30 September 2002

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Dear sirs

EXPOSURE DRAFT OF PROPOSED IMPROVEMENTS TO INTERNATIONAL ACCOUNTING STANDARDS

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

The main issue about which we have concerns relates 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.

Turning now to the detailed issues contained in the exposure draft, the main points that we have as a Group 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 is fundamental to the results reported in the financial statements.
- IAS 24 – possible 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.
- 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.
- IAS 33 – prohibition of disclosure of alternative EPSs on the face of the P&L account. We are averse to the 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,
- IAS 40 – treatment of owner occupied properties which are also "*held .. to earn rentals or for capital appreciation or both*". We seek confirmation as to the order in which the definitions of investment properties and owner occupied properties are applied. This is a particular issue for insurers where such properties may be held for investment purposes and the policyholder liabilities may (in part) be determined by the value of such properties. Currently in the UK, this issue is dealt with in FRS 15, by granting an exemption to insurance companies, in allowing a similar treatment for owner occupied and investment properties.

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

Yours faithfully,

Doug Logan
Director, Group Technical Accounting

RESPONSES TO PARTICULAR ISSUES ON WHICH COMMENTS ARE INVITED

IAS 1 - PRESENTATION OF FINANCIAL STATEMENTS

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) ?***

We agree with the principle of requiring departure in the rare circumstances in which such a departure is necessary to prevent a conflict with the objective for financial statements in the framework, however we do not agree that a regulatory restriction should qualify this requirement. We believe it would be unfortunate if IAS could permit different treatments based upon local regulatory requirements.

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) ?***

We agree with this treatment.

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) ?***

We agree with this treatment.

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 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) ?***

We agree with these treatments.

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)?***

We have no reason to oppose these proposals.

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)?***

We have no reason to oppose these proposals.

<u>IAS 2 - INVENTORIES</u>

1 ***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.

2 ***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.

<u>IAS 8 - CHANGES IN ACCOUNTING ESTRIMATES AND ERRORS</u>

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)?***

We agree with this treatment.

2 ***Do you agree with eliminating the distinction between fundamental errors and other material errors (see paragraphs 32 and 33)?***

On balance we can understand the need to eliminate the distinction between the two types of error. We are not however convinced that the proposed standard provides sufficient guidance on the difference between an error and an accounting estimate.

For an insurance company, the estimation techniques employed by the company provide the greatest source of potential for variation between the estimated liabilities at the end of one accounting period and the outcome as measured in the subsequent period. These estimates often include estimates that are made on a portfolio basis in addition to estimates of individual liabilities. It would be wrong therefore to consider the estimates made on an individual liability basis when reviewing and making judgements between an error and a change in estimate at this individual level.

It would helpful if the standard could clarify a company's accounting policy should clarify the basis of making estimations and that it is on this basis that the company should consider whether errors have arisen.

Other Issues

Paragraphs 5 and 6 - A major concern for insurers is the application of these two paragraphs in the absence of an accounting standard on insurance contracts prior to the 2005 deadline for the adoption of IAS by European listed Groups. 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 draft statement of principles on accounting for insurance contracts that the IASB has been considering 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 exemption to insurers within IAS8 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. This exemption should cover only those items which are to be covered under the proposed interim standard.

Paragraph 29 and 30 – These paragraphs are unclear as to whether the disclosure is required for each subsequent period. Such a disclosure may be onerous for insurers. By way of example, if a provision is discounted and the discount rate is different at the end of the accounting period to that used at the end of the previous period, then the effect of a change in the estimate will impact on each subsequent period until the liability is settled.

<u>IAS 16 - PROPERTY, PLANT AND EQUIPMENT</u>

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)?***

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

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?***

We agree.

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)?***

We agree.

Other issues

Currently, under local GAAP in the UK and some other European territories, owner occupied properties are treated as investment properties not withstanding the definition under IAS 40. This issue is discussed under the comments on the proposed changes to IAS 40.

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 can see the logic that has been applied in making this judgement but believe that this issue may be better addressed in the ongoing project on all aspects on accounting for leases.

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?***

Again we understand the need reduce options but consider that this would be better addressed within the ongoing project on all aspects on accounting for leases.

IAS 21 - THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

1 ***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.

2 ***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.

3 ***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.

4 ***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.

5 ***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)?

On balance we concur with this treatment.

IAS 24 - RELATED PARTY DISCLOSURES

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'.

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,

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)?***

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.

IAS 27- CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

1 ***Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?***

We agree with the criteria set out in paragraph 8.

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)?***

We agree with treatment proposed.

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)?

The guidance in the proposed revision to IAS 39 in respect of equity instruments for which no active market exists would appear, in many instances, to preclude the use of measurement at fair value. The revision to IAS 27 would then default to cost. We are not convinced that the use of cost would be an improvement on the existing option, which is deleted in the exposure draft, of using the value determined under the equity method.

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 have no comment in respect of this.

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)?***

This treatment appears to be reasonable.

IAS 33 - EARNINGS PER SHARE

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?***

We do not disagree with this treatment.

2 ***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.

Other issues

We do not believe that the IASB should prescribe the disclosure of the results of additional earnings per share calculations, in 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.

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?

We agree with this treatment.

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?***

We agree with this treatment.

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 fair value model should be adopted in all cases and that this choice should be eliminated.

Other issues

Currently, under local GAAP in the UK and some other European territories, owner occupied properties are treated as investment properties not withstanding the definition of owner occupied property under IAS 40.

In the UK, FRS 15 (the equivalent standard to IAS 16) includes a specific exemption for insurance companies in allowing the revaluation gains and losses to be recognised in the same manner as revaluation gains and losses on other investment properties.

It would be useful if IASB can confirm whether the definitions in IAS 40 would allow insurers to treat properties occupied by the insurer (or by another group company) as investment properties in circumstances where the primary objective of the owner is provide income or capital growth as an invested asset of the insurance activities. This is particularly relevant in those circumstances where the insurance liabilities may be determined taking into account the valuation of such properties.