ASB should request the IASB to review in due course?	No.
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?	Yes.
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 the profit or loss (paragraph 31). Do you agree with retaining these requirements?	Yes.

ANNEX G

FRED 29 PROPERTY, PLANT AND EQUIPMENT

BORROWING COSTS

Q.	Particular Issue	Comment
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?	Yes. Deferral is also supported if the revaluation project leads to changes before 2005.
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 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?	Disagree with the proposed international approach, and support the approach taken by FRS 15.
ASB (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?	Yes to both elements of the question. UK public sector entities do, in certain circumstances, use renewals accounting as an estimate of depreciation. The Commission supports this approach.
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	The Commission supports the approach in the IAS of allowing, as an alternative treatment, the revaluation of property, plant and equipment (at fair value). The definition of fair

	17 above?	value should be broad enough to include the concept of 'value in use' contained in FRS 15.
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?	The international standard should also cover the issue of donated assets, which are a feature of public sector entities in the UK. The Commission believes that such assets should be recognised by an entity at fair value when they are donated.
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 IASB's projects on insurance and reporting financial performance?	The Commission is not familiar with the insurance industry and therefore is not in a position to make an informed response to this question. But the proposal to maintain the current UK position pending the outcome of IASB work is consistent with the ASB's approach in other areas.
ASB (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 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, this is supported – in practice historical cost data may not be available.
ASB (viii)	Do you believe that ASB should consider any other transitional arrangements?	No.
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?	None in addition to the comments made elsewhere.
ASB (x)	Do you agree that the capitalisation of borrowing costs	Yes. If a choice has to be made, the Commission would opt for

	should remain optional? If you had to choose between mandatory capitalisation and prohibition of capitalisation, which would you support and why?	prohibition, on the grounds of prudence.
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?	Yes.
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?	The Commission supports the FRS 15 approach
ASB (xiii)	Do you have any comments on IAS 23 that you wish the ASB to bring to the IASB's attention?	No.
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] FRS on property, plant and equipment)?	The Commission agrees in principle, subject to the observations above about the definition of fair value being broad enough to incorporate the concept of 'value in use'.
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?	Yes.
IASB (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 in respect of temporary idleness. In respect of 'retired from active use and held for disposal' then if it has not been fully depreciated than the asset should be reviewed for impairment, with a view to being written down to its residual value.

THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND

CA HOUSE
21 HAYMARKET YARDS
EDINBURGH EH12 5BH
PHONE 0131 347 0233
FAX 0131 347 0105
E-MAIL dwood@icas.org.uk
WEB http://www.icas.org.uk

Technical Director
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
LONDON
WC1X 8AL

E-mail: fred26@asb.org.uk

11 September2002

Dear Sirs

ASB FINANCIAL REPORTING EXPOSURE DRAFTS 23 TO 29

The Accounting Standards Committee has considered the above Exposure Drafts and I am pleased to set out its comments below.

Timing of Convergence Process

We are concerned at aspects of the timing of the ASB's proposed process of convergence in the UK. The proposed process would seem to involve the publication in the first quarter of 2003 of a number of new accounting standards based on, but not entirely replicating, the equivalent International Financial Reporting Standards ("IFRSs"). Presumably, under this process, there will also be further exposure drafts during the course of 2002 to 2004. If these first standards come into effect during 2003, and subsequent ones come into effect on a phased basis thereafter, the financial statements of each and every UK company over the next few years will contain a number of changes in accounting policy and corresponding prior year adjustments. For listed groups, this will be compounded in 2005, when the IASs/IFRSs replace the UK standards. It will be further compounded if the IASB changes those standards on which the ASB has already based its own new standards, thus requiring further changes to the UK standards.

We have a number of concerns on the effect of this phased process.

- Firstly, the changes required by the new standards will involve a great deal of planning and preparation by companies. Some changes may involve the introduction of new accounting processes and systems, and even different ways of doing business (eg hedging). Requiring changes every year for a number of years would be significantly more onerous for companies than a single "Big Bang" move to IASs/IFRSs for listed companies in 2005. This is particularly true in relation to a subject as pervasive as financial instruments.

- Some aspects of the FREDs retain UK-specific differences that will disappear for listed companies in 2005 but will apparently remain for those entities not subject to the EU regulation. This is likely to cause some confusion. In particular, although this might not be too significant for note disclosures, it could cause problems in relation to differences in recognition, measurement and presentation.

- Furthermore, it does not seem sensible to converge UK accounting standards on IASs when convergence at this early stage is not essential and when it is not clear to what extent these IASs may themselves change in the near future. Listed groups could be left to move across to IASs/IFRSs wholly in 2005. Subject to the current consultation by the DTI, other entities (individual companies, and unlisted groups, and other non-company entities) could also move across to IASs/IFRSs, or a version of UK standards based on those IASs/IFRSs, in 2005 or shortly thereafter.

- The number of changes in accounting policy and prior year adjustments which will arise from a phased implementation over the next few years may bring discredit on accounting and the accounting profession. Users of accounts are likely to mistrust these changes and fail to understand why it is necessary to make such prior year adjustments to accounts which previously claimed to give a true and fair view, and why these changes in policies are necessary to improve future accounts. In the post-Enron business environment, this may be regarded with extreme scepticism.

- The adoption of IAS-based standards in the UK, at the same time as current UK standards, will also inevitably result in inconsistencies between terms and definitions, which could have a detrimental effect on the application of those standards. It may also affect the perception of users of accounts and undermine the confidence which they have in the accounting framework. For example, differences in the definition of “control” and “significant influence” between a new standard on related party disclosures and existing FRSs 2, 5 and 9 may give rise to difficulties. There are also differences in terminology which would be even more confusing to users of accounts, for example the synonymous use of “income statement” and “profit and loss account”.

- There are also educational needs to be considered for preparers, auditors and accounting students, but also for users of accounts. The current situation of having two evolving sets of accounting standards – the developing IAS/IFRSs and the ASB standards which are trying to converge with the IASB’s moving target - makes this very difficult.

For these reasons we prefer a “Big Bang” application of the new standards wholly in 2005, but with a phased consultation and publication timetable.

Changes to International Accounting Standards

We note that the IASB discussion and justification for changes is not included fully in the ASB exposure drafts for consideration by UK consultees. This means that UK consultees are not necessarily made aware of the issues being addressed by the IASB. In some instances this discussion may be critical to consideration of the FRED, eg in considering whether the disclosure of management compensation should be required, in FRED 25.

In future, it would be helpful, if the IASB's rationale for its proposed changes were routinely incorporated in the ASB's FRED.

One further observation which we would make is that by the ASB issuing their own FREDs and consultation paper, UK commentators may focus on the FRED's and not give sufficient attention to the IASB's document. For example, the ASB's consultation paper on IASB proposals (issued at the same time as these FREDs) does not even mention the fact that the IASB's own exposure draft has over 50 pages dealing with consequential amendments to other IASs.

Recommended Approach

We would like to emphasise the importance of providing a reasonable lead time between the new requirements becoming clear and the implementation of those requirements. As indicated above, we would prefer a phased consultation, to allow interested parties to consider the proposed changes in the necessary detail. On balance, we recommend that the ASB develops and publishes its UK standards on a phased basis, but defers implementation until 2005. A phased period of development would allow the necessary consultation of interested parties, and would allow any changes in the IASB's approach to be reflected in the UK standards before they are implemented. Publication in advance would also allow the necessary education processes to occur.

Accordingly we recommend that all standards to be implemented in 2005 need to be finalised by mid-2003. Any subsequent (ASB and IASB) standards issued after mid-2003 should not be mandatory until after 2005.

This would result in a "Big Bang" approach to the adoption of extant IASs/IFRSs by listed companies in 2005, and to the adoption of revised ASB standards by other UK entities around the same time.

Materiality

We note that each draft revised IAS contains an opening paragraph in italics which, *inter alia*, states that "International Accounting Standards are not intended to apply to immaterial items" and refers to paragraph 12 of the Preface. However, as a result of the changes to the IASB Preface, the authority for standards not needing to be applied to immaterial items has been removed. We presume that the IASB intends to include such authority in each standard but no longer in the Preface. If this is the case, the reference to paragraph 12 of the Preface needs to be deleted from the opening paragraph to each of the standards. (The ASB has not reproduced this IASB opening paragraph in its FREDs, but has similar authority in paragraph 13 of its Foreword to Accounting Standards.)

We recommend that the ASB encourage the IASB to reinstate in the Preface the concept that standards need not be applied to immaterial items, to reinforce the above statement in the opening paragraph of each standard. Clearly, the costs of applying IASs/IFRSs to immaterial items would far exceed any benefits of so doing.

11 September2002
ASB FRED 26

Public Sector Issues

We are concerned that the IASB does not appear to consider the public sector in its development of IASs/IFRSs. Whilst these are developed primarily for the private sector, the principles contained therein are taken up by the IFAC Public Sector Committee, and will increasingly be taken up by local public sector bodies, in the development of accounting standards for central governments and public sector bodies more generally.

We suggest that consideration be given in the course of the development of the respective IASs/IFRSs to the application of the principles contained in those standards to the public sector. If the IASB feels that it does not have the resources to address public sector issues directly, then we would suggest a more proactive mechanism for ensuring public sector comments at the standard setting stage are sought through national standard setters, such as ASB, and through IFAC's Public Sector Committee.

Regardless of whether the IASB responds to these concerns, we recommend that the ASB considers the public sector aspects of the standards it proposes to introduce into the UK.

Detailed Comments

Our detailed comments on FRED 26 are included in the attached Appendix.

We hope that our comments are of assistance to you in the finalisation of these standards and in your consideration of their implementation. If you wish to discuss any of our comments further, please do not hesitate to contact me.

Yours sincerely

DAVID A WOOD
Deputy Director, Accounting & Auditing
Secretary to the Accounting Standards Committee

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on FRED 26 "Earnings per Share"
September 2002

Responses to ASB Questions

(1) 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?

Please refer to the comments on the convergence process in the covering letter. Our general position is that we would be happy for new standards to be published, but recommend that implementation be deferred until 2005. In the case of earnings per share, however, because FRS 14 was itself based on the old IAS 33, we would be more relaxed about a new UK standard being issued and implemented as soon as the new IAS 33 is approved by the IASB.

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

No. Subject to our answer in (i) above, we do not see why any specific transitional arrangements should be necessary in the implementation of the standard.

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

Additional BPS Figures

We see no reason why additional earnings per share figures should be prohibited from the face of the profit and loss account, and would be happy for such additional figures to be disclosed on the face of the profit and loss account so long as:

- they are not given more prominence than the four earnings per share figures required by paragraph 58; and
- explanation of these additional figures is given in the notes, as required by paragraph 65.

In-substance Share Buy-backs

Paragraph 25 of the draft standard addresses one particular situation which, in substance, represents a share buy-back. We believe that this should be broadened to apply to any arrangements which are in substance share buy-backs. One example is where a company issues B shares via a bonus issue or share split, which are then redeemed for cash, together with a share consolidation of the original shares (Severn Trent plc, 1998).

Dilutive Options and Dilutive Potential Ordinary Shares

Paragraph 35 lays down a principle which is then not followed in the test of the document. The principle in paragraph 35 has been applied to options, but not, say, to convertible debt. Paragraph 35 therefore needs to be revised, to make it clear that it is dealing only with share options and similar dilutive instruments such as warrants.

Contracts to be settled by Issuing New Shares etc

There is a section on contracts to be settled in shares or cash – Paragraphs 51 to 55. We suggest that there should also be a section on contracts to be settled by issuing new shares or by buying shares in the market.

Responses to IASB Questions

(i) ***Do you agree that contracts that may be settled either in ordthary 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. This seems to be the most prudent approach, consistent with the calculation of diluted earnings per share.

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

No. We do not agree with the proposed approaches. These would result in different EPS for companies which report on a quarterly or half-yearly basis from those which only report annually, and this would be exacerbated for companies with seasonal variations in profit.

British Broadcasting Corporation Room 3515 Broadcasting House Portland Place London W1A 1AA
Telephone 020 7765 1299 Fax 020 7765 1177

BBC

26 September 2002

Hans Nailor
Accounting Standards Board,
Holborn Hall,
100 Gray's Inn Road,
London WC1X 8AL

Fred29@asb.org.uk

Dear Mr Nailor,

Exposure draft: FRED 29 Property, plant and equipment

I am writing in response to the invitation to comment on Exposure Draft FRED 29: Property, plant and equipment; Borrowing costs. I appreciate that this response is after the deadline given in the exposure draft but hope that my views are still useful to you.

My answers to the questions posed in the Exposure Draft are set out in the accompanying appendix. From these you will see that my main concern is around the uncertainty on revaluation policy. I consider the policy in FRS 15 to be superior to that in IAS 16. Assuming that no immediate change is forthcoming here for IAS 16, I believe that the ASB should hold back in issuing FRS 15 (revised). To adopt the IAS 16 policy before 2005 weakens our position and imposes an inferior result on the UK constituency earlier than necessary.

Yours sincerely,

Alison Bexfield
Technical accounting manager

Appendix

Property, plant and equipment; Borrowing costs (FRED 29)

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?

We are in favour of a gradual implementation for changes to UK GAAP where the proposed changes are very straight forward to implement (and hence easy for users of the accounts to understand) or where they are unlikely to have a major effect on the majority of companies. This standard fits within this category for those companies that have opted not to revalue assets as IAS 16 also permits a choice in the matter of revaluation.

But the revaluation issue is one of some significance and FRS 15 also covers those companies that <u>have</u> opted to revalue assets. Currently there are difference in the UK approach to revaluation in FRS 15 and that in IAS 16. I believe that the UK approach is superior to that of IAS 16. For the UK to effectively adopt IAS 16 early (prior to 2005) might be seen as a weakening of our position concerning the revaluation issue. If we truly believe the approach in FRS 1 5 is superior, then we should continue with it right up to 2005 rather than adopt an 'inferior standard' early.

In light of this, I do support the proposal to issue a revised FRS 15 whilst the position on revaluation remains unclear. Should this issue be resolved with new proposals from the IASB, the resulting proposed changes to FRS 15 will need to be reissued for consultation in the UK.

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 disagree with the proposed international approach. Under this approach, where a company has chosen not to revalue its assets it will be required to mix historic cost accounting (for the acquisition cost) with current cost accounting (for the residual value) all for the one asset. This does not appear very sensible with the net book value representing neither one basis nor the other.

ASB (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?

No comment.

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 of the Preface to the FRED)?

We prefer the existing UK approach to revaluations within FRS 15 than that set out in IAS 16. In particular we do not agree with the lAS 16 approach whereby a property could be revalued upwards to reflect a high open market value in a situation where the company concerned requires the property to be used within its business and has no intention of selling it. In such a case, the higher market value should merely be indicated in the notes to the accounts as is required by FRS 15.

The IAS 16 approach would take the accounts another step away from the reality of how management operate their business. We prepare accounts on a going concern basis, and tangible fixed assets represent assets for ongoing use in the business. Valuing assets at a higher open market value would take no account of the disruption to the business of selling up and moving operations to another site or the unlikelihood of this occurring. It could also result in spurious revaluation gains in the performance statement that are unlikely to be realised and that may mislead users of the accounts.

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?

No.

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 lAS 16 revised pending the outcome of the IASB’s projects on insurance and reporting financial performance?

No comment.

ASB (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 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. We believe a similar transitional arrangement should be included. This is a pragmatic arrangement so that companies do not incur undue burdens when adopting the new standard. Over time any differences are eliminated as the assets concerned reach the end of their useful lives.

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

As already stated, I believe that the ASB should hold back on issuing a re vised FRS 15 whilst the revaluation debate is ongoing. The ASB should not adopt an inferior standard in the UK earlier that is required for 2005 harmonisation.

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?

The revised IAS 16 has fewer regulations governing revaluations than FRS 15. It might be sensible for it to include a maximum period, as FRS 15 currently does, after which a full revaluation is required for companies that have adopted the revaluation option.

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 agree this should remain optional until the subject has been properly debated.

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?

No. This is a new stand alone standard for the UK. It would therefore be sensible for it to mirror IAS 23. This is not a principle where I feel the ASB needs to take a stand.

ASB (xii) What arc 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?

No comment

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

No.

British Broadcasting Corporation Room 3515 Broadcasting House Portland Place London W1A 1AA
Telephone 020 7765 1299 Fax 020 7765 1177

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

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] FRS on property, plant and equipment)?

Yes.

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?

No comment.

IASB (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)?

The simple example of a car illustrates how an asset continues to depreciate in value, due to its age, even when not being used. So it appears sensible to continue with depreciation of the asset. However, residual values may change and the rate of depreciation might change once the asset is taken out of use. Such changes are permitted by the standard and so I have no problem with continuing to depreciate in such circumstances.

16 September 2002

Hans Nailor
Accounting Standards Board,
Holborn Hall,
100 Gray's Inn Road,
London WC 1X 8AL

Fred27@asb.org.uk

Dear Mr Nailor,

Exposure draft: FRED 27 Events after the balance sheet date

I am writing in response to the invitation to comment on Exposure Draft FRED 27: events after the balance sheet date.

We support the changes proposed in FRED 27. It is sensible to bring this standard fully in line with FRS 12 once UK law has been amended to permit this.

Yours sincerely,

Alison Bexfield
Technical accounting manager

QUALITY ASSURANCE DEPARTMENT

CA House • 87-89 Pembroke Road • Dublin 4

TEL: +353-1 637 7200
FAX: +353-1 660 4472
e-mail: ca@icai.ie website:
www.icai.ie

THE INSTITUTE OF
Chartered Accountants
IN IRELAND

12 September2002

Allan Cook CBE
The Technical Director
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

Dear Allan

Earnings Per Share (FRED 26)

The following are the comments of the Accounting Committee (AC) of the Institute of Chartered Accountants in Ireland on FRED 26. Also included are the comments of the AC that have been sent to the IASB on its proposed revisions to IAS 33 Earnings per Share.

1. <u>Overall Comment</u>

AC welcomes the opportunity to comment on FRED 26 and supports the ASB strategy of convergence in a number of areas in advance of 2005 in order to ease the challenge of change for users of UK GAAP.

AC recommends that ASB should endeavour to explain the technical reason for the proposed changes to existing UK accounting standards. AC considers that users of UK GAAP have been well served by the explanations within the FRS's, issued by ASB, supplemented by the Appendix to each FRS on "The Development of the FRS"

While FRED 26 identifies the main changes proposed to existing UK requirements in the preface, AC considers that it would benefit users of UK GAAP, and would further ease the challenge of convergence, if the technical reasons (ie. reasons other than convergence) for those changes were set out. AC assumes that the eventual IFRS will focus on the changes from existing IFRS, and considers that ASB should provide UK GAAP users with a separate explanation of the changes from existing UK practice.

