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International Accounting Standards Board
30 Cannon Street
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16 September 2002

Your ref
Our ref

Dear Sirs

Exposure Draft of Proposed Improvements to International Accounting Standards

We are writing to comment on the Exposure Draft of improvements to International Accounting Standards, principally the proposed changes to IAS 17 - Leases and IAS 40 - Investment Property.

IAS 17

We do not believe that property leases should be split and accounted for as between a lease of land(generally an operating lease) and a lease of buildings (which may be an operating lease or a finance lease depending on the circumstances). The reasons for this are:

The transparency of financial statements will deteriorate significantly. Analysts and shareholders will have great difficulty in understanding the revised statements; concepts of rent and market value are well understood in the property industry and market statistics about rental growth, yields and valuation are readily available in the UK. It will be very hard to derive these measures from the accounts of a property company with anything other than an immaterial finance lease component.

- Leases are indivisible. A property lease reflects a combination of the building, its location and the uses and permissions that have been granted in respect of the property.

- Significant work will be required by both lessors and lessees in analysing the somewhat artificial split of property lease cash flows and in considering the finance/operating lease decision.

- Where finance leases are identified for the buildings elements, income recognition and asset/liability classification will be different from current, well understood, practice. Generally lease income and expenses will be recognised earlier than is currently the case and debtors in respect of lease assets, and borrowings in respect of lease liabilities, will be recognised in place of the current property assets. This will impact gearing and very likely the timing of the tax cash flows. Further a lessor may have one asset (a property) but it may be partly held in fixed assets (the land) and partly held in debtors (the building). This will be confusing.

In addition to the reasons set out above, we feel that it is not sensible to reinforce the distinction between operating and finance leases when a project is being undertaken by the UK Accounting Standards Board aimed at eliminating precisely this distinction.

IAS 40

The proposal to accept that a lessee's long leasehold interest in the property can be treated as an investment property and fair valued where these leases otherwise meet the requirements of the definition of investment property, is welcome. However, we do not agree that it should be a prerequisite under the fair value model that a lessee's property interest be accounted for as a finance lease for the following reasons:-

- The open market value of the lease would take into account the existence of the headlease and the rental payments due under it. Treating the headlease as a finance lease would therefore either result in the double counting of headlease obligations or necessitate the grossing up of the balance sheet.

- As we have already indicated, treating property leases as finance leases can be difficult given the variety of lease types. For example, headlease rents are often "geared" with an element of the rent payable linked to the amount of rent receivable, which may in turn be linked to a tenant's rental income in the case of a retailer. An objective assessment of the amount to be recognised as a finance lease liability could therefore be difficult.

We have seen the proposals set out by the British Property Federation and consider them to be a sensible and workable solution to the issues. We would suggest that, until the leases accounting project is completed, The British Property Federation's suggested approach, be adopted.

Yours faithfully

Andrew Macfarlane
Group Finance Director