Brian Walsh FCA Chief Executive
Judy Fay FCA Secretary
Belfast Office: 11 Donegall Square South, Belfast BT1 5JE.
TEL: 048-90231541 • FAX: 048-90319320 • e-mail: qad@icai.ie

2. AC's answers to the questions posed in FRED 26 are set out below.

1. 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 MS 33 is approved by the IASB?

AC agrees with the proposal to issue a new UK standard on EPS to replace FRS 14, as soon as the new IAS 33 is approved by the IASB.

2. Do you believe that ASB should consider any other transitional arrangements?

AC considers that the ASB should not consider any transitional arrangements as it would be particularly desirable, in the area of EPS calculation, to minimise the period during which differing standards were used.

3. Are there any aspects of the draft standard that the ASB should request the L4SB to review when finalising the revised MS 33?

AC recommends that ASB should consider the wisdom of requiring that additional earnings per share amounts be relegated to the notes to the financial statements, and that ASB should request IASB to reconsider its proposal, if ASB considers that appropriate.

While AC is conscious of the difficulties for users that have been posed by the use of pro-forma EPS numbers in recent years, AC questions whether relegating such additional EPS numbers is the solution.

AC continues to agree with FRS 3 Explanation paragraph 52 that "It is not possible to distil the performance of a complex organisation into a single measure. Undue significance, therefore, should not be placed on any one measure of which may purport to achieve this aim". AC considers that relegating additional EPS numbers may militate against that view, by focusing undue prominence, and thus apparent importance, on the Basic and Diluted EPS numbers specified by the FRED.

AC considers that the practice that has developed, since the issue of FRS 3, of preparers providing and explaining additional EPS measures of performance on a consistent basis from year to year where they wish to highlight another version of EPS, often by excluding the effect of significant one-off items, has been well received by users of financial statements and has facilitated more prompt and incisive analysis of reported financial performance.

AC also notes that relegating such additional EPS numbers to the notes in the full financial statements may well have no effect on the approach taken by preparers in preliminary announcements of results (or other announcements of results apart from the full financial statements), which represent a more immediate, and potentially influential, reporting of financial performance, and which may not be subject to the rigours of IFRSs or FRSs.

Indeed, preparers may even choose to place the EPS "note to the financial statement" on the face of the profit and loss account in order to circumvent the FRED's proposal.

In considering this matter, AC strongly recommends that ASB should take account of the views of investors, analysts and other users of financial statements.

3. AC's responses to the IASB's questions on the proposed amendments to IAS 33 are set out below:

1. 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.

2. 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)?

- ***The number of potential ordinary shares is a year-to-date weighted average of the number o 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).***

Yes.

4. AC's additional comments are set out below:

AC favours strongly the inclusion of the Illustrative Examples in the Appendix to the FRED as it will aid preparers significantly in their interpretation of the detached application of the rules. AC considers it would be more useful and authoritative if these examples were to be approved by the Boards of both ASB and IASB, rather than the staff only.

If you require any clarification or further details on any of the points raised in the response please contact the Secretary to the Committee, Alix Brebbia on +353 1 6377316 or at alix.brebbia@icai.ie

Yours sincerely

Alix Brebbia

Alix Brebbia
Secretary
Accounting Committee
Institute of Chartered Accountants in Ireland

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers
1 Embankment Place
London WC2N 6RH
Telephone +44 (0) 20 7583 5000
Facsimile +44 (0) 20 7822 4652

Hans Nailor Esq
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

16 September 2002

Dear Sir

FRED 29 'Property, plant and equipment';
'Borrowing costs'

We are writing with our comments on FRED 29. We agree that the UK standard on fixed assets should be replaced by a new standard that is as close as possible to the international standards on property, plant and equipment and borrowing costs. However, we also agree that, where the UK standard appears to be superior to the existing IAS, the ASB should continue to seek to have IAS changed to adopt the UK approach, for example in the area of valuation bases.

We have considerable reservations about the proposed change to the assessment of residual values in the international (and proposed UK) standard. Our reservations on this matter are set out in more detail in the appendix.

We believe that the existing UK standard sensibly and pragmatically takes account of practical difficulties experienced in certain industries by including guidance on methodology to be adopted to overcome those difficulties in order to secure compliance with the principles of the standard. Examples are the use of renewals accounting in specific circumstances (utilities) and the guidance on donated assets (charities). We consider that the UK standard, whilst remaining consistent with the principles of IAS, should retain this specific guidance.

PRICEWATERHOUSECOOPERS

Hans Nailor Esq
16 September 2002

Our detailed comments on the questions posed by the ASB in the FRED are contained in Appendix I. Appendix II deals with other matters arising from our review. Our responses to the questions raised by the IASB are set out in our global response to the IASB Exposure Draft, Proposed Improvements to International Accounting Standards'.

Please contact Peter Holgate if you would like to discuss any of the above comments or those in the appendix.

Yours faithfully

PricewaterhouseCoopers

Appendix 1 Responses to specific ASB questions

FRED 29 'Property, plant and equipment';
'Borrowing *costs*'

1. **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?**

Yes. We agree that it is appropriate for the UK to harmonise with the international standards on property, plant and equipment and borrowing costs, unless further changes to IAS 16 are likely before 2005.

2. **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?**

We strongly disagree with the proposed international approach to revise the definition of residual values to reflect current estimates for the following reasons:

For assets held at depreciated historical cost the calculation of depreciable amount, being the difference between cost and residual value, will be meaningless as it is not based on like for like values, as one will be on a historical cost basis and the other on a current cost basis. Furthermore, in some cases, the residual value could be greater than the carrying value.

Basing residual values on current prices rather than on prices prevailing at the date of acquisition will reduce the depreciation charge by inflation since acquisition. This will result in a decreasing depreciation profile even when all other factors have remained constant, which is not consistent with the definition of depreciation as it does not result in the 'systematic allocation' of the depreciable amount of an asset over its useful life. Neither does such a basis reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity as required by paragraph 41.

3. **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?**

Renewals accounting is primarily used in the water industry. There are a number of issues and arguments surrounding accounting for infrastructure assets in that industry.

a) The infrastructure has generally been regarded as one asset and is not susceptible to component accounting except where individual assets are clearly identifiable, which generally relates to overground assets. A component approach would be extremely difficult to implement for cost reasons and because components would be very difficult, if not impossible, to identify.

b) The water regulator specifically allows the entity to recover renewals expenditure in computing the required rate of return. This is analogous to a grant from the regulator. For this reason there is an argument that as the recovery is earned generally in the same period as the expenditure is incurred, it would not be appropriate to capitalise the expenditure and amortise it over a period greater than that over which the recovery is allowed. If the renewals expenditure were to be capitalised it would in many cases be necessary to carry out an impairment review and recognise an impairment charge if; for example, the act of capitalising the expenditure took the carrying value significantly above the regulatory asset value on which the regulator bases the return allowed to the entity, that is, under the regulatory approach, the return on the renewals expenditure asset would have been earned fully in the year of expenditure. In effect this could end up having much the same effect as renewals accounting.

c) The useful life of the infrastructure asset may be very long indeed. Unlike other resources, such as gas, water is not a finite resource and it is an essential part of society's needs. Therefore the operating capacity of the infrastructure is required to be maintained indefinitely. This means that the physical life has to be very long indeed. Thus any depreciation is likely to be small and possibly immaterial.

d) The residual value of the asset, because of the maintenance expenditure, is likely to be high at the end of the useful economic life to the entity (as opposed to the end of the physical life, which for the reasons stated above is likely to be very long and possibly indeterminable). Thus again depreciation may be immaterial. This would be even more so if residual values, as proposed, are based on current prices.

Renewals accounting is a pragmatic approach to dealing with the above issues and represents the most practical solution at present. We support keeping renewals accounting until the issues above have been debated and resolved, possibly between the ASB and the IASB. If the Board feels unable to sanction renewals accounting in the context of convergence with IFRS, then we consider that any removal of the specific guidance in FRS 15 should be deferred until years ending December 2005.

4. 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?

The approach to revaluations in IAS 16 has the advantage of being simpler and easier to apply and therefore we would not disagree with converging with IAS 16 in the UK should IAS 16 maintain the same approach. However, our view and preference is that the FRS 15 approach is conceptually superior and should be adopted internationally, because we believe that the 'value to the business' (i.e. deprival) basis is a more relevant valuation basis than fair value as defined in IAS 16 (i.e. exit values), for property, plant and equipment. Because items of property, plant and equipment are held for the continuing use in the business, rather than for resale, current deprival values are more relevant than realisable values, and consistent with the preparation of the accounts on a going concern basis rather than a break up basis.

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

We strongly recommend that the issue of donated assets should be dealt with in the standard along similar lines to the existing paragraph 18 of FRS 15, which refers to the relevant SORP. To remove this guidance would create problems for many charities.

Paragraphs *53A-53B* of the FRED require compensation for impairments and related replacements to be included in the profit or loss for the period and disclosed separately on the face of the income statement. This is inconsistent with companies' legislation in those cases where the compensation is not a realised profit (i.e. does not meet the definition of a 'qualifying asset' in Tech 25/00). This would be the case where compensation was in the form of a replacement asset. The FRED should be revised to eliminate this inconsistency.

In addition, the FRED should clarify that, where realised, the net gain or loss on disposal arising under paragraphs *53A* and 53B should be recognised in the profit and loss account in accordance with paragraph 21 of FRS 3.

The treatment of exchanges of assets in paragraph 21 and assets acquired in exchange for shares issued by the entity in paragraph 1 6A is not consistent with existing UK GAAP for intra-group transactions, which are often recognised at book values. The proposed approach is not necessarily appropriate for transactions between entities under common control, which are often not carried out on an arm's length basis. In such cases, similar principles should be used as for other transactions between entities under common control, for example business combinations. Our preference is for transactions between wholly owned entities of the same group to be exempt from these requirements Therefore, we consider that exchanges of assets between entities under common control should be excluded from the scope of paragraphs 21 and 21A of the revised standard.

Paragraph 20 of the FRED states that the carrying amount of an asset may be reduced by applicable government grants in accordance with SSAP 4. However, as noted in paragraph 25 of SSAP 4, this is inconsistent with the Companies Act *1985.* We therefore recommend that paragraph 20 is deleted from the FRED, to avoid confusion with SSAP 4.

6. 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 IASB's projects on insurance and performance reporting?

Yes, although it should be noted that the IASB is unlikely to have finalised its project on insurance contracts before 2005.

Appendix I Responses to specific ASB questions

FRED 29 'Property, plant and equipment';
'Borrowing costs'

7. 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 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, but only provided that the transitional rule is consistent with the proposed IASB standard on the first time implementation of IFRSs.

8. Do you believe that ASB should consider any other transitional arrangements?

The ASB should consider whether specific transitional arrangements are needed in respect of differences in the costs capitalised under FRS 15 and the FRED. Any transitional arrangements should be consistent with the IASB's standard on first time adoption of IFRSs and should not be more onerous.

9. Are there any other aspects of the draft standard on property, plant and equipment that the ASB should request the IASB to review when fmalising the revised IAS 16?

There are two aspects that we consider the SB should ask the IASB to review. These are:

Cost capitalisation

The definition and guidance relating to the cost of plant, property and equipment in paragraphs 14-18 is similar to that in respect of the cost of inventories in IAS 2. Furthermore, paragraph 18 implies that the same costs would be capitalised under the revised IAS 16 as are capitalised under IAS 2. However, the guidance is not the same, particularly in relation to the treatment of administration and other general overhead costs. None of these costs would be capitalised under paragraph 17 of the revised IAS 16, whereas some such costs would fall to be capitalised in inventory under paragraphs 10-14 of IAS 2.

IAS 16, therefore, should be revised to ensure that it is clear whether the same principles as apply in IAS 2 should also be applied to the capitalisation of property, plant and equipment, or whether there are differences between the two standards. In our opinion IAS 16 should be consistent with IAS 2, whilst clarifying that those items in paragraphs 17(a)-(c) and 17A should be excluded from the cost of property, plant and equipment. This would involve reinstating the first paragraph of paragraph 17 of IAS 16. As well as affecting those assets that are capitalised as property, plant and equipment that are also made for sale in the normal course of business, this issue is also relevant where entities have large capital expenditure departments, devoted solely to the production (or construction) of property, plant and equipment, for example, in the utility and property development industries

Appendix I - Responses to specific ASB questions

FRED 29 'Property, plant and equipment';
'Borrowing costs'

Comparative information

We disagree with the proposed removal of the exemption from disclosure of comparative information for the reconciliation of movements in the opening and closing carrying amount of property, plant and equipment in paragraph 60. The key information is in respect of the movements between the opening and closing balance sheet. Giving comparatives is superfluous and will unnecessarily clutter the financial statements.

10. 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 consider that, where possible, international accounting standards should not contain options and that therefore this option should be withdrawn. Selecting a single treatment is a difficult judgement that may require further consideration and consultation by the IASB.

11. 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?

No. In our view there are no grounds for departing from IAS 23, as proposed in FRED 29. Exchange differences that are in substance an adjustment to interest costs should be included in borrowing costs, even though in practice it may be difficult to differentiate between those and other exchange differences.

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

The UK should adopt the approach in IAS 23.

13. Do you have any comments on IAS 23 that you wish the ASB to bring to the IASB's attention?

No.

Appendix II – Other comments

FRED 29 ‘Property, plant and equipment’;
‘Borrowing costs’

Before finalising FRED 29 the ASB should incorporate the principle in SIC 2 ‘Consistency - Capitalisation of borrowing costs’ to require an entity adopting a policy of capitalising borrowing costs to capitalise borrowing costs on all qualifying assets, regardless of whether they are included in stock, investments, intangible assets or property, plant and equipment. As presently drafted FRED 29 could be interpreted as allowing entities to pick and choose which qualifying assets borrowing costs should be capitalised on.

The Auditing Practices Board

Independent Regulation of the Accountancy Profession

117 Houndsditch
London
EC3A 7BT

Telephone +44 (0)20 7293 7931
Facsimile +44 (0)20 7293 7940

www.auditingpracticesboard.com

7 August 2002

Ms. Mary Keegan
Chairman
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
LONDON WCIX 8AL

Dear Mary

FRED 25 Related Party Disclosures

The Auditing Practices Board (APB) welcomes the opportunity to comment on the ASB's proposals to revise FRS 8 'Related Party Disclosures'. The APB notes that the Exposure Draft has been issued as part of the ASB's programme to bring about convergence between UK Accounting Standards and International Financial Reporting Standards.

The APB is fully supportive of the objective of converging UK and International Accounting Standards (IAS). We are also supportive of robust accounting standards that, where necessary, provide adequate support to auditors in seeking to ensure that financial statements provide the disclosures necessary to present a true and fair view. However, we are not supportive of convergence being achieved at the expense of the quality of the resulting accounting standards. We are of the view that the proposed revisions to FRS 8 may diminish its effectiveness.

FRS 8 was issued in *1995* at the same time as Statement of Auditing Standards (SAS) 460 'Related Parties' was issued by the APB. During 1994 and 1995 the ASB and the APB worked together, very effectively, in order to produce accounting and auditing standards, dealing with related parties, that were aligned with each other. For the APB these Standards dealt with an extremely important expectation gap issue.

The APB's press release announcing SAS 460 noted, *'In most companies related party transactions are carried out on an arms-length basis for bonafide purposes. However experience has shown that corporate structures and the operating style of management are occasionally deliberately designed to obscure related party transactions. This has been highlighted in recent reports by Inspectors appointed by the Secretary of State for Trade and Industry.'* Research carried out on behalf of the APB into the content of DTI Inspectors' Reports in the period 1971 to *1995* reveals that issues relating to related party transactions, inter-group transactions and window dressing arise in 22% of the reports (19 of 88 reports).

Subsequent research into recent major frauds, that we carried out in connection with our 1998 paper 'Fraud and Audit: Choices for Society', indicates that most material frauds involve directors or other senior management and range across all sizes of entity.

It is difficult to measure the effectiveness of accounting and auditing standards. However, the issuance of FRS 8 and SAS 460 seems to have had a marked effect on the volume of disclosure of related party transactions in the financial statements of UK listed companies. A study published by the journal Company Reporting in its April 2000 edition reveals that in the period from 1997 to 2000 there was an upsurge in the reporting of related party transactions from a quarter of companies surveyed to over a half

Despite evidence of improved disclosure in the United Kingdom, related party transactions have featured in many recent corporate collapses such as Enron, Adelphia, Worldcom and Tyco. A recurring feature of each of these collapses has been improper behaviour on the part of directors and management, frequently involving related parties such as special purpose entities. As improper related party transactions involving directors may be indicative of an entity's involvement in accounting irregularities and of going concern difficulties it is important that such transactions be subject to proper scrutiny and disclosure.

Consequently, it is the APB's strongly held view that it is undesirable for the ASB to propose a weakening of standards on related party transactions merely to harmonise with international standards. The recent events in North America referred to above provide compelling evidence that related party disclosure standards need to be considerably strengthened.

There are many similarities between the existing requirements of FRS 8 and the proposals in FRED *25*. However, the APB is of the view that the approach proposed in FRED 25 is overly focused on rules and matters of bookkeeping and is insufficiently focused on the principles underlying the need to disclose related party transactions and control relationships.

As you are aware, from 2005 all EU companies whose shares are traded on a regulated market will be required to prepare their consolidated financial statements in accordance with IAS. As the Regulation does not appear to allow any deviation from IAS. any additional requirements included in FRS 8 by the ASB will not apply to the consolidated financial statements of UK and Irish companies traded on a regulated market.

The APB urges the ASB, therefore, to make strong representations to the 1ASB to amend its proposals as follows:

- to include paragraphs l3A and 1 3B of FRED 25 relating to control disclosures;
- to require disclosure of the name of the transacting related party where separate disclosure of the transaction is required by the Accounting Standard;
- to replace the proposed objective paragraph in the Standard with one that is more principled along the lines of the objective paragraph of FRS 8;
- to restructure the definition of a related party along the lines used in FRS 8;
- to make the disclosure requirements within the Accounting Standard consistent with the definition of related party used in the Standard;
- to include the expression 'at any time during the financial period' within the definition of a related party;
- to replace the expression 'significant influence' with 'influence';
- to specify more qualitative disclosures in paragraph 14 of the Exposure Draft; and
- to remove the proposed exemption for management compensation.

In Appendix 1 of this letter we elaborate on the bullet points set out above. In Appendix 2 we provide a response to each of the questions posed by the ASB in FRED *25* and the IASB in its Exposure Draft.

We have also written separately to the IASB and enclose a copy of that letter for your information.

Yours sincerely

WID Plaistowe
Chairman

Enc.

Significant concerns of the APB with respect to the proposals in FRED 25

Disclosure of control
Where an entity is controlled by another party, FRS 8 requires disclosure of:

- the related party relationship;
- the name of that party and, if different, that of the ultimate controlling party; and
- if the controlling party or ultimate controlling party is not known, disclosure of that fact.

By contrast the IASB proposes the removal of the existing requirement in IAS 24 to disclose related party relationships where control exists and replacing it with the disclosure of relationships between parents and subsidiaries.

The APB believes that it is in the public interest for the name of the controlling party/ultimate controlling party to be disclosed. Consequently, the APB strongly supports the additional paragraphs 13A and 13B included in FRED *25*. We urge the ASB to encourage the IASB to adopt such disclosures in IAS 24. If the IASB does not adopt such disclosures then, from 2005, the consolidated financial statements of UK and Irish publicly traded companies will not be required to disclose their controlling party.

The APB notes that paragraph 117 of IAS 1 (revised) proposes disclosure of the name of the parent and the ultimate parent of the group. However, as a parent is defined (in the IASB Glossary) in terms of being an enterprise it excludes control exercised by, for example, individuals and organisations such as trusts. The APB takes the view that paragraph 13A of FRED 25 provides for more comprehensive disclosure of control relationships and therefore will be more likely to meet public expectations than the IASB's proposal.

Disclosure of the names of related parties

As stated above the APB believes that the name of the controlling party, and **if different the** name of the ultimate controlling party, should be disclosed in the financial statements. However, it is less clear whether it is necessary for the names of transacting related parties to be disclosed. Arguably knowledge of the nature of the relationship with the related party and the effect of related party transactions provides more decision useful information to users of financial statements than knowledge of the name of the related party.

FRS 8 requires the names of transacting related parties to be disclosed but makes exemption for naming related parties where confidentiality is legitimised by law. FRS 8 also recognises that it may be desirable to aggregate the disclosure of similar transactions by type of related party.

The FRED (at paragraph *15),* by contrast, does not require the naming of related parties but disclosure of related party transactions for each of the following categories of related party:

- the parent;

- entities with joint control or significant influence over the entity;
- subsidiaries;
- associates;
- joint ventures in which the entity is a venturer;
- key management personnel of the entities or its parent; and
- other related parties.

At paragraph 18 the FRED also permits the aggregation of items of a similar nature except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

Although the APB accepts that it may not be necessary for the names of transacting related parties to be disclosed it is nevertheless of the view that the name of the transacting related party should be disclosed in those circumstances where separate disclosure of the transaction is required by the Accounting Standard.

Knowing the identity of a related party is of benefit to users of financial statements insofar as it enables them to cross refer to the financial statements and other sources of information issued by the related party. This benefit is acknowledged in FRS 5 ***Reporting the substance of transactions*** which states '...in assessing the commercial effect of a transaction, it will be important to consider the position of all the parties to it, including their apparent expectations and motives for agreeing to its various terms.'[1]

The objective paragraph

The objective of FRS 8 set out in paragraph 1 is a much broader and more principled objective that the proposed objective of FRED *25*. The APB recommends that an objective paragraph more along the lines of that in FRS 8 replace the proposed objective which focuses too much on compliance with rules without explaining why the rules are important.

The definition of a related party

Although the definition of a related party in FRED 25 is broadly similar to the definition in FRS 8 we recommend that the definition be structured more along the lines of that in FRS 8. The FRED 25 definition is a list of related parties or situations that give rise to a related party relationship which, as the ASB notes, excludes shadow directors and persons acting in concert. By contrast, in FRS 8 the principles underlying what constitutes a related party relationship are set out. This is followed by various lists providing examples of related party relationships. These lists conclude with the caveat that they are not intended to be exhaustive.

We believe that the approach in FRS 8 is superior to the approach adopted by FRED 25 because it establishes high level principles and is consequently not open to abuse through preparers asserting that disclosure of a particular relationship is not required because such a relationship does not fall within any of the specific categories in the FRED.

The disclosure categories in paragraph 15 of the FRED are not fully aligned with the categories of related party outlined in the definition in paragraph 8. We recommend that the disclosure requirements be made consistent with the definition.

The proposed definition of a related party omits to include the expression 'at any time during the financial period' and is consequently open to abuse to the extent that preparers may contend that disclosure is only required of transactions with those parties that were related at the year end date.

Use of the term significant influence
The definition of related party includes 'an interest in the entity that gives it significant influence over the entity'. Significant influence is defined as 'the power to participate in the financial and operating policy decisions of an economic activity [including] but not [limited to] control or joint control over those policies'. The APB recommends that the expression 'significant influence' be replaced with the expression 'influence'; which is the expression used in FRS 8. The term significant influence is used in Accounting Standards in the context of defining associated companies and we are of the view that the concept needs to be broader than that. The explanation of 'influence' set out in paragraph 2.5(a) (iii) and (iv) of FRS 8 provides a useful model of how the term might be explained.

The need to specify more qualitative disclosures
The second sentence of paragraph 14 of the FRED which purports to set out the minimum disclosures focuses on the quantitative aspects of related party transactions but not the qualitative aspects. We believe that this is a major deficiency in the proposed requirements of the FRED. We recommend that:

- the words 'at a minimum' be deleted. Such wording is generally inappropriate for a bold letter paragraph and as drafted a number of disclosures contemplated in the first sentence would seem to be negated by not being included in the minimum disclosures; and

- adding to the list in the second sentence:

  (a) the nature of the related party relationship and

  (b) any other elements of the transaction necessary for an understanding of the financial statements. (A guidance paragraph along the lines of paragraph 22 in FRS 8 would usefully support this bold letter requirement).

The proposed exemption for management compensation
The APB does not support such an exemption because it would be too readily open to abuse. Key management personnel are related parties of an entity and the principle underpinning the requirements in the FRED is that transactions with related parties should be disclosed. Exempting disclosure of management compensation in the ordinary course of an entity's operation begs the question of what is meant by 'ordinary course of an entity's operation'. It may be difficult for auditors to argue that specific transactions with management were other than in the ordinary course of an entity's operations. The recent disclosures concerning how directors were remunerated at Tyco and Adelphia illustrate the breadth of imagination that can be applied in these matters.

Establishing a precedent for exemption based on transactions carried out "in the ordinary course of an entity's operations" could be a slippery slope leading to calls for exemption of all sorts of related party transactions. As you are aware, this approach to related party transactions was mooted in the UK in the late 1980's but did not win support.

Questions for respondents posed by ASB in FRED 25

Question No.	Question	Suggested Response
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 IAASB?	APB supports the harmonisation of national and international accounting standards and therefore agrees, in principal, with the proposal to conform FRS 8 with IAS 24. However, a number of proposed changes to FRS 8 are of concern to the APB. These are: • the removal of the requirement (in IAS 24) to disclose the name of the ultimate controlling party; • the change in the objective of the Standard away from the 'principle' of making the disclosures necessary to draw attention to the fact that the financial position and results may have been affected by the existence of related parties towards a more 'rule' based approach to prescribe disclosures about related party relationships and transactions; and • the risk for abuse inherent in the proposed exemption in respect of management compensation paid in the ordinary course of an entity's operations.
ASB(ii)	Do you believe that the ASB should consider any transitional arrangements?	No. Transitional arrangements would be confusing.
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?	The APB believes it is in the public interest for the name of the controlling party/ultimate controlling party to be disclosed. Consequently, the APB supports the additional paragraphs set out in the UK Standard and would urge the ASB to encourage the IASB to adopt such disclosures in IAS 24. If the IASB does not adopt such disclosures then, from 2005, the consolidated financial statements of European publicly traded companies will not be required to disclose their controlling party. The APB notes that paragraph 117 of IAS 1 (Revised) will require disclosure of the name of the parent and the

		ultimate parent of the group. However, as a parent is defined (in the IASB Glossary) in terms of being an enterprise it excludes control exercised by, for example, individuals and organisations such as trusts. The APB takes the view that paragraph 13A of FRED 25 provides for more comprehensive disclosure of control relationships.
ASB(iv)	Do you believe that an accounting standard should require disclosure of the names of transacting related parties?	The APB believes that the name of the controlling party, and if different the ultimate controlling party, should be disclosed in the financial statements. However, it is less clear whether it is necessary for the names of transacting related parties to be disclosed. Arguably, knowledge of the nature of the relationship with the related party and the effect of related party transactions provides more decision useful information for users than the name of the related party per se. FRS 8 already recognises that it is desirable to aggregate similar transactions by type of related party. Although, therefore, it is not necessary for the names of transacting related parties to be disclosed the APB is of the view that where separate disclosure of a transaction is necessary for the understanding of the effects of a related party transaction on the financial statements of the entity (see paragraph 18 of FRED 25) that the name of the transacting related party should be disclosed. A benefit of knowing the name of a related party is that it enables the user of financial statements to cross refer to the financial statements and other sources of information issued by the related party. As FRS 5 acknowledges, knowledge of how a counterparty has accounted for a transaction may provide

		additional insight or corroboration to the users of financial statements.
ASB(v)	Should the definition of related parties specifically refer to shadow directors/ Should it also refer to persons acting in concert?	Although the definition need not refer specifically to these categories of related party these categories should clearly be encompassed within the general definition of what constitutes a related party.
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 materiality in the context of such transactions?	The APB believes that it is unnecessary for the accounting standard to specify that disclosure is required of material related party transactions because all accounting standards are only intended to apply to material items. The APB would not support the retention of the guidance on materiality in respect of related party transactions presently set out in paragraph 20 of FRS 8. However, the APB would support the inclusion of appropriate guidance dealing with the more qualitative aspects of materiality in relation to 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.	Yes. In line with our comment above regarding the move away from the more principled approach of FRED 8 to a more prescriptive approach we would recommend changes be made to: • the objective paragraph, • the structuring of the definition of a related party • use of the term 'significant influence'; and to • Paragraph 14. The objective of FRS 8 set out in paragraph 1 is a much more high level and principled objective that the proposed objective of FRED 25. The APB recommends that an objective paragraph more along the lines of that in FRS 8 replace the proposed objective which focuses too much on compliance

		with rules without explaining why the rules are important. Although the definition of a related party in FRED 25 is broadly similar to the definition in FRS 8 we recommend that the definition be structured more along the lines of that in FRS 8. The FRED 25 definition is a list of related parties or situations that give rise to a related party relationship. By contrast, in FRS 8 the principles underlying what constitutes a related party relationship are set out. This is followed by various lists providing examples of related party relationships. These lists conclude with the caveat that they are not intended to be exhaustive. We believe that this approach is superior to the approach adopted by FRED 25 because it establishes high level principles and is consequently not open to abuse through preparers asserting that disclosure of a particular relationship is not required because such a relationship does not fall within any of the specific categories in the FRED. The categories in paragraph 15 of the FRED are not fully aligned with the definition of related party in paragraph 8. We recommend that lists of categories of related party should be consistent with each other. The definition of related party includes 'an interest in the entity that gives it significant influence over the entity'. Significant influence is defined as 'the power to participate in the financial and operating policy decisions of an economic activity but not control or joint control over those policies. The APB recommends that the expression 'significant influence' be replaced with 'influence'. The term significant influence is used in the context of defining associated companies and we are of the view that the concept needs to be broader. The

		explanation of influence set out in paragraph 2.5(a) (iii) and (iv) of FRS 8 provides a useful model of how the term might be explained. The proposed definition of related party omits to include the expression 'at any time during the financial period' and is consequently open to abuse to the extent that preparers may contend that disclosure is only required of transactions with those parties that were related at the year end date. The second sentence of paragraph 14 of the FRED which purports to set out the minimum disclosures focuses on the quantitative aspects of related party transactions but not the qualitative aspects. We believe that this is a major deficiency in the requirements of the FRED. We recommend that: • the words 'at a minimum' be deleted. Such wording is generally inappropriate for a bold letter paragraph and as drafted a number of disclosures contemplated in the first sentence would seem to be negated by not being included in the minimum disclosures; • adding to the list in the second sentence: (a) the nature of the related party relationship and (b) any other elements of the transaction necessary for an understanding of the financial statements. (A guidance paragraph along the lines of paragraph 22 in FRS 8 would support this bold letter requirement)

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)?	The APB does not support such an exemption because it would be too readily open to abuse. Key management personnel are related parties of an entity and the principle underpinning the requirements in the FRED is that transactions with related parties should be disclosed. Exempting disclosure of management compensation in the ordinary course of an entity's operation begs the question of what is meant by 'ordinary course of an entity's operation'. It may be difficult for auditors to argue that transactions with management were other than in the ordinary course of an entity's operations. Establishing a disclosure criteria of "in the ordinary course of an entity's operations" could be a slippery slope to exemption of all sorts of related party transactions. Again "ordinary course of an entity's operation" would need to be defined. This approach to related party transactions was attempted in the UK in the late 1980's and was not supported.
	"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 do not consider these concerns to be warranted as the need for definition applies equally if the transactions are to be exempted from disclosure.
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	The APB does not support the proposed exemption and believes that related party disclosures should be required in the separate financial statements of a parent or wholly

	wholly owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs (see paragraph 3)	owned subsidiary that are published with the group's consolidated financial statements. The APB supports the reasoning of the six members of IASB who expressed a dissenting view (to the exposure draft's proposals) on this issue. However the APB would limit such disclosure to those transactions that (in the consolidated accounts) are not eliminated on consolidation.

BBA BRITISH BANKERS' ASSOCIATION

Pinners Hall
105-108 Old Broad Street
London EC2N 1EX

Tel: +44 (0) 20 7216 8800
Fax: +44 (0) 20 7216 8811

<u>BBA Response to ASB Financial Reporting Exposure Draft 23 – Hedge accounting</u>

Issue of principle

The ASB has attempted to tackle a complex area through the introduction of a principles-based standard and has shown that there can be a better starting point than the prescriptive rules-based approach found in IAS 39. We support this initiative and believe that in this respect FRED 23 constitutes an important contribution to the development of a comprehensive international standard on financial instruments.

Implementation issues

The US experience of implementing FAS 133 shows that companies need a certain amount of time to implement the changes required by a fair value based standard, particularly the changes to their risk management practices as well as their accounting systems needed to achieve hedge accounting. In our view, trying to accelerate the 2005 timetable for IAS 39 implementation is simply not possible and it is harmful to try to implement IAS 39 on a piecemeal basis. The proposed transitional arrangements, that the standard would be issued early in 2003 to apply to hedges taken out after a given date and to existing hedges, although without the requirement for pre-designation, are not achievable. Some companies will have started accounting periods to which the standard would apply and will not be given sufficient opportunity to review and, if necessary, change their practices.

Given the complex nature of hedge accounting and the delicate nature of the risk positions that they seek to mitigate, we are very much against piecemeal changes to the accounting rules in this area. This is the case whether those rules are set out in a UK standard or an international standard and for this reason we believe that the objective should be to devise a cohesive set of principles governing hedge accounting and for these to be applied in 2005.

This has the advantage of:

- Allowing companies until 2005 to plan the structural changes to their books that will be necessary following the introduction of IAS 39 even if the main excesses are removed.

- Avoid the risk of commercial loss as a result of hastily introduced procedures aimed at meeting definitions of hedge effectiveness which at present remain unclear.

- Avoiding the potential of companies having to restructure their books to meet the terms of two changes in rules in a relatively short period of time.

Since compliance with FRED 23 will not achieve compliance with IAS 39, we consider that it would be damaging to UK companies that are required to adopt IFRS in 2005 to implement FRED 23. The time and effort taken to achieve documentation and effectiveness testing for hedge procedures that are acceptable under UK GAAP but not under IAS 39 would be wasted unless IAS 39 was significantly amended along the lines of the FRED before 2005.

Environmental issues

We live in an environment where IAS 39 and its implementation guidance have been in place for the last year. IAS 39 has much in common with FAS 133 which has its own set of implementation guidance. FRED 23 uses language imported directly from IAS 39 and it is not clear to what extent the FRED should be interpreted in accordance with IAS 39 or to what extent its approach results in differences from IAS 39. Given that listed companies are expecting to adopt IAS 39 in 2005, many users of the standard will be inclined to interpret it in the same way as IAS 39. Whether or not this is the ASB's intention, we consider that, if a standard is issued, its requirements should be clarified.

The hedge accounting rules

FRED 23 proposes an approach to hedge accounting which is based on three essential tenets:

- Predesignation, with formal documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge;

- Reliable measurement of the effectiveness of a hedge; and

- For forecast transactions, that they are highly probable and involve an exposure to variations in cash flows that could ultimately affect reported net profit or loss.

This, we believe, provides a base more grounded in principle than IAS 39, though there remain issues that require further investigation before a definitive view can be reached on the compatibility of the resulting rules with the objectives of sound risk management.

These are issues that we are actively considering as part of our comprehensive review of IAS 39 and we would expect to be in a position to write to the ASB again on these within the deadline set for comment on FRED 30 and the ED on IAS 32 and 39.

Responses to Specific Questions

Q1. 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?

No. We are opposed to the phased implementation of IFRS in the UK, particularly in the case of financial instruments where we believe that companies will need until 2005 to implement IAS 39. If the ASB persists in the phased approach, hedges of net investments in foreign operations should be dealt with as part of the revision of SSAP 20 (FRED 24).

Q2. 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 do not agree that the process of bringing UK practice on hedge accounting into line with international practice is helped by the issuance of a standard that does not actually achieve convergence. However, we support the ASB in seeking to develop principles based proposals that may help influence the IASB to make IAS 39 a more principles based standard.

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

We do not believe that other principles should be necessary, although the actual meaning of the proposals is difficult to interpret given that the language of IAS 39 is used.

Q3. 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?

It is not clear at present what restrictions the ASB intends. The FRED should be explicit about what is and what is not prohibited. If the intention is to preserve current UK practice, this should be clarified.

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

Yes.

Q4. 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 wish to consider this material further and will provide our conclusions shortly.

Q5. 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?

No. We believe that this halfway stage toward IAS 39 is unhelpful.

Q6. 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)?

As set out above, we believe that this issue should be dealt with in the revision of SSAP 20.

(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)?

No. We believe that this halfway stage toward IAS 39 is unhelpful.

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

No. We believe that this halfway stage toward IAS 39 is unhelpful.

Q7. 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?

No. We do not believe it will be possible for companies to reconsider their risk management strategies and change their accounting systems to be able to implement FRED 23 in 2003. If this work then has to be redone in order to implement IAS 39, it would be most unfortunate. Practically, hedge accounting requirements cannot be introduced in the UK before 2005.

British Bankers' Association
16 September 2002

BRITISH BANKERS' ASSOCIATION

Pinners Hall
105-108 Old Broad Street
London EC2N 1EX

Tel: +44 (0) 20 7216 8800
Fax: +44 (0) 20 7216 8811

BBA Response to ASB Financial Reporting Exposure Draft 24 - The Effects of Changes in Foreign Exchange Rates/Financial Reporting in Hyperinflationary Economies

Q1. 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.

Q2. Do you agree with the proposal not to include the IAS 21 provisions on the recycling of certain exchange gains and losses?

If the ASB persists with its phased approach and issues a standard before this issue is resolved internationally, we agree with the proposal not to include the IAS 21 provisions on recycling of certain exchange gains and losses. However, this should be re-visited in the event that the IASB decides to retain recycling since, in general, we consider that there should be no significant differences between international standards and UK standards.

Q3. Do you agree with the proposal not to include any transitional arrangements in these UK standards?

Transitional arrangements may need to be considered with respect to the disclosure of net exchange differences recognised in the statement of total recognised gains and losses and treating goodwill as a foreign currency asset where historic records may not be available.

Other comments

- Paragraph 50(b) requires disclosure of net exchange differences recognised in the statement of total recognised gains and losses and a reconciliation of the amount of such exchange differences at the beginning and end of the period. We believe it would be helpful if the ASB provided transitional guidance on the determination of the opening balance for this reconciliation. Companies may have written foreign exchange differences to reserves over a number of years. As the amount of cumulative exchange differences is not required to be disclosed under current UK GAAP, issues arise as to how far back companies should go in order to determine the opening balance without causing undue cost and effort. In its exposure draft, 'First-time Application of International Financial Reporting Standards' at paragraph 23, the IASB has recognised the difficulty of this disclosure for first-time adopters (see also Basis for Conclusions BC51 and 52). We would suggest that a similar approach be taken in FRED 24.

In addition, we believe this disclosure only makes sense if a policy of recycling is in place. The disclosure requirement, therefore, appears inconsistent with the ASB's decision not to include the recycling provisions of IAS 21.

- The FRED in paragraph 6 defines a foreign operation to include a branch. Should "branch" be defined in the way set out in SSAP 20 paragraph 37, i.e. a legally constituted enterprise located overseas or group of assets and liabilities which are accounted for in foreign currencies? Where non-monetary assets are in a foreign currency and also funded by foreign currency borrowings, SSAP 20 permits assets and borrowings to be regarded as a "branch", allowing the non-monetary items to be translated at the closing rate. Exchange differences on the non-monetary assets of the branch can therefore be matched with the exchange differences on the borrowings.

- We note that the hedging provisions have been moved to FRED 23 'Financial instruments: hedge accounting'. SSAP 20, paragraph 51, allowed hedge accounting for foreign currency borrowings used to hedge against foreign equity investments at the individual entity level – subject to satisfaction of certain conditions, exchange differences were taken to reserves. Under the current proposals, there would be no hedge accounting at individual entity level. FRED 23 paragraph 16 (a) (i) states that the gain or loss on the hedging instrument should be taken to reserves. However, there would be no offsetting gain or loss on the equity investment since under FRED 24, an equity investment (for example, an 'other participating interest') would not be a monetary item and would, therefore, remain at the historic exchange rate.

  Also, under paragraph 30 of FRED 24, foreign exchange gains or losses on monetary items which form part of an entity's net investment in a foreign operation would be taken to the profit and loss account at individual entity level, leading to a mismatch if they are hedged with foreign currency borrowings. We are unclear why there should be a different treatment on such items at individual entity level when compared to group level, when they are taken to reserves. The treatment in paragraph 30 could lead to a lack of distributable profits at the individual entity level when the group is profitable.

- The definition of 'spot exchange rate' is 'the exchange rate for immediate delivery' under paragraph 6 of FRED 24. Under market convention in the UK, settlement date is generally two days after the deal date. Would such a contract still meet the definition of a spot exchange rate, in particular the immediate delivery criteria?

- Where a foreign currency transaction is to be settled at a contracted rate, SSAP 20 allows the use of the contracted rate to record the transaction and any resulting asset or liability. FRED 24 does not allow this method; instead it requires the transaction to be measured initially at the spot exchange rate on the date of the transaction. The Preface to FRED 24, paragraph 12, states that a different rate may be used if hedge accounting techniques are used and FRED 23 is applied. We prefer the treatment allowed under SSAP 20. It is simpler and we believe it more accurately reflects the economic substance of the transaction. In addition, we believe the reference to an interaction with FRED 23 is confusing, especially as it is silent on the use of hedge accounting techniques for hedging instruments and hedged items that are not financial instruments.

- Draft standard 'Financial reporting in hyperinflationary economies' - we welcome the additional guidance given on the determination of when hyperinflation is deemed to arise and the method of accounting to be used. However, we have doubts of the usefulness of paragraph 33, which requires that all items in the cash flow statement should be expressed in terms of the measuring unit current at the balance sheet date. This requirement results in a cash flow statement that contains items that are not cash flows and cannot, therefore, be readily understood.

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 21:

Q4. 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?

Yes.

Q5. 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?

Yes.

Q6. 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)?

No. In the case of a translation that is made merely for the convenience of readers, we consider that it is preferable to use the closing rate to translate the financial statements. This will not result in the creation of new gains and losses and will maintain ratios.

Q7. Do you agree that the allowed alternative to capitalise certain exchange differences in paragraph 21 of IAS 21 should be removed?

Yes.

Q8. Do you agree that

(a) goodwill and
(b) fair value adjustments to assets and liabilities

that arise on 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)?

We agree with the proposed improvement: goodwill is generated as a result of the acquisition of an entity and therefore relates to the acquired entity. For the same reason, we concur with the improvement regarding fair value adjustments to assets and liabilities.

British Bankers' Association
16 September 2002

BRITISH BANKERS' ASSOCIATION

Pinners Hall
105-108 Old Broad Street
London EC2N 1EX

Tel: +44 (0) 20 7216 8800
Fax: +44 (0) 20 7216 8811

BBA Response to ASB Financial Reporting Exposure Draft 25 – Related Party Disclosures

Q1. 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?

No.

Q2. Do you believe that the ASB should consider any transitional arrangements?

No.

Q3. 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?

Inclusion of such information is relevant information for users of financial statements, and the ASB should recommend its inclusion to the IASB. As commented in the response to (i) above, we are not in favour of the issuance of a new UK standard: the content of paragraphs 13A and 13B are included within FRS 8.

Q4. Do you believe that an accounting standard should require disclosure of the names of transacting related parties?

In general, disclosure of related party transactions aggregated by type of related party, as, required by paragraph 15, should be sufficient. However, the standard should require disclosure of the name of the related party where this is relevant to an understanding of the potential effect of the relationship on the financial statements and paragraph 14 should be amended to make this clear.

Q5. Should the definition of related parties specifically refer to shadow directors? Should it also refer to persons acting in concert?

The definition of a related party in paragraph 9 of the new IAS 24 is drawn sufficiently wide not to require shadow directors or persons acting in concert to be specifically referred to.

Q6. Do you believe that an accounting standard should specify that disclosure is required of *material* related party transactions and give more guidance on materiality in the context of such transactions?

Yes. Materiality guidance is relevant because transactions that are not material to the reporting entity may be material to the other party to the transaction and therefore may need to be disclosed. The ASB should recommend the inclusion of guidance on materiality to the IASB. In addition, we consider that the standard should include reference to the fact that disclosure cannot be made where this conflicts with the reporting entity's duty of confidentiality arising by operation of law. For example, the standard cannot override bank's obligation to preserve confidentiality of customers' dealings.

Q7. Are there any other aspects of the draft standard that the ASB should request the IASB to review when finalising the revised IAS 24?

The revised IAS 24 exempts wholly owned subsidiaries from disclosing transactions with group entities. We agree with the principal of this exemption as it recognises that those wishing to find more information about the group could do so provided that consolidated financial statements were publicly available. The exemption provided by FRS 8 includes subsidiary undertakings, 90% or more of whose voting rights are controlled within the group. The IASB could consider broadening the disclosure exemption for 90% or more owned subsidiaries on conceptual and practical grounds.

It is further noted that the existence of such an exemption lends support to the inclusion of a requirement to disclose the name of the parent company, and the ultimate holding company, if different, in the notes of the reporting entity (see Q3 , above).

A further area meriting review is the treatment of Employee Share Ownership Plan trusts and similar entities, as they typically hold shares of the reporting company.

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 24 :

Q8. 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'.

No. The disclosure of management remuneration either in aggregate or for each director by name is useful to users of financial statements of all size companies. While IAS 24 may not be the best place to include such disclosure, which is often subject to legal or other regulatory disclosure requirements, it does not seem appropriate to exclude it.

Q9. 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)?

We support the proposals in paragraph 3 of the draft amendment to IAS 24 'Related Party Disclosure' that: 'The standard does not require disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or wholly owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs.'

As noted above, exemption for subsidiary undertakings should be widened to include those for which 90% of the voting rights are controlled by the group. (By definition, this would be based solely on shares with voting rights.)

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BBA BRITISH BANKERS' ASSOCIATION

Pinners Hall
105-108 Old Broad Street
London EC2N 1EX

Tel: +44 (0) 20 7216 8800
Fax: +44 (0) 20 7216 8811

<u>BBA Response to ASB Financial Reporting Exposure Draft 26 – Earnings Per Share</u>

Q1. 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.

Q2. Do you believe that ASB should consider any other transitional arrangements?

As the requirements of FRED 26 are broadly similar to those of FRS 14, no additional transitional arrangements should be necessary.

Q3. Are there any aspects of the draft standard that the ASB should request the IASB to review when finalising the revised IAS 33?

Using an average based on interim periods rather than using a cumulative full year average may produce different values for the components of the dilutive calculation, as potential ordinary shares could be dilutive in one interim period but not in another.

The ASB Statement 'Interim reports' states that the interim period should be treated as an accounting period distinct from the annual cycle; however, certain elements should be presented on an integral basis – i.e. predicting financial information for the full financial year - such as taxation. Whilst we agree that earnings per share should be based on the interim period alone, extrapolating this discrete approach to cover the issuance of options that are based on annual results for the purposes of calculating diluted earnings per share could produce a potentially misleading result. We believe that the dilutive element should be presented on an integral basis rather than using a discrete approach.

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

Q4. 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.

Q5. 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)?

- **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).**

No, we do not agree with the approach to deal with the year-to-date calculation of diluted earnings per share. Using an average based on interim periods rather than using a cumulative full year average may produce different values for the components of the dilutive calculation, as potential ordinary shares could be dilutive in one interim period but not in another.

British Bankers' Association
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BRITISH BANKERS' ASSOCIATION

Pinners Hall
105-108 Old Broad Street
London EC2N 1EX

Tel: +44 (0) 20 7216 8800
Fax: +44 (0) 20 7216 8811

BBA Response to ASB Financial Reporting Exposure Draft 27 – Events After the Balance Sheet Date

Q1. 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?

No.

Q2. Do you believe that ASB should consider any other transitional arrangements?

No. All matters are adequately covered and convergence will have been achieved.

Q3. Are there any aspects of the draft standard that ASB should request IASB to review when finalising the revised IAS 10?

No. The proposals are in line with the UK Statement of Principles for Financial Reporting.

British Bankers' Association
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BRITISH BANKERS' ASSOCIATION

Pinners Hall
105-108 Old Broad Street
London EC2N 1EX

Tel: +44 (0) 20 7216 8800
Fax: +44 (0) 20 7216 8811

BBA Response to ASB Financial Reporting Exposure Draft 28 - Inventories; Construction and service contracts

Q1. 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?

No.

Q2. 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 do not agree with the extension of the standard on construction contracts to include service contracts, as this addresses issues that are currently being considered in the current ASB/IASB project on revenue recognition; it would be preferable to await the conclusions of that project rather than implement requirements now that may be changed in the near future.

We also note that the proposed standard does not include the detailed examples given in IAS 18, and in particular the example of loan fees. We believe that the accounting treatment for loan fees set out in the BBA SORP on Advances is consistent with the principles set out in IAS 18 and the proposed ASB standard, in that it distinguishes between the service of arranging a loan and the subsequent collection of interest and repayments on the loan itself; fees properly attributable to the arrangement of the loan should therefore be recognised at the time and not spread over the period of the loan. However, this is inconsistent with the accounting for loan fees set out in the appendix to IAS 18. We believe that further consideration of this issue is necessary before IAS 18 is incorporated into UK standards.

Q3. Do you believe that the ASB should consider any transitional arrangements?

No.

Q4. 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?

None noted.

Q5. Are there any aspects of the standard on construction contracts that the ASB should request the IASB to review in due course?

None noted, other than the accounting for loan arrangement fees referred to above.

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

Q6. 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?

Yes.

Q7. 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).

Do you agree with retaining those requirements?

Yes.

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BRITISH BANKERS' ASSOCIATION

Pinners Hall
105-108 Old Broad Street
London EC2N 1EX

Tel: +44 (0) 20 7216 8800
Fax: +44 (0) 20 7216 8811

BBA Response to ASB Financial Reporting Exposure Draft 29 - Property, plant and equipment; Borrowing costs

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

No.

Q2. 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?

In a historical cost model, we consider that the residual value should not be revised to reflect current estimates and so disagree with the proposed international approach. This approach has the unfortunate consequence of increasing the possibility that companies will avoid depreciating certain properties on the grounds that the depreciation is immaterial and would be a retro-grade step for UK GAAP.

Q3. 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?

The standard permits different depreciation methods to be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. It seems unlikely that the annual expenditure required to maintain an infrastructure asset could be deemed to be an allocation of the depreciable amount of the asset. Therefore, we believe that renewals accounting is not within the letter of the standard. We see no particular benefit in allowing UK GAAP to deviate from international practice in this area.

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 of the Preface to the FRED)?

We believe that the value to the business model provides information that is more relevant to users of financial statements than a pure fair value model. The open market value of a property may be higher than the existing use value. While we agree that the higher value should be disclosed, it seems less useful to recognise this in the financial statements since it is not a value that could be obtained by the business if there is no intention or possibility of disposal. This is an example of the difficulties of using pure exit values.

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

No.

Q6. 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 IASB's projects on insurance and reporting financial performance?

The uncertainty about how listed insurance groups will report in 2005 is a further reason why we do not support a phased implementation into UK GAAP of international accounting standards before 2005. However, if the ASB intends to continue with this course, we agree that present UK practice should be preserved as a transitional measure.

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 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. For those companies that adopt the new UK standard, we believe that the transitional arrangements in FRS 15 should remain.

Q8. Do you believe that ASB should consider any other transitional arrangements?

No.

Q9. 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?

Paragraph 53A of IAS 16 deals with compensation from third parties for items of property, plant and equipment that are impaired, lost or given up. It states that such compensation should be recognised in the profit and loss account in the period in which it is received. In order to be consistent with the recognition of a contingent asset under IAS 37 'Provisions, contingent liabilities and contingent assets', we suggest that the wording of the paragraph be changed to require that the compensation be recognised when it is virtually certain to be received.

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?

Yes. We would support prohibition of capitalisation since, unless there is a clear linkage between a particular borrowing and a qualifying asset, the capitalised interest will be based on theoretical allocations of the total borrowing cost of an enterprise. An enterprise's financial resources support the whole business and we are not in favour of arbitrary allocations being made to capitalise some of a year's finance cost.

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?

No. In general, we do not support differences from international standards being introduced into UK standards.

Q12. 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 are not in favour of capitalising borrowing costs and this difference in views helps illustrate why we support prohibition. We do, however, prefer the FRS 15 treatment since this shows a more clear linkage between element of the borrowing relating to the qualifying asset and the capitalised borrowing cost.

Q13. Do you have any comments on IAS 23 that you wish the ASB to bring to the IASB's attention?

No.

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

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 (see paragraphs 21 and 21A of the [draft] FRS on property, plant and equipment)?

No. We believe that the issue of whether gains or losses should be recognised on exchanges of similar assets should be addressed in the Revenue Recognition project. Therefore, we do not consider it should be addressed at this time in the improvements project.

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?

No, for the reasons set out in the response to Q14.

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

Yes.

British Bankers' Association
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BRITISH BANKERS' ASSOCIATION

Pinners Hall
105-108 Old Broad Street
London EC2N 1EX

Tel: +44 (0) 20 7216 8800
Fax: +44 (0) 20 7216 8811

BBA Response to ASB Consultation Paper – IASB proposals to amend certain International Accounting Standards

Preface to International Accounting Standards

Each international accounting standard includes a statement that international accounting standards are not intended to apply to immaterial items, and a cross-reference is given to the Board's Preface. However, the cross-referenced paragraph no longer appears in the revised Preface published by the Board in May 2002. We object strongly to this change to the Preface, which was not included in the exposure draft. The absence of this statement has far reaching and serious implications for financial reporting and the phrase should be reinstated at the earliest opportunity. In the meantime, the Board may wish to reinsert this important statement within IAS 1 or IAS 8 as part of their revisions.

IAS 1 – Presentation of financial statements

Q1. Do you agree with the proposed approach regarding departure from a requirement of an International Financial Reporting Standard or an Interpretation of an International Financial Reporting Standard to achieve a fair presentation (see proposed paragraphs 13-16)?

We strongly support the inclusion in the standard of 'override' provisions, but disagree that these provisions should be made by reference to the regulatory framework of the country in which the financial statements are issued. In our view, if the standards themselves require an override in specific, exceptional circumstances, then there would be no departure from standards where such provisions are used. Therefore, paragraph 15 is unnecessary and the phrase 'if the relevant regulatory framework requires or otherwise does not prohibit such a departure' should be deleted from paragraph 13.

Q2. Do you agree with prohibiting the presentation of items of income and expense as 'extraordinary items' in the income statement and the notes (see proposed paragraphs 78 and 79)?

Whilst we support the idea of preventing entities labelling items as "extraordinary", we do not believe that paragraph 78 will be effective in preventing the practice. Entities can just use a different term than "extraordinary". The better way of preventing this practice would be to require items of such size, nature or incidence that their separate disclosure is relevant to an understanding of the entity's performance to be included within the appropriate income statement heading to which they relate. Paragraph 80 should be amended to make this requirement clear and should include the following words at the end: 'under the headings set out in paragraph 76'.

Q3. Do you agree that a long-term financial liability due to be settled within twelve months of the balance sheet date should be classified as a current liability, even if

an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue (see proposed paragraph 60)?

Yes. At the balance sheet date the entity has a current liability

Q4. Do you agree that:

(a) a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date, even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach (see proposed paragraph 62)?

Yes.

(b) If a lender was entitled to demand immediate repayment of a loan because the entity breached a condition of its loan agreement, but agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment , the liability is classified as non-current if it is due for settlement, without the breach of the loan agreement, at least twelve months after the balance sheet date and:

(i) the entity rectifies the breach within the period of grace; or

Yes. If the breach is rectified within the period of grace, we agree that it is appropriate to classify it as non-current.

(ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified (see proposed paragraph 63 and 64)?

Yes, provided that it is not unlikely that the breach will be rectified.

Q5. Do you agree that an entity should disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements (see proposed paragraphs 108 and 109)?

No. We do not consider that disclosure framed along these lines is necessary or useful. At best, such a requirement will only result in boilerplate disclosures. Indeed, the example given in paragraph 109 with regard to financial assets held-to-maturity can only result in boilerplate disclosure since the categorisation of financial assets is based on the rules in IAS 39 and is not a matter of management judgement. We recommend that these paragraphs be deleted.

However, we consider that disclosure should be required of the methods and assumptions used to measure assets and liabilities where management judgement is needed to determine the appropriate methods and assumptions. The disclosure requirements are best set within the context of a specific accounting standard, for example IAS 32 with regard to measuring the fair value of financial assets and liabilities and IAS 19 with regard to measuring pension assets and liabilities.

Q6. Do you agree that an entity should disclose key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year (see proposed paragraphs 110-115)?

We do not agree with the proposals. For most financial businesses, assumptions underlying key measurements of assets and liabilities are likely to be varied and wide-ranging, encompassing economic and commercial trends which are to a greater or lesser extent interrelated. Any meaningful discussion of such assumptions would need to be much more extensive than appropriate to the financial statements. Furthermore, sensitivity of measurement to these assumptions will not always depend on a direct relationship but will itself involve a considerable degree of judgement.

We also consider that the proposal confuses uncertainties relating to the measurement of the item at the accounting date, and changes that might occur over the next period. For example, the value of a traded bond at the balance sheet date is directly available from market price quotations, but its value over the next year is dependent on interest rates, possibly currency rates, and many factors that underlie the issuer's credit rating.

Disclosures of sensitivity to changes in assumptions are also likely to be misinterpreted as meaning that the accounts could be wrong to the extent of the range indicated; such misinterpretation would further undermine the credibility of financial reporting generally. Sensitivity disclosure may also be commercially damaging in some circumstances.

We therefore suggest that such disclosures should focus on the assumptions used, rather than the range of possible outcomes, and should consider only the range of possible assumptions at the measurement date, rather than potential changes in assumptions over the following year.

We also believe that such disclosures are more appropriate to the MD&A or OFR section of the annual report than the financial statements themselves. This places the information in a more appropriate category for audit purposes, and also affords 'safe harbour' treatment. It is also less likely to result in 'boilerplate' discussion.

IAS 8 – Accounting policies, changes in accounting estimates and errors

Q1. Do you agree that the allowed alternative treatment should be eliminated for voluntary changes in accounting policies and corrections of errors, meaning that those changes and corrections should be accounted for retrospectively as if the new accounting policy had always been in use or the error had never occurred (see paragraphs 20, 21, 32 and 33)?

We agree that voluntary changes in accounting policy and the correction of errors should be accounted for retrospectively. Voluntary changes in accounting policies should be rare and should only be made where the new policy is better than the old policy. Since they are at the discretion of management, it should generally be expected that restatement should not cause undue cost or effort. The wording of paragraph 21 could be improved to make these points clear. We believe it is important for the standard to include a reference to material errors. In the absence of such a reference, IAS 8 could be read as requiring the restatement of comparatives for all errors, however trivial, and entities may be encouraged to use the provision to manage earnings.

Q2. Do you agree with eliminating the distinction between fundamental errors and other material errors (see paragraphs 32 and 33)?

Yes, although as stated in our response to question 1 above, we believe the requirements should apply to material errors.

IAS 17 – Leases

Q1. Do you agree that when classifying a lease of land and buildings, the lease should be split into two elements – a lease of land and a lease of buildings? The land element is generally classified as an operating lease under paragraph 11 of IAS 17, Leases, and the buildings element is classified as an operating or financing lease by applying the conditions in paragraphs 3-10 of IAS 17.

We have sympathy with the motive for the change, which is to try to ensure that the land element of a lease does not prevent what would otherwise be a finance lease from being accounted for as a finance lease. However, we do not believe it is either appropriate or practical to allocate amounts attributable to the land and buildings separately. Therefore, we do not support this amendment and suggest that it is an area that should be addressed in the wider project on lease accounting.

Q2. Do you agree that when a lessor incurs initial direct costs in negotiating a lease, those costs should be capitalised and allocated over the lease term? Do you agree that only incremental costs that are directly attributable to the lease transaction should be capitalised in this way and that they should include those internal costs that are incremental and directly attributable?

We agree that this choice should be eliminated and agree with the approach taken.

IAS 27 – Consolidated and separate financial statements

Q1. Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?

Yes. We agree for the reasons explained in the basis for conclusions. However we would make following points:

- It seems impractical for an accounting standard to introduce the requirements in 8 (a) with regard to obtaining unanimous agreements from minority interests. How decisions are made by shareholders is a matter for company law and not accounting standards. It would be better for the accounting standard to be less specific in this regard, for example, by merely requiring that minority interests do not object.
- Paragraph 8 (d) should include intermediate parent companies.

- In paragraph 8 (b) what is meant by securities and publicly traded? This should be reworded so that subsidiaries of listed companies which have only issued CDs, commercial paper, etc, should not be required to produce consolidated financial statements if they meet all the other tests.

Q2. Do you agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity (see paragraph 26)?

We do not agree that minority interests should be classified as part of equity. Although the presentation on the balance sheet, as a separately presented element of equity and distinguished from parent shareholders' equity is acceptable, the corollary of this classification is that in the profit and loss account minority interests would not be shown as a deduction in arriving at net profit. We believe that in consolidated accounts the focus must be on the shareholders of the parent, and that from their perspective minority interests are not part of equity. We would also point out that in many cases minority interests represent an obligation of the Group that is more akin to a liability than equity.

Q3. Do you agree that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS 39, in the investor's separate financial statements (paragraph 29)?

Do you agree that if investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments should be accounted for in the same way in the investor's separate financial statements (paragraph 30)?

Whilst we generally favour deletion of unnecessary options in this case two options are retained and only the third is deleted. That option – to carry these investments under the equity method – is in some ways the most relevant because it usually allows the equity in the financial statements of the investor and in the Group consolidated financial statements to be the same.

In this case therefore we favour retaining all three existing options – cost, equity method and fair value – as the basis for accounting for subsidiaries, jointly controlled companies and associates in the financial statements of the investor.

A holding company may hedge its investment in its subsidiaries by matching their net asset value ('NAV') against foreign borrowings. Under revised IAS 27, the holding company would not be allowed to report the subsidiaries at NAV; suppose it recognises them at historical cost. Then, assuming the holding company can apply hedge accounting to the historical cost of the investment under IAS 39, the holding company accounts will effectively report a foreign exchange position equal to the difference between the subsidiaries' historical cost and NAV. This does not reflect the economics of the situation.

We do agree that if investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 39 in the consolidated financial statements then such investments should be accounted for in the same way in the investor's separate financial statements.

However, we would note the case where a listed company acts purely as the holding company for a single trading subsidiary. If in this situation IAS 39 were applied then it would result in the listed parent company recognising its own market capitalisation in the balance sheet.

IAS 28 – Accounting for investments in associates

Q1. Do you agree that IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, should not apply to investments that otherwise would be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with IAS 39, when such measurement is well established practice in those industries (see paragraph 1)?

Yes. We agree that for venture capital organisations, mutual funds, unit trusts and similar entities IAS 28 and 31 should not apply to investments that otherwise would be associates or joint ventures where these investments are held as part of a portfolio of such investments. We agree that the investments should be accounted for as held for trading in accordance with IAS 39. However, we note that IAS 39 makes an exception to the general rule that trading assets should be carried at fair value in the case of unquoted equity instruments whose fair value cannot be reliably measured. While the requirement that fair value measurement must be a well-established practice in the industries where this exemption will be used should go some way toward ensuring that fair values are generally available, we consider that the standard must acknowledge that there will be some circumstances where reliable fair values cannot be obtained. In such circumstances, the investments should be held at cost less provision for impairment in accordance with IAS 39. This will ensure that all investments that are part of the same portfolios are treated the same way. It would be unacceptable if the standard could be interpreted to mean that an investment in a portfolio of other venture capital investments had to be treated as an associate or joint venture merely because a reliable fair value was not available.

Q2. Do you agree that the amount to be reduced to nil when an associate incurs losses should include not only investments in the equity of the associate but also other interests such as long-term receivables (paragraph 22)?

We do not agree with the proposed approach since this might lead to the inappropriate write-down of, for example, long-term receivables when good collateral is in place. We consider that the investor should continue to record changes in the carrying amount for an associate that is incurring losses even if this results in the recognition of net liabilities rather than net assets.

IAS 40 – Investment property

Q1. **Do you agree that the definition of investment property should be changed to permit the inclusion of a property interest held under an operating lease provided that:**

(a) the rest of the definition of investment property is met; and
(b) the lessee uses fair value model set out in IAS 40, paragraphs 27-49?

Yes.

Q2. **Do you agree that a lessee that classifies a property interest held under an operating lease as investment property should account for the lease as if it were a finance lease?**

Yes.

Q3. **Do you agree that the Board should not eliminate the choice between the cost model and the fair value model in the Improvements project, but should keep the matter under review with a view to reconsidering the option to use the cost model in due course?**

Yes. However, as fair values are increasingly used, it will become more untenable for investment property not to be carried at fair value.

British Bankers' Association
16 September 2002

13 September2002

Hans Nailor
Accounting Standards Board
100 Grays Inn Road
London
WC1X 8AU

The London Society of Chartered Accountants

Dear Sir

FRED 26 Earnings per share

With a membership of 30,000, the London Society of Chartered Accountants (LSCA) is the largest of the regional bodies which form the Institute of Chartered Accountants in England & Wales. London members, like those of the Institute as a whole, work in practice or in business. The London Society operates a wide range of specialist committees including Technical (accounting and auditing), Tax, Regulation and Ethics Review and Financial Services and Insolvency, which scrutinise and make representations to issuing bodies such as yourselves. The LSCA Technical Committee welcomes the opportunity to respond to the Accounting Standards Board ('the Board') regarding the revision to FRS 26, 'Earnings per share', based on the revised version of the International Accounting Standard of the same name published by the L&SB for comment at the same time m May 2002

We have reviewed the exposure draft and set out below a number of comments specifically relating to the proposed changes to current UK require4ents and the extent to which the ASB should seek to persuade the IASB to change the proposed IAS To this end, please find attached a copy of our response to the IASB on their ED for the revision of IAS 33 "Earnings per share"

We also have sent a letter to Mary Keegan to express our views on the general approach the ASB is undertaking towards convergence with international standards and this response should be read in the light of the views we have expressed in t4t letter

INFLUENCING THE IASB

1 Whilst most of our comments to the IASB arise as a result of changes now proposed to IAS 33, we acknowledge that some of our comments apply to provisions currently in IAS 33 Nevertheless, this is an improvements project and it would not be appropriate for us to ignore the issues.

2. Our concerns are significant ones and we urge the ASB to press the JASB very hard to accept the need for revisions in these areas.

3. Should the L&SB not take on board any of the changes outlined, in the interests of international harmonisation, we would not wish the ASB to reflect the changes as UK specific paragraphs. The UK and international standards should be identical.

RESPONSES TO SPECIFIC ASB QUESTIONS

(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?

4. Yes.

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

5. No.

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

6. The issues that we wish the ASB to raise with the IASB are those set out in our letter to the IASB.

OTHER UK ISSUES

Scope

7 Paragraph 1 of the draft standard should state that the standard applies to financial statements intended to give a true and fair view. such a statement has been added as a UK specific change to the other FREDs issued as part of the convergence project and applies equally to earnings per share

Employee share schemes

8. Paragraph 18A proposes, as a UK specific paragraph, that shares held by an ESOP trust and reflected in a company's balance sheet as assets are to be treated for eps purposes as though they had been cancelled

9 We concur with this treatment but recommend that the paragraph be added into UITF 13 In this way the UK standard could be identical to its international equivalent and yet the guidance be retained The need for the guidance falls away once UITF 13 is no longer applicable: Following our recommendation means that the guidance will automatically be withdrawn when UITF 13 is withdrawn.

10. We note that the useful guidance in FRS 14 on the dilutive effect of employee share schemes will not be provided in the new standard. It might be helpful to add this guidance, for the time being, to UITF Abstract 17, Employee share

schemes'. The guidance on the dilutive effect of share schemes, as currently drafted, is applicable only so long as UITF 17 is extant. Thus, adding the guidance into UITF 17 itself would enable the UK standard to be identical to its international equivalent and ensure that the guidance will be automatically withdrawn when UITF 17 is withdrawn.

If there are any matters arising from this letter you would like to discuss, please do not hesitate to contact Danielle Stewart on 020 7731 6163.

Yours faithfully

Danielle Stewart
Chairman, LSCA Technical Committee

LSCA
The London Society of
Chartered Accountants

13 September 2002

Hans Nailor
Accounting Standards Board
100 Gray's Inn Road
London
WC1X 8AU

Dear Sir

FRED 25 Related Party Disclosures

With a membership of 30,000, the London Society of Chartered Accountants (LSCA) is the largest of the regional bodies which form the Institute of Chartered Accountants in England & Wales. London members, like those of the Institute as a whole, work in practice or in business. The London Society operates a wide range of specialist committees including Technical (accounting and auditing), Tax, Regulation and Ethics Review and Financial Services and Insolvency, which scrutinise and make representations to issuing bodies such as yourselves. The LSCA Technical Committee welcomes the opportunity to respond to the Accounting Standards Board (the Board') regarding the revision to FRS 8, Related Party Disclosures, based on the revised version of the International Accounting Standard of the same name published by the IASB for comment at the same time in May 2002.

We have reviewed the exposure draft and set out below a number of comments specifically relating to the proposed changes to current K require4ents and the extent to which the ASB should seek to persuade ti4 IASB to change the [proposed] IAS. To this end, please find attached a copy of out response to the IASB of their ED for the revision of IAS 24

We also have sent a letter to Mary Keegan to express our views on the general approach the ASB is undertaking towards convergence with international standards and this response should be read in the light of the views we have expressed in that letter.

INFLUENCING THE IASB

1 Addressing each of the main issues in our letter to the IASB m turn

(a) **Materiality** we recognise that this is a problematic issue It is not yet clear whether the exclusion of the relevant paragraph from the IASB Preface will be dealt with in the rubric to each standard or by inclusion of a paragraph in IAS 1 or IAS 8 when revised We have taken the opportunity to point out to the IASB that they need to address it somewhere or it will keep getting raised for each new or revised standard. It is less clear whether there is any chance of the FRS 8 paragraph 20 approach being taken up; as demonstrated in our letter, we would support any moves on your part to encourage such a move within the IAS.

(b) **Exemptions for subsidiaries:** as you can see, we have several concerns with the JASB drafting and intentions behind the exemption. It seems to us that the practical issue of publishing each exempt subsidiary's accounts rather than making sure the group accounts are available, as with the UK exemption, is fairly fundamental, as is the issue of the practicality of allowing only 100% subsidiaries to be exempt.

(c) **Management compensation:** we do not see that the definitional problem identified by the TASB is insuperable in that IAS 19's definition of employee compensation and the in-built definition in the IAS draft of key management personnel should, in combination, deal with the issue. We are well served by legal and listing rules requiring such disclosures in the UK; however, we cannot be complacent, given the risk of losing these, eg if the relevant requirements of the listing rules are lost to a European prospectus directive that does not require them.

(d) **Names of transacting related parties**: we find the loss of the UK requirement to disclose names as particularly unfortunate, as it represents such a strong safeguard for users and auditors. The practical experience of our Committee would suggest that the naming requirement is the one disclosure that is resisted most strongly in circumstances where the reporting entity may have something to hide. In fact, as suggested in our letter to the IASB, we would actually go further than the current UK requirements. Moreover, this is an issue where disclosure is just as relevant for SMEs, although perhaps for different reasons than for large/public companies. We find it hard to see how users are served by the exclusion of the name from the list of minimum disclosures paragraph 14 of the draft standard

(e) **Controlling parties** we support disclosur4 of the identity if the controlling party and ultimate controlling party and we welcome the ff suggested additions to the standard by ASM m the form of paragraphs 13A and 13B However, most unfortunately, we consider that the case for diverging from IAS is not made convincingly in the FRED (paragraph 8 page 8, and paragraph 13B page 21) This appears to be more of an assertion than a careful reasoning for use of such a 'nuclear' option of diverging from the IAS text

2 We think we have made our preferences clear m all the above cases and would encourage the ASB to 'fight the good fight' on our behalf In particular, we would wish ASB to lobby strongly in respect of (d) and (e) above However, if the changes to the proposed international standard requested by the ASB are not made, then we would support the adoption of the final IAS text in the UK in the interests of convergence We cannot support more onerous standards being applied to non-listed companies than t listed companies.

OTHER UK ISSUES

3. One further issue has come to our attention that relates entirely to the UK. At present, paragraph' 165 of the Charities SORP contains a relaxation of the requirements of FRS 8 to name transacting related parties. The experience of our members suggests that, in particular in relation to paragraph 165(a) (donations from related parties, who often wish to remain anonymous), this relaxation is considered not to be applicable to charitable companies, on the grounds that the SORP cannot override accounting standards that are applied through the Companies Act. Obviously, if the proposals in FRED 25 come into force as they stand, the problem will disappear as there will be no overt requirement to name transacting related parties. However, if the new standard does, in the end, require disclosure of the names of transacting related parties, it does not seem right that this anomalous situation should continue. In our view, in order to provide a level playing field for unincorporated and incorporated charities, the UK standard should state the relaxation of rules for charities, as was done in FRS 15 for donated assets, thus giving effective 'statutory' backing to the approach in the SORP.

ANSWERS TO OUESTIONS

(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?

Yes

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

No.

(iii) Do you believe that an accounting standard shoul4 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?

See paragraphs 1(e) and 2 above

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

See paragraphs 1(d) and 2 above

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

See paragraph 14 of our response to the IASB re shadow directors and paragraph 22 of that response re persons acting in concert. We believe that subject to the change we have suggested (i.e. substitution of QR 'for AND) shadow directors will be caught under the definition of key management personnel.

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

Yes, see above.

(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 believe our views on various matters are clear from the above, including the relative importance we attach to each.

If there are any matters arising from this letter you would like to discuss, please do not hesitate to contact Danielle Stewart on 020 7731 6163.

Yours faithfully

Danielle Stewart
Chairman, LSCA Technical Committee

Hans Nailor
Accounting Standards Board
100 Gray's Inn Road
London
WC1X 8AL

18 September 2002

Dear Hans

Events after the balance sheet date (FRED 27)

The Association of Chartered Certified Accountants (ACCA) is pleased to have this opportunity to comment on the above exposure draft issued by the ASB. The exposure draft was considered by ACCA's Financial Reporting Committee at a recent meeting and I am writing to give you their views.

I attach an extract from our response to the International Accounting Standards Board (IASB) on their proposed revision to IAS10.

ACCA's responses to ASB's questions

Q1. 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?

We agree in principle that a new UK standard should be issued which is harmonised with the new IAS10.

Q2.Do you *believe that ASB should consider any other transitional arrangements?*

No.

The Association of Chartered Certified Accountants
29 Lincoln's Inn Fields London WC2A 3EE United Kingdom
tel: +44 (0)20 7396 7000 fax: +44 (0)20 7396 7070 www.accaglobal.com

Q3.Are there any aspects of the draft standard that ASB should request IASB to review when finalising the revised IAS 10?

A copy of our response to IASB is attached. The principle of the recognition dividends payable could be stated more clearly.

If there are any matters arising from the above where you would like further clarification, please be in touch with me.

Yours sincerely

Richard Martin
Secretary to the Financial Reporting Committee

Appendix

IAS10 — Events after the balance sheet date

We support in principle the proposed change. The wording of paragraph 32, however, needs to be improved to make the principle clearer: that is, that dividends not yet paid should not be recognised as a liability unless there is an unavoidable obligation to pay them existing at the balance sheet date (in line with IAS37). The process for the approval and determination of dividends tends to be a matter which varies from one jurisdiction to another. The meanings of 'proposed' and 'declared' dividends will not be clear in all countries.

The Technical Director
Accounting Standards Board
100 Gray's Inn Road
London
WC1X SAL

18 September 2002

Dear Allan

Earnings per share (FRED 26)

The Association of Chartered Certified Accountants (ACCA) is pleased to have this opportunity to comment on the above exposure draft issued by the ASB. The exposure draft was considered by ACCA's Financial Reporting Committee at a recent meeting and I am writing to give you their views.

I attach an extract from our response to the International Accounting Standards Board (IASB) on their proposed revision to IAS33.

ACCA's responses to ASB's questions

Q1. 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?

We agree in principle that a new UK standard should be issued which is harmonised with the new IAS33.

We agree that the further explanation in paragraph 18A concerning ESOPs is a helpful addition. We note that the references to IAS32 and the treatment of preference dividends may need to be adjusted when that standard is adopted fully into UK standards.

Q2. Do you believe that ASB should consider any other transitional arrangements?

No.

Q3. Are there any aspects of the draft standard that the ASB should request the IASB to review when finalising the revised IAS 33?

We have noted in our attached response to the IASB that EPS figures other than those calculated in accordance with the standard should be able to be shown on the face of the income statement.

If there are any matters arising from the above where you would like further clarification, please be in touch with me.

Yours sincerely

Richard Martin
Secretary to the Financial Reporting Committee

Appendix

IAS 33 Earnings per share

Question 1

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.

Question 2

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

Yes.

Other comments:

The restriction on the disclosure of just the standard EPS figure on the face of the income statement in IAS33 (paragraph 65) is not desirable. We support the ability of entities also to show with equal prominence EPS figures on different bases which they believe better portray the result for the period, or which are of equal or greater relevance to users (for instance the headline figures which will have been quoted in newspapers or analyses).

Hans Nailor
Accounting Standards Board
100 Gray's Inn Road
London
WC1X 8AL

18 September 2002

Dear Hans

Property, plant and equipment; Borrowing costs (FRED 29)

The Association of Chartered Certified Accountants (ACCA) is pleased to have this opportunity to comment on the above exposure draft issued by the ASB. The exposure draft was considered by ACCA's Financial Reporting Committee at a recent meeting and I am writing to give you their views.

I attach an extract from our response to the International Accounting Standards Board (IASB) on their proposed revision to IAS16.

ACCA* 's *responses to ASB's questions

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

No. The current revaluation project at IASB is, we understand, looking at whether value in use (or existing use value) should be a basis for revaluations of property, plant and equipment (see Q4 below). There is also a project looking at the measurement bases of assets in general. Given the importance of this item and our general support for such a valuation model, means that we consider FRED29 should not be proceeded with until the full international consideration of these issues is completed. To propose adopting the current IAS16 basis of revaluations in the near future might appear to be conceding the argument.

Q2. 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 disagree with this change, which we have highlighted to the IASB in our attached letter.

Q3. 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 agree that in the absence of specific guidance renewals accounting is not possible. We do not favour continuing to allow renewals accounting.

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 of the Preface to the FRED)?

We regard as inadequate and unrealistic the current basic requirement in IAS16 to use market values for revaluations of property, plant and equipment. There needs to be more consistency with the basis of valuations for impairments in IAS36 the higher of value in use and a market exit value. See our letter to the IASB.

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

In our attached letter to IASB we have highlighted a number of improvements which we consider could be made to IAS16

- The wording of paragraph 23
- Annual impairment tests where no depreciation is charged
- The treatment of donated assets
- Requiring the involvement of external valuers in revaluations
- Treatment of downward revaluations

Q6. 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 lASB's projects on insurance and reporting financial performance?

Yes.

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 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% transitional arrangement to continue to recognise the carrying amounts under that arrangement?

Yes. FRS15 in this regard moved UK practice into alignment with 1AS16. We see no reason to alter this concession now when the wording of the two standards has been harmonised, but the substance of the revaluation regime has not changed.

Q8. Do you believe that ASB should consider any other transitional arrangements?

No.

Q9. Are there any other aspects of the draft standard on property, plant and equipment that the ASS should request the IASS to review when finalising the revised IAS 16?

IAS16 does not address its application to infrastructure networks, and guidance would be helpful. IASB should consider any relevant issues which have arisen from the accounting problems of telecoms network companies.

Q1 0. 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 are content with the option on the treatment of borrowing costs to remain. If we had to choose we would support the mandatory prohibition of capitalisation

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 would prefer to see IAS23 altered in this regard rather than for this to appear as a permanent difference between IAS and UK standards. The reasonableness or otherwise of the allowance in IAS23 depends on the phrase "to the extent that they are regarded as an adjustment to interest costs". IASB should provide more guidance on when exchange differences might be so regarded. If that has not happened by the time a new standard is implemented in the UK, ASS could consider adding such explanation.

Q12. 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 FRS15 version.

Q13. Do you have any comments on IAS 23 that you wish the ASA to bring to the IASB's attention?

Where optional treatments are allowed by accounting standards, then in principle full disclosures should be made to allow users of the accounts to assess fully the effects of those choices. The further disclosures in respect of borrowing costs highlighted in paragraph 15 of the Preface to FRED29, should be added to IAS23.

If there are any matters arising from the above where you would like further clarification, please be in touch with me.

Yours sincerely

Richard Martin
Secretary to the Financial Reporting Committee

Appendix

IAS16 — Property plant and equipment

Question 1

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)?

Yes. We recognise, however, real concerns that the quality of the fair values used will directly affect the reliability of the profits recognised. In many countries, the profits recognised in general purpose financial statements are also the basis for the distribution of dividends, and traditionally that has meant restricted to realised profits. It is difficult to see that, where two identical assets are exchanged, any realisation in substance has occurred. The problems, however, of trying to determine whether items are identical or merely similar mean that treating all exchanges at fair value is probably the better answer.

Question 2

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? (See the amendments in paragraphs 34-348 of IAS 38, Intangible Assets, proposed as a consequence of the proposal described in Question 1.)

Yes, in line with our response to Question 1 above.

Question 3

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)?

Not in every case, as is proposed in the ED. In most cases, there will be a loss of value over time and in these cases depreciation should continue even where the asset is temporarily idle or retired from active use. There are cases where the consumption of value is related entirely to use (for example, the extraction of minerals or the consumption of airspace in a landfill site) and in these instances depreciation should cease when an item is temporarily withdrawn from use.

Other Comments:
We do not agree with the proposed amendments to paragraph 23 of IAS16. In deciding whether subsequent expenditure may be capitalised, the assessment of expected performance should be when the asset was originally acquired or was last improved. As it is worded, it is likely that much repair and maintenance expenditure would qualify for capitalisation.

We do not think that paragraph 29 as it stands is very satisfactory in its simple requirement for fair value (usually to be market value) as the basis of revaluations. This model is not consistent with that for impairments in IAS36, which recognises that either net realisable value or value in use might be appropriate. The IAS36 model seems more realistic than the single measure of fair value. We note that there is a revaluation project under way and hope that the results of that can be incorporated into a revised IAS16

We do not agree with the change proposed in paragraph 46 to move to a system of re-estimating residual values each year. We would prefer to retain the existing estimation at the time of acquisition (or revaluation) and to leave any adjustment to the time of disposal when the actual residual value will be known. The proposal appears to be creating a mixture of historical cost and revaluation. This is a significant change to the standard, but one which was not highlighted by the questions asked or by the basis for conclusions.

An annual impairment test should be incorporated into IAS16 where there is no depreciation charged on assets other than land, or where it is insignificant because the expected economic life of the asset is very long. Such a test would be comparable to the intended future IAS38 in its treatment of intangible assets with indefinite lives.

IAS16 would benefit from guidance on how to treat donated assets. The revaluation regime should be made more rigorous and should, for example, include:

- the use of external valuers to be required and

  and

- the treatment of downward valuations as impairments when there has been a clear consumption of benefits.

Hans Nailor
Accounting Standards Board
100 Gray's Inn Road
London
WC1X SAL

18 September 2002

Dear Hans

Related Party Disclosures (FRED 25)

The Association of Chartered Certified Accountants (ACCA) is pleased to have this opportunity to comment on the above exposure draft issued by the ASB. The exposure draft was considered by ACCA's Financial Reporting Committee at a recent meeting and I am writing to give you their views.

I attach an extract from our response to the International Accounting Standards Board (IASB) on their proposed revision to IAS24

ACCA's responses to ASB' questions

Q1. 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? We agree in principle that a new UK standard should be issued which is harmonised with the new IAS24.

Q2. Do you believe that the ASB should consider any transitional arrangements?

ASB should review very carefully the amended IAS24. As can be seen from the comments which we have made to IASB, there are a significant number of areas where the proposals could be improved. The need for transparency in financial reporting is very important, and IAS24. needs to ensure that it meets the highest quality in this regard. If the revised IAS24 achieves this then we see no reason why its implementation in the UK should not proceed right away. If, however, the revised IAS24 does not incorporate all of these changes, then its early implementation as a UK standard would not be desirable. In these circumstances ASB could consider extra disclosures compared to the IAS to ensure the continued transparency of UK reporting.

Q3. 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 138 of the [draft] FRS?

Yes. Potentially this might remain as an extra disclosure requirement of a UK standard.

Q4. Do you believe that an accounting standard should require disclosure of the names of transacting related parties?

Yes. We have noted this in our response to IASB.

Q5. Should the definition of related parties specifically refer to shadow directors? Should it also refer to persons acting in concert?

There is no need for the definition to refer to shadow directors, as this is not a term which has much international currency. Appendix 1 on the legal requirement should make plain that shadow directors, as the term is defined in UK legislation, would be included as related parties on the basis of control.

A revised IAS would benefit from further explanation of control where there may be parties who have agreed to act together.

Q6. Do you believe that an accounting standard should specify that disclosure is required of material related party transactions and give more guidance on materiality in the context of such transactions?

Yes. We have noted this in our response to IASB.

Q7. Are there any other aspects of the draft standard that the ASS should request the IASB to review when finalising the revised IAS 24?

The standard makes it clear that an investor who would treat the reporting entity as a joint venture, would be a related party. Also a joint venture in which the reporting entity is a venturer, would be a related party. The position, however, of transactions between venturers, that is between the investors in a joint venture, does not seem to be covered.

If there are any matters arising from the above where you would like further clarification, please be in touch with me.

Yours sincerely

Richard Martin

Richard Martin
Secretary to the Financial Reporting Committee

Appendix

IAS24 Related party disclosures

Question 1

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'.

No, we strongly disagree with the proposal that management compensation should not be disclosed under IAS24. Management compensation is the most frequent form of related party transaction. Against the background of recent failures of financial reporting, changes to accounting standards should be reinforcing transparency and not reducing it. In developing a single set of high quality accounting standards for use across the world, IASB cannot assume that national regulations will cover the gaps which it has left and, in this case, ensure proper disclosure. Management compensation is a critical item of disclosure from a stewardship and corporate governance viewpoint. It is also vital for other users in understanding financial statements where the ownership and management are essentially the same, because management compensation and dividends may be interchangeable.

The problems of the definition of the terms management and compensation are not reasons for excluding these disclosures; indeed, definitions are only needed because of the exclusions. Paragraph 9(d) already sets out a definition of key management personnel and that would seem to be adequate for the purpose of compensation as well. As for measurement of compensation, IAS19 already addresses this subject and the main missing element will be covered by the future output of the project on share-based payments.

Question 2

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)? (Note that this proposal is the subject of alternative views of Board members, as set out in Appendix B.)

Yes, but the exclusion should apply to transactions with other group companies only. There may be transactions with other related parties, for example with key management personnel, which should be required even for wholly owned subsidiaries.

Other comments:
There are a number of other very important shortcomings in IAS24 which have not been addressed by these proposals.

- Names of related parties should be disclosed, not just the nature of the relationships.

- Names of controlling parties need to be disclosed, including parent companies and individuals or trusts.

- Materiality needs better definition in some cases, this should be material to the reporting entity and, in cases of transactions with individuals, it should be material to the other party.

- The definition of significant influence from the UK standard FRS8 would provide a helpful elaboration '...such that the other party might be inhibited from pursuing at all times its own separate interests'. This gets to the heart of why related party disclosures are needed.

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.

FRED 26 - Earnings Per Share
Responses to particular issues on which comments are invited

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.

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

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 (vii) ***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.

Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

16 September 2002

Dear Sir

CONSULTATION PAPER ON IASB PROPOSALS TO AMEND CERTAIN INTERNATIONAL ACCOUNTING STANDARDS

We are pleased to have this opportunity to comment on the above Consultation Paper on the proposed amendments to IAS 1, 8, 17, 27, 28 and 40. We note that the IASB would like comments on certain specific matters in each standard. We also have some more general comments.

In general, we support the IASB's Improvements Project. However, we question the wisdom of revising standards now when further substantial changes are likely to be proposed within a matter of months as a result of other IASB projects, in particular that on performance reporting. New and revised standards arising from this project are likely to come into force only one year after changes arising from the improvements project. We are not convinced that the credibility of standards is enhanced by such frequent changes. The standards within the scope of this consultation paper that are most affected by this would appear to be IAS 1 and IAS 8. Therefore from a UK point of view we thoroughly agree with the ASB's intention not to convert these proposals to FRS at this point.

Our major concerns on these proposals are that:

- The concept of "undue cost or effort" should be clearly and consistently explained wherever it occurs, for example in IAS 1, IAS 8 and ED 1.
- We consider that the issue of materiality, which was thrown into confusion by the late deletion of the paragraph in the Preface, must be made clear. We note that the rubric on the exposure drafts continues to say the IAS are not applicable to immaterial items, but refers to the paragraph in the Preface which does not now exist.

We respond in detail to the questions raised in the Consultation Paper in the appendix. If you would like us to amplify our comments, please contact Robert Carroll on 0870 991 2210.

Yours faithfully

Grant Thornton

APPENDIX

IAS 1 PRESENTATION OF FINANCIAL STATEMENTS

1 Do you agree with the proposed approach regarding departure from a requirement of an International Reporting Standard or an Interpretation of an International Financial Reporting Standard to achieve a fair presentation?

In general, we are comfortable with the broad thrust of the proposals. We have the following comments:

- The parenthesis in paragraph 10 seems to raise the status of the Framework above that of the set of IFRS and Interpretations. From a practical point of view, it would be more helpful and understandable to put the words in the parentheses as explanation of "present fairly" in a subsequent paragraph, perhaps before, in or after paragraph 12.

- The phrase "true and fair view" is often used as an alternative to "fairly presents". It would improve comprehensibility if the relationship between the phrases were made clear here.

- Paragraph 15 describes the response when fair presentation requires a deviation from IFRS but local law prohibits that deviation. Whilst accepting that this may occur rarely, we consider that the proposals of paragraph 15 are badly wrong. In essence, they allow local law to override what should be done to give a fair presentation, by permitting explanatory disclosure only. In our view, such a result weakens the whole basis of IFRS being strong, and the whole principle of paragraphs 10 and 11. If the highest objective is fair presentation, then local interference with that should result in the financial statements no longer earning the tag of compliance with IFRS. If there is a practical problem here, that paragraph 15 is trying to deal with, possibly the solution is to require, in theses circumstances only, that the compliance statement from paragraph 11 be qualified.

- We consider that the existing paragraph 12 in IAS 1, pointing out that disclosure cannot rectify poor accounting treatment, is a powerful and helpful paragraph, and should be retained. (It occurs to us that its proposed demise may have been the result of the facilitation of the mechanism in paragraph 15 with which we have disagreed above)

2 Do you agree with prohibiting the presentation of items of income and expense as "extraordinary items" in the income statement and the notes?

We see no reason to object to this proposal. We consider that this is a matter of mandating a treatment to reduce differences in accounting for items, increase comparability and prevent abuse of standards. Therefore, as there is the ability to describe items as exceptional and so highlight them, prohibiting extraordinary items would not inhibit the amount of information given to the users of financial statements.

3 Do you agree that a long term liability due to be settled within twelve months of the balance sheet date should be classified as a current liability, even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue?

Yes.

4 Do you agree that:

(a) a long term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date, even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach?

(b) if a lender was entitled to demand immediate repayment of a loan because the entity breached a condition of its loan agreement, but agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:

(i) the entity rectifies the breach within the period of grace; or

(ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be?

Yes.

5 Do you agree that an entity should disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements?

This proposal is not explicit enough in what it is seeking to require. As such, it could become a charter for unwarranted criticism, which will not help the reputation of reliable accounting standards. Therefore, we suggest that the IASB re-expose this concept, with more examples of the type of judgements and the extent of disclosure that is envisaged. The

IASB has not been shy of providing examples in the rest of IAS 1, and there seems to be no reason to be so here.

6 Do you agree that an entity should disclose the key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year?

We do not agree with this proposal as a general proposition. While we have sympathy with attempts to make financial statements more useful in predicting the future, we consider it could be onerous, costly and commercially sensitive. It is similar to the proposal in question (v) but it is posing questions about the future. It could create difficulties in drawing lines between a profit forecast and financial statements.

In a similar way to paragraph 108, the lack of precision of the requirements of paragraph 110 carries the dangers of unwarranted criticism of IFRS and their application. We think that more detail and more examples might help to show where the boundaries of these requirements are.

Other issues

"Undue cost or effort"

We note that, in common with other recent proposals by the IASB, the term "undue cost or effort" is used in place of "impracticable". In the revised IAS 1, there is material in paragraphs 35 to 39 explaining this idea, relating specifically to comparative figures. We have concerns about the use of this phrase, as, at face value, it appears to be a weaker requirement than the concept of impracticability that it replaces. We recognise the need for some concept of this type, but recommend strongly that its meaning and intent be explained consistently and clearly in the standards affected to minimise the potential for abuse. For example, some companies may regard almost any cost or effort as "undue". We believe that there is a strong case for a definition to be included in the IASB's Glossary of Terms.

The IASB should also ensure that the "undue cost or effort" exemptions are consistent as between IAS 1, IAS 8, and ED 1 on first-time application of IFRS. IAS 1 paragraph 35 and IAS 8 paragraph 13 make general allowance for undue cost or effort when changing accounting policies – however ED 1 only explicitly makes exemptions in the case of a limited number of specified items. It would be helpful to include the general exemption explicitly in ED 1, if that is intended to be available, and also to make reference to (the IFRS resulting from) ED 1 in IAS 1, paragraph 39.

IAS 8 NET PROFIT OR LOSS FOR THE PERIOD, FUNDAMENTAL ERRORS AND CHANGES IN ACCOUNTING POLICY

1 Do you agree that the allowed alternative treatment should be eliminated for voluntary changes in accounting policies and corrections of errors, meaning that those changes and corrections should be accounted for retrospectively as if the new accounting policy had always been in use or the error had never occurred (see paragraphs 20, 21, 32 and 33)?

Yes.

2 Do you agree with eliminating the distinction between fundamental errors and other material errors (see paragraphs 32 and 33)?

Yes. However, we note that the text of the draft revised standard itself does not refer to materiality in this context. We recommend that the word "material" be incorporated either into the definition of an error or into paragraph 32.

Other issues

Developing accounting policies

Paragraphs 5 and 6 of the draft standard set out factors to consider in developing an accounting policy for a matter that is not addressed by a standard. We suggest that the IASB consider extending the scope of the factors in paragraph 5 to include the development and application of accounting policies and estimation techniques in general. The highest quality financial reporting is most likely to be achieved where there is not merely a requirement to comply with standards where they exist and with more general principles where there is no specific standard, but where entities are required to select and apply accounting policies and estimation techniques in the manner most appropriate to the entity's particular circumstances, in addition to complying with standards. This may be of particular relevance where a choice of treatment is permitted or where significant judgement is required. It may also be useful to give more emphasis to the importance of comparability with other entities in the same industry or business sector when selecting and applying accounting policies and techniques. Such an approach would converge International Financial Reporting Standards with the approach set out in the UK ASB's standard FRS 18 'Accounting Policies'.

Proposed disclosure requirements

We have concerns about the proposed disclosure requirements relating to future adoption of a standard in issue but not in force, as set out in paragraph 19, in particular the numerical disclosure in sub-paragraph (d)(i). We consider this proposed disclosure to be unduly burdensome and likely to be difficult or impracticable to comply with, especially where a new standard is issued shortly before the accounts are finalised or where a new standard makes significant changes to recognition or measurement requirements. We acknowledge that sub-paragraph (d)(ii) grants relief on the grounds of undue cost or effort but consider that such an exemption is likely to be invoked so frequently when a major new standard is issued as to undermine the disclosure requirement itself.

IAS 17 LEASES

1 Do you agree that when classifying a lease of land and buildings, the lease should be split into two elements—a lease of land and a lease of buildings? The land element is generally classified as an operating lease under paragraph 11 of IAS 17, Leases, and the buildings element is classified as an operating or finance lease by applying the conditions in paragraphs 3-10 of IAS 17.

We agree in principle with this proposal. However, we consider that there may be considerable practical difficulties in distinguishing between the land element and the buildings element, especially in fully developed areas where values for the land element may be difficult to determine by reference to market transactions.

2 Do you agree that when a lessor incurs initial direct costs in negotiating a lease, those costs should be capitalised and allocated over the lease term? Do you agree that only incremental costs that are directly attributable to the lease transaction should be capitalised in this way and that they should include those internal costs that are incremental and directly attributable?

We support the IASB's proposal to eliminate the choice currently in IAS 17. Although we see merit in the argument that initial direct costs are in the nature of selling costs and should be expensed, we support the IASB's proposed treatment on the grounds of international convergence.

IAS 27 CONSOLIDATED FINANCIAL STATEMENTS AND ACCOUNTING FOR INVESTMENTS IN SUBSIDIARIES

1 Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?

We agree, although we are not convinced that unanimous consent of any minority interest should be required. A requirement for unanimous consent is simple but may lead to group accounts being required in circumstances where the costs outweigh the benefits, for example if there is a dissident or uncontactable minority shareholder. We suggest that the IASB consider the approach currently embodied in UK companies legislation. In the UK, the parent of the company seeking exemption from preparing consolidated accounts must hold more than 50% of the company's shares and group accounts must not have been requested by the holders of more than half of the remaining shares or the holders of 5% of the total shares of the company. Alternatively, the IASB may wish to consider amending the requirement for unanimous consent of the minority to one of no objections from the minority to not preparing group accounts.

2 Do you agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity (see paragraph 26)?

Yes.

3 Do you agree that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, in the investor's separate financial statements (paragraph 29)?

Do you agree that if investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments should be accounted for in the same way in the investor's separate financial statements (paragraph 30)?

In response to the first part of this question, we accept that the IASB's proposals will reduce the scope for choice by eliminating the option of using the equity method for such investments in the investor's separate financial statements. However, given that a choice will remain between cost and fair value under IAS 39, we see little merit in removing one option whilst still permitting the other two. In addition, the use of the equity method in the parent's separate financial statements has the attraction of aligning shareholders' equity between the parent and group accounts. We favour either retaining the current alternatives or permitting only one treatment. Our preferred treatment would be to carry such investments at cost as we consider that obtaining fair values in accordance with IAS 39 may be unduly burdensome and not provide useful information to users of the financial statements.

We agree with the second part of the question.

Other comments

Disclosure of significant subsidiaries

The IASB has not explained its proposal to delete the disclosure requirement currently set out in paragraph 32(a) of IAS 27. This currently requires disclosure of a listing of significant subsidiaries including name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held. In our view, readers of the accounts may find this information valuable and we therefore suggest that this disclosure be retained. We note that the IASB has included in the draft revised IAS 24 (paragraph 12) a more general requirement to disclose relationships between parents and subsidiaries, but our preference is for the more specific requirement of IAS 27 to be retained.

Publishing consolidated financial statements

Paragraph 8(d) refers to the parent "publishing" consolidated financial statements. It would be helpful to give an indication of what "publish" involves eg a member of the public can access them. (The previous disclosure requirement for the registered office of the parent has been deleted – and we do not disagree with this).

Separate financial statements

The description of "separate financial statements" is tortuous and hard to follow, encompassing paragraphs 4, 8 and 9. Several comments:

The purpose of paragraph 9 is not clear. Is it telling the parent not to prepare any other accounts?

Paragraph 4 refers to preparing financial statements in accordance with IAS 28 or 31. But financial statements are not prepared in accordance with a single IAS, but in accordance with all IFRS.

Quite apart from that, it is unclear what is intended by "separate financial statements". It seems to encompass parent company accounts produced in addition to consolidated accounts (from para 4) and non-consolidated financial statements of a parent exempt under para 8. But what is "in addition to financial statements prepared in accordance with" IAS 28, or IAS 31? If a company with an associate prepared financial statements, IAS 28 would require it to use the equity method irrespective of whether the financial statements were consolidated or company only – what additional financial statements might it produce? More clarity is required.

IAS 28 ACCOUNTING FOR INVESTMENTS IN ASSOCIATES

1 Do you agree that IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, should not apply to investments that otherwise would be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries (see paragraph 1)?

We agree, provided that the meaning of "venture capital organisation" and "well-established practice in those industries" are unambiguous. We suggest that the IASB consider including a definition of the former term in the revised standard. However, we would not support an extension of this exemption to cover similar investments that would otherwise be treated as subsidiaries.

2 **Do you agree that the amount to be reduced to nil when an associate incurs losses should include not only investments in the equity of the associate but also other interests such as long-term receivables (paragraph 22)?**

We agree, provided that such long-term receivables are not thereby stated at an amount below their recoverable amount.

Other comments

We note that the requirement to disclose an appropriate listing and description of significant associates in paragraph 27(a) of the current IAS 28 is proposed for deletion. In our view, this disclosure requirement provides valuable information and should be retained.

Paragraph 27(b) of the proposed revised standard introduces a requirement to disclose summarised financial information of associates. It is not clear from the draft text whether this applies to associates individually or in aggregate. We assume that it is the latter but it may be helpful to clarify the wording on this point.

Paragraph 24A requires an associate to be accounted for in the separate financial statements of the investor either at cost or fair value (under IAS 27). However, paragraph 8A requires that the equity method be used irrespective of whether the investor has subsidiaries, in which case it would not present consolidated financial statements, but only separate ones. Perhaps this issue is related to the confusing description of separate financial statements to which we refer in our comments on IAS 27. In any case, more clarity is required.

IAS 40 INVESTMENT PROPERTY

1 **Do you agree that the definition of investment property should be changed to permit the inclusion of a property interest held under an operating lease provided that:**

(a) **the rest of the definition of investment property is met; and**

(b) **the lessee uses the fair value model set out in IAS 40, paragraphs 27-49?**

Yes.

2 **Do you agree that a lessee that classifies a property interest held under an operating lease as investment property should account for the lease as if it were a finance lease?**

Yes.

3 Do you agree that the Board should not eliminate the choice between the cost model and the fair value model in the Improvements project, but should keep the matter under review with a view to reconsidering the option to use the cost model in due course?

We believe that the IASB should eventually standardise on a single approach to investment property, based on fair values. However, we agree that this cannot be achieved within the scope and timescale of the improvements project.

Our Ref FRED26/BRS
Your Ref FRED 26

Accounting Standards Board
Holborn Hall
100 Grays Inn Road
London
WC1X 8AL

For the attention of The Technical Director

16 September 2002

Dear Sir

FRED 26 - EARNINGS PER SHARE (EPS)

We are pleased to comment on FRED 26. We also make some comments that we would like the ASB to pass on to the IASB with regard to the revised IAS 33.

GENERAL COMMENTS

Our overall view is that FRED 26 should not be converted to a UK FRS at this time, even if the IASB, having received comments on its revised IAS 33, issues that as a revised standard. We explain why in the following paragraphs.

The FRED contains a number of amendments to the IASB's text. Changes have been made to terminology and definitions to conform to that used in UK standards. An example is a change from 'discontinuing' to 'discontinued' in paragraph 38. Paragraph 4A gives definitions under UK GAAP, which are slightly different to those given in IAS 32. The FRED also includes some minor changes that have been made to reflect differences between FRS 4 and IFRS.

In our view, it would improve the convergence with IFRS if the UK terminology and definitions were altered to conform to those in IFRS. In our view, it would be extremely confusing if the wording in the UK standard were not identical to the international standard, apart from cross references. Implementation of the new reporting standard should be delayed until we are certain that there will be no further changes to the definitions and terminology in IFRS before 2005.

The ASB proposes implementation into a new UK standard in the first quarter of 2003, alongside the IASB's issue of the revised IAS 33. This appears likely to be in advance of the revised UK and international standards on performance reporting. Revised performance reporting will fundamentally change the face of the 'profit and loss account' which will in turn alter the presentation, disclosure and calculation aspects of IAS 33 (and so of FRED 26). In our view, implementation of FRED 26 into a new UK standard should be delayed until we are certain of no further changes to IAS 33, and until the ASB know the results of the consultation on performance reporting, and have a UK financial reporting standard in line with IFRS. In fact, because the FRS on EPS is primarily of interest to listed companies who will be using IFRS from 2005 anyway, and because it will take a considerable time to get the standard on reporting financial performance in place, there is a good argument for not progressing a UK amendment to FRS 14 at all, but simply adopting the eventual IAS 33 in time for 2005.

DILUTED EPS

The exposure draft does not give any guidance on how to estimate profit or loss from continuing operations. In particular there is no guidance on allocation of interest and tax. This guidance is a helpful part of FRS 14, and would usefully be included in the revised IAS 33, or cross-referred from IAS 35 if that is where the guidance is to be given.

DISCLOSURE

FRS 14 includes additional guidance in respect of the presentation of financial statistics in historical summaries, but there is no equivalent guidance in the exposure draft. This could lead to reduced comparability within a single annual report and between companies. We recommend that the ASB ask the IASB to include equivalent guidance in the revised IAS 33.

OTHER DIFFERENCES BETWEEN PROPOSED UK REQUIREMENTS AND PROPOSED IFRS

We recommend that implementation of the exposure draft be delayed until these differences have been resolved.

If you have any queries on our response, please contact Nick Jeffrey direct on 0870 991 2787, or by e-mail at nick.jeffrey@gtuk.com.

Yours faithfully

Grant Thornton

FRED 26 EARNINGS PER SHARE

We set out below our responses to specific questions raised by the ASB:

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. In our view a new UK standard should only be issued once the new standard on performance reporting has been issued.

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

No. We support transitional arrangements in line with those of the revised IAS 33, but no further than that.

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?

Yes. See comments above on 'presentation and disclosure of EPS'; 'Diluted EPS'; and 'Differences between proposed UK requirements and proposed IFRS'.

It might be helpful to clarify paragraph 37 of the draft to the effect that potential ordinary shares are only dilutive where they decrease EPS or increase loss per share.

The IASB has asked commentators to respond to the following questions on the proposed changes to IAS 33. We set out below our responses to those questions:

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. The rebuttable presumption that the contract will be settled in shares should be allowed only where there is past experience of settling similar contracts in shares or where there is a stated policy.

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)?

- **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).**

No. It should be the second option, without regard to diluted EPS information reported during the interim period(s). The performance statement is a report for a period, not a report for the sum of a number of constituent periods. In our view, the first option would hinder comparability, and would require the audit of figures in the 'interim' report. It would be ludicrous for two companies with identical performance and results to report different annual EPS because one of them had reported interim figures (or more interim figures than the other).

- **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.**

No. We support the second option, for the reasons given in our response above.

- **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).**

No. We support the second option, for the reasons given above.

ADDITIONAL COMMENT

It is not clear to us why the definition of contingently issuable ordinary shares should require that they will be issued for "little or no cash". Although this may be the norm, it is the future satisfaction of conditions that is the defining characteristic and principle. Including the phrase about the cash amount may incite financial engineers to develop instruments that bend round the rules.

Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

16 September 2002

Dear Sir

FRED 27 - EVENTS AFTER THE BALANCE SHEET DATE

We welcome the issue of this exposure draft (FRED 27), and the opportunity for us to comment on the proposals.

We draw your attention to our separate letter on the implementation of revisions to UK GAAP, in which we have set out our overall comments on the Board's proposals in FREDs 23-30. As stated therein, our view is that new UK standards should only be issued where they follow IFRS word for word (except for cross references), and where the IFRS will not itself be changed before 2005. We therefore disagree with the removal of guidance on going concern from the IFRS version.

However, we do not believe that the revised IAS 10 could be introduced into UK GAAP as it stands because of the conflict with FRS 18. In addition, the implementation may be subject to amendments in companies legislation, although this is debatable. Therefore, we advocate the retention of SSAP 17 until the above issues have been resolved.

We respond in detail to the questions raised in the FRED in the appendix. If you would like us to amplify our comments, please contact Brian Shearer on 0870 991 2723.

Yours faithfully

Grant Thornton

Chartered Accountants
UK Member of
Grant Thornton International

National Office

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?

In principle, we support the ASB's proposal to converge UK standards with IFRS. However, if IASB standards are to be brought into UK GAAP, we believe that this should be done only if they can be incorporated verbatim (except for cross-references and a scope exclusion for the FRSSE).

We therefore do not agree with the removal of the paragraphs on going concern from the exposure draft as this would result in a standard different from the IFRS. In addition, if those paragraphs are removed in the UK, the remaining guidance on going concern will only be from FRS 18 (but this does not specifically address post balance sheet circumstances), unlike SSAP 17 that is being replaced, which already contains some guidance.

However, bringing these paragraphs into UK GAAP would result in inconsistency with FRS 18 in respect of management intent (to liquidate or to cease trading). This raises the issue of inconsistency between FRS 18 and IAS 1, which needs to be addressed as part of the international convergence process. We believe that in this specific instance, the financial information given under IFRS could be more useful, even if the decision leading to loss of going concern status is technically after the balance sheet date. Therefore, unless the ASB believes that FRS 18 concepts will become part of IAS, and notwithstanding the recent issue of FRS 18, our view is that the paragraphs on going concern should be adopted verbatim in the draft standard.

In addition, we note the comments regarding the incompatibility of the presentation of dividends with the legislation, ie. paragraph 3(7) of Schedule 4 to the Companies Act 1985. Although we support making this amendment to further assist in implementing the standard, some may consider that this may not be strictly required as the existing paragraph, which requires the dividends paid and proposed to be shown, could be interpreted such that a memorandum disclosure would suffice.

The change in the way dividends are treated represent a significant change to current practice. To assist with its implementation, we think the timing of its adoption could be made in conjunction with other related projects, particularly on the revision of the performance statement.

In conclusion, although we support convergence with IFRS, we do not believe that the draft standard is ready to be adopted in the UK until these matters have been resolved.

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

We believe that there are no major practical difficulties in implementing the proposed standard in full, other than possible misunderstanding or misinterpretation of the resulting numbers particularly in respect of dividends. However, these could be subdued by the

Grant Thornton House
Melton Street
Euston Square
London NW1 2EP
T +44 (0)20 7383 5100
F +44 (0)20 7383 4715
DX 2100 EUSTON
www.grant-thornton.co.uk

entity's good reporting practice, supported by requirements of FRS 18, by providing supplemental disclosure.

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

In terms of the structure of the draft standard, we feel that the presentation of examples (of adjusting and non-adjusting events) could be better organised. In SSAP 17, this has been neatly presented in the Appendix. However, the draft standard at present lists examples of adjusting events within 'Recognition and Measurement' (paragraph 8), but gives examples of non-adjusting events in both 'Recognition and Measurement' (paragraph 10) and 'Disclosure' (paragra

Hans Nailor
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

16 September 2002

Dear Sir

FRED 29 - PROPERTY, PLANT AND EQUIPMENT; BORROWING COSTS

We welcome the opportunity to comment on the proposals set out in FRED 29.

In principle, we support the ASB's proposals to converge UK standards with IFRS. However, we draw your attention to our separate letter on the implementation of revisions to UK GAAP, in which we have set out our overall comments on the Board's proposals in FREDs 23-30. As stated therein, our view is that new UK standards should be issued only where they follow IFRS word for word, and where the IFRS will not itself be changed before 2005. We do not support the early introduction of FRED 29 into UK GAAP because the IASB is currently carrying out a project on valuation that may lead to significant revisions to IAS 16 prior to 2005.

As set out in detail in the appendix, we disagree with the IASB's proposals regarding residual values and we support the retention of the existing approach in FRS 15 and IAS 16. We support the ASB's value to the business approach to valuation and we believe the ASB should argue for its adoption internationally. We agree that capitalisation of borrowing costs should remain optional at present.

We respond in detail to the questions raised in the FRED in the appendix. If you would like us to amplify our comments, please contact Robert Carroll on 0870 991 2210.

Yours faithfully

Grant Thornton

Chartered Accountants
UK Member of
Grant Thornton International

National Office

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?

In principle, we support the ASB's proposal to converge UK standards with IFRS. However, given that the IASB is at present carrying out a project on valuation, we believe that there is a significant possibility that IAS 16 will change further prior to 2005. Therefore, we do not support the early introduction of the proposals in FRED 29 into UK GAAP. If IASB standards are to be brought into UK GAAP, we believe that this should be done only if they can be incorporated verbatim (except for cross-references and a scope exclusion for the FRSSE).

Our comments in response to the remaining questions focus on points related to the proposed international text that we believe the ASB should put forward to the IASB.

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 disagree with the IASB's proposals. We note that the IASB has not provided adequate explanation in their draft to justify this proposed change. The proposed method of determining residual values raises wider conceptual issues about depreciation and valuation. We believe that the proposed approach will lead to the indirect recognition of holding gains by effectively netting such gains off against the depreciation charge. We do not see how the proposed approach fits in with historical cost principles. We support the approach in FRS 15 and the current version of IAS 16 of basing residual values on prices at the date of acquisition or subsequent revaluation.

Whilst the IASB's assertion in paragraph 46 of their proposed revised standard that residual values will often not be material is undoubtedly true for many assets, residual values may be material in a significant number of cases, for example scrap values of major plant or vessels. Therefore, on a practical level, we consider that the need to reassess residual values annually in line with current price levels will be unnecessarily burdensome for many businesses. For this reason also, we favour retaining the approach in FRS 15 and the current version of IAS 16.

ASB (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?

Grant Thornton House
Melton Street
Euston Square
London NW1 2EP
T +44 (0)20 7383 5100
F +44 (0)20 7383 4715
DX 2100 EUSTON
www.grant-thornton.co.uk

We do not consider renewals accounting to be a sufficiently major area to warrant special treatment under IAS 16, in particular as we understand that the method is not widely used internationally. Nor do we believe that the UK should take a stand on this issue, and have an accounting standard different from the IASB.

However, there may be practical problems in this approach for UK companies currently using renewals accounting. Under the proposals for first-time application of IFRS, such companies could use a one-off fair value measurement as their IFRS starting point. An equivalent provision would seem to be appropriate in a UK FRS, although the companies affected would probably prefer to have a transitional provision allowing them to start with their current net book value as deemed cost.

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 of the Preface to the FRED)?

IAS 16's fair value approach has the apparent attraction of being more straightforward and well understood but there is the hidden danger that simply accepting this approach will be interpreted as supporting exit values as appropriate values for all valuation needs, which may have unforeseen or undesirable consequences. Therefore, we support the value to the business model and believe that the ASB should argue for its adoption internationally. As the valuation debate internationally is still alive, this is a major reason why we would encourage ASB not to proceed to a FRS at this time, unless and until it becomes clear that the IAS will not change again before 2005.

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?

At present, FRS 15 contains specific provisions relating to non-depreciation of assets other than freehold land (FRS 15, paras 90-91). There is no equivalent material in either the current or proposed revised IAS 16. In view of the significance of this issue to particular industries in the UK, we believe that the ASB should press the IASB to clarify their position regarding non-depreciation on the grounds that the uncharged depreciation would be immaterial in aggregate. The use of the word "normally" in paragraph 42 of the draft revised IAS 16 does appear to leave open the possibility of non-depreciation but we believe that further clarification would be helpful to users, especially during the transition to IFRS.

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 IASB’s projects on insurance and reporting financial performance?

As stated above, we believe that international standards should only be brought into UK GAAP word-for-word. However, the major unresolved issues regarding insurance accounting at the international level suggest that there should be no change to the current UK position until the international position is clarified.

ASB (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 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?

As stated above, we believe that international standards should only be brought into UK GAAP word-for-word. The proposed IFRS on first-time application of International Financial Reporting Standards appears to be compatible with the ASB's proposal, and would effectively treat such amounts as deemed cost as at the date of valuation. (Care will need to be taken with the disposition of the revaluation reserve.) For the purpose of UK GAAP we propose that the transitional provisions mirror those in IFRS as far as possible in their wording.

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

No.

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?

No.

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 support the IASB's position that the option should be retained at present. In the longer term, we believe that it would be desirable for the IASB to eliminate the choice currently contained in IAS 23. However, we do not consider that a compelling case has yet been made for either mandatory capitalisation or the prohibition of capitalisation. We do not consider that this should be a high-priority area for the IASB at present.

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 disagree with this proposal. We believe that the exchange differences covered by this part of IAS 23 are usually economically similar to interest costs, and so should be included. However, the IASB should be prevailed upon to provide more guidance on what is meant by "akin to interest". We also disagree with the concept of introducing differences between UK GAAP and IFRS, as the ASB are proposing here.

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?

In principle, we prefer the ASB's approach, but we consider the IASB's approach to be acceptable.

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

No.

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] FRS on property, plant and equipment)?

Yes. It will be important to present the gain appropriately, a matter to be dealt with in the project on reporting financial performance. Although there may be some conceptual merit in treating exchanges of similar items differently from other exchanges, making such a distinction will inevitably involve drawing bright lines, which, in our view, the IASB should be seeking to avoid.

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?

Yes. See our answer to (i) above.

IASB (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)?

We disagree with the IASB's proposal, which appears to go against the definition of depreciation in paragraph 41, as the asset is not being used up. In particular this would be true of assets whose primary indicator of consumption is units of output, rather than effluxion of time. In addition, the IASB has provided no explanation for the change. We believe that it would make more sense to mandate impairment reviews of idle assets, if it is felt that something is needed in this area.

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
London SW1A 1RP

Allan Cook Esq
The Technical Director
ACCOUNTING STANDARDS BOARD
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

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
Holborn Hall
100 Gray's Inn Road
London WC1X 8AL

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

Rosemary Thorne
Chairman
100 Group Technical Committee
Bradford & Bingley plc
8 Bennet Street
London SW1A 1RP

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.

LIBA

LONDON INVESTMENT BANKING ASSOCIATION
6 Frederick's Place, London, EC2R 8BT
Tel: 020 7796 3606 Fax: 020 7796 4345
E-mail: liba@liba.org.uk Website: www.liba.org.uk
Direct: 020 7367 5507 Email: ian.harrison@liba.org.uk

10 September2002

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

By email to: fred24@asb.org.uk

Dear Mr. McEwan

Financial Reporting Exposure Draft 24: The Effects of Changes in Foreign Exchange Rates; Financial Reporting in Hyperinflationary Countries

LIBA is pleased to comment on the above exposure draft. LIBA is, as you probably know, the principal UK trade association for investment banks and securities houses, and our members have considerable experience of, and interest in, the reporting of the effects of exchange rate movements under different accounting and reporting regimes. A full list of our members is attached.

Before responding to the detailed proposals, we wish to state an important general view of our members, which is set out in more detail in the attached letter to Allan Cook, that the overriding goal of the current exercise should be to achieve - as nearly as possible - full harmonisation between IAS and UK GAAP. It follows that any differences between the IASB and ASB standards which result, respectively, from IAS 21 and FRED 24 should be kept to the absolute minimum necessary.

The comments below follow the numbering and format of the "Questions for respondents" set out on pages 13-14 of the FRED; our responses to the IASB questions are extracted from our separate letter to the IASB on their Exposure Draft Improvements to International Accounting Standards. Please note that we have not responded to all of the questions.

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

No. While we see both sides of the technical argument in the case of recycling, we do not believe that application of the recycling concept is fundamentally misleading. It has been accepted and adopted by the IASB and the FASB for many years. In our view, this is not an area for departure from L&S that the ASB should be considering.

Of course, the issue is on the agenda at the TASB and if the IASB does indeed ban recycling,! that should be reflected in UK GAAP. Given that companies will not want to alter their accounting twice in the next few years, perhaps the best and most pragmatic way forward is to continue the current UK practice of not recycling but make it clear that the position will be revisited when the IASB completes its deliberations on reporting financial performance.

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?

Yes. We agree that the definition of functional currency should be based on the concept of "the currency of the primary economic environment in which the entity operates". The changes proposed relating to the definition and guidance provided will harmonize these concepts with those contained in US GAAP (SFAS *52).* We find particularly helpful the additional criteria that relate to the determination of the functional currency of a foreign operation. The relationship between an entity and its parent or the rest of its group is particularly important when determining its functional currency and additional factors such as those listed in paragraph 9 become relevant where they would not be for stand alone entities.

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 agree that a reporting entity should be permitted to choose the reporting currency for its financial statements. This choice of a common reporting currency is essential for a group that includes several different individual entities with different functional currencies.

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)?

We agree that all entities within a reporting group should translate their financial statements using the same method. This is an essential element in providing consistent and comparable financial information.

IASB (v)

Do you agree that
(a) goodwill and
(b) fair value adjustments to assets and liabilities

that arise on 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)?

We disagree. The financial statements of a foreign operation should not be affected by the sale of its shares in the secondary market. This principle is fundamental to the integrity of stand-alone financial statements. These financial statements represent the results of operations and the financial position of the individual company for the period and at period end respectively, and should not be affected by transactions to which it is not a party, such as the sale of its shares. Further we do not believe that it is appropriate to require push-down accounting in a standard on foreign exchange. If the intention was not to require push-down accounting, but only to require translation of the items in (a) and (b) above at the closing rate on consolidation, this differentiation should be made clearer in the text.

We agree that fair value adjustments to assets and liabilities of an acquired foreign operation should be translated at the closing rate. This method ensures that the entire asset is treated consistently and translated at the same rate. Using different rates to translate parts of assets depending of their date of purchase would not lead to financial statement transparency.

However, we disagree with the proposition that goodwill should be translated at the closing rate. Unlike a fair value adjustment, goodwill is not an asset of the entity being acquired. It forms part of the cost of the acquisition and is an asset of the parent. As discussed i13 the Basis for Conclusions, the proposal would be impractical to implement when the acquired has multinational operations and subsidiaries with many functional currencies. The question of how far to 'push down' the goodwill is not merely a theoretical issue but a real concern in practice.

We recommend that the existing choice in IAS 21 remain until the Board has agreed an approach to the issue of push-down accounting in its project on Business Combinations. In our view, to force a change in the name of elimination of a difference in a foreign exchange standard before the issue has been fully considered and debated will lead to confusion both by preparers and users of financial statements.

Other comments on IAS 21

1. Paragraph 30 proposes that exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation should be recognised as income or expense in the separate financial statements of the reporting entity. This treatment seems inequitable if the parent entity is equity accounting for its investment or carrying it at historical cost. (We realise that there are proposals to ban the use of the equity method, but we disagree with these proposals - see our comment in Appendix 4 *(of our 10 September letter to the IASB)* on Paragraph 13A of IAS 27). If the parent accounts using the equity method, its share of the assets and liabilities of the foreign operation will be included in its financial statements at the closing rate and the exchange differences will be reflected in equity whilst the foreign exchange gains or losses on the hedge would be included in the income statement. This seems inappropriate.

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In addition, if a reporting entity carries its investment at cost, the portion of the net investment represented by equity shares will remain at the exchange rate at the date of the purchase of the shares but the receivable for which settlement is neither planned nor likely (in substance equity) is revalued to the closing rate through the income statement. This treatment seems inconsistent and ignores the equity-like substance of the receivable.

2. Paragraph *50* proposes that an entity disclose the amount of exchange differences included in profit or loss for the period. Whilst we are not opposed to this disclosure for most foreign exchange gains and losses , we would thaw your attention to the fact that most of our members are dealers in foreign exchange and other financial instruments. Whilst certain gains or losses from dealer transactions include an exchange difference that are required to be recognised in the income statement, we feel that the more appropriate disclosure of such trading gains and losses is to include them in trading revenues rather than group them with dissimilar foreign exchange transaction gains and losses recognised on other non-trading items. This treatment is standard industry practice for broker dealers in the UK and would be consistent with US GAAP (SFAS 52 paragraph 30).

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We would of course be very pleased to elaborate on any or all the views set out above - either in writing or at an informal meeting — if you would find that helpful.

Yours sincerely

Ian Harrison
Director

LIBA

LONDON INVESTMENT BANKING ASSOCIATION LIST OF MEMBERS

Ansbacher & Co Limited
ABN AMRO Bank N.V.
Arbuthnot Latham & Co., Limited
BNP Paribas
Bank Insinger de Beaufort plc
Barclays Capital
Bear, Stearns International Limited
Beeson Gregory Limited
Cazenove & Co. Ltd
CIBC World Markets Plc
Citigroup Inc.
Close Brothers Corporate Finance Ltd
Collins Stewart Limited
Commerzbank AG
Credit Suisse First Boston (Europe) Ltd
Daiwa Securities SMBC Europe Limited
Dawnay, Day & Co., Limited
Deutsche Bank AG London
Dresdner Kleinwort Wasserstein
Goldman Sachs International
Greenhill & Co. International LLP
Hawkpoint Partners Limited
HSBC Investment Bank plc
ING Bank N.Y.
Instinet Europe Ltd
Investec Bank (UK) Limited
J.P. Morgan Securities Ltd
KBC Peel Hunt Ltd
Lizard
Lehman Brothers
Merrill Lynch Europe PLC
Mizuho International plc
Morgan Stanley International Ltd
Nomura International plc
N M Rothschild & Sons Limited
Old Mutual
Robert W. Baird Group Limited
Singer & Friedlander Limited
Société Générale
3i Group plc
The Toronto-Dominion Bank
UBS Warburg
Westdeutsche Landesbank Girozentrale

September 11, 2002

LIBA

LONDON INVESTMENT BANKING ASSOCIATION
6 Frederick's Place, London, EC2R 8BT
Tel: 020 7796 3606 Fax: 020 7796 4345
E-mail: liba@liba.org.uk Website: www.liba.org.uk
Direct: 020 7367 5507 Email: ian.harrison@liba.org.uk

10 September 2002

Allan Cook Esq CBE
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London WC1X 8AL

By email to: a.cook@asb.org.uk

Dear Allan

Current FREDs and the ASB programme of convergence with IFRS

I am writing to express a general LIBA concern about one aspect of the ASB programme to bring about convergence between UK Accounting Standards and International Financial Reporting Standards. This concern has been highlighted by our current work on preparing responses to the IASB Improvements Project Exposure Draft, to the proposed amendments to IAS 32 and IAS 39, and to certain of the related FREDs.

A recurrent topic in the course of our discussions on these various exposure drafts is a worry that we appear to risk ending up with an unnecessarily large number of differences between the amended IAS/IFRS and the amended UK FRS.

While we share a number of the ASB's reservations on aspects of the IASB proposals, we would stress that we believe the overriding objective of the ASB 's current programme should be to achieve - as nearly as possible - full convergence between UK GAAP and IAS.

We would, for example, strongly support the approach taken by the ASB in its efforts to simplify hedge accounting, which we believe offers a way to achieve a significant improvement to IAS 39. We presume you will be making representations to the IASB to encourage them to adopt this approach in their current revision of IAS 39, and very much hope that you - and others expressing similar views - will be able to persuade them to accept this change. Should this pressure be unsuccessful, however, we would have considerable difficulty in supporting an ASB standard which conflicted with the revised IAS 39, in whatever form it finally emerges. In the final analysis we would regard a UK standard which is consistent with an inherently unsatisfactory IAS as a lesser evil than an inherently better UK standard which is incomp atible with such an IAS.

LIBA

A closely related point is that we think the ASB should wherever possible avoid proposing FRS which contain slight differences from the corresponding IASB proposals. Such small changes risk creating a ‘UK version of IAS which, if not defeating the purpose of harmonisation entirely, will certainly decrease its benefits. For example, one such ‘minor’ difference in each standard would result in around 40 differences between IAS as promulgated by the IASB and as applied in the UK.

We recognise that in certain instances it may be appropriate for UK GAAP to require a departure from IAS but we believe this should happen only when application of the published IAS would be inadequate or misleading, or in contravention of UK company law. Given the due process and experience of the IASB, we would expect few such departures to be necessary.

We would of course be very pleased to elaborate on our views - either in writing or at an informal meeting - if you would find that helpful.

With kind regards

Yours sincerely

Ian Harrison
Director