THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND

International Accounting Standards Board
30 Cannon Street
LONDON
EC4M 6XH

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

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Dear Sir or Madam

PROPOSED IMPROVEMENTS TO INTERNATIONAL ACCOUNTING STANDARDS

The Institute's Accounting Standards Committee has considered the IASB's "exposure draft of proposed improvements to international accounting standards", and I am pleased to set out its comments below.

Materiality

We note that each draft revised IAS contains an opening paragraph in italics which, *inter a/ia,* 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.

Our preference would be 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.

Fair Presentation

We strongly support a requirement for financial statements to show a true and fair view of the financial position, financial performance and cash flows of an entity. We accept that the "fair presentation" as required by IAS I is a very important component of showing a true and fair view.

We also strongly support the principle that where compliance with an IFRS or an Interpretation of a Standard would result in the financial statements no longer giving a fair presentation, then an entity should depart from that requirement. In our view, the requirement for the financial statements to give a fair presentation should be paramount.

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. We are aware of the demands and the resource constraints already facing the JASB, but would like to ensure that the public sector aspect is given adequate consideration.

"Impracticability" Exemptions

Many of the exposure drafts' exemptions that were previously allowed on grounds of impracticability have been replaced by exemptions on grounds of 'undue cost or effort'. We are concerned that the 'undue cost or effort' criterion is less stringent, particularly as there is no guidance as how it is to be applied.

Other Issues

There are also some further issues which have a particular UK context, and which we highlight in the attached Appendix. We have also raised these issues with the ASB, and it is likely that the ASB will pursue these further with yourselves.

Detailed Comments

Our detailed comments on the individual IASs are included in the attached Appendix.

We hope that our comments are of assistance to you in the finalisation of these standards. If you wish to discuss any of our comments further, please do not hesitate to contact me.

Yours sincerely

DAVID OOD
Deputy Director, Accounting & Auditing
Secretary to the Accounting Standards Committee

cc: Hans Naior, ASB (conspaper1@asb.org.uk)
Paul Rutteman, FAFRAG (prutteman@efrag.org)

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 1 "Presentation of Financial Statements"
September 2002

Responses to IASB Questions:

1. ***Do you agree with the proposed approach regarding departures from a requirement of an IFRS or an Interpretation of an IFRS to achieve a fair presentation (paragraphs 13-16)?***

   Yes. We strongly support a requirement for financial statements to show a true and fair view of the financial position, financial performance and cash flows of an entity, and we accept that the "fair presentation" as required in paragraph 10 is a very important component of showing such a true and fair view. We also strongly support the principle that where compliance with an IFRS or an Interpretation of a Standard would result in the financial statements no longer giving a fair presentation, then an entity should depart from that requirement. In our view, the requirement for the financial statements to give a fair presentation should be paramount.

   We accept that paragraph 15 may be a necessary compromise by the IASB to cater for jurisdictions which prohibit departures from accounting standards. However, we do not agree with the implication inherent in paragraph 15 that inappropriate accounting can be rectified by giving additional disclosures.

2. ***Do you agree with prohibiting the presentation of items of income and expense as 'extraordinary items 'in the income statement and the notes (paragraphs 78 and 79)?***

   Yes. However, in the absence of a definition of "extraordinary items" in either the revised IAS 1 or revised IAS 8, the value of this prohibition is limited. We suggest that the prohibition needs to be extended to cover any items appearing below the profit or loss for the year.

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 (para 60)?***

   Yes. We agree with the Board's reasoning as set out in A19 to A25, and support the preference to show liquidity and solvency as at the balance sheet date.

4. ***Do you agree that 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. We agree for the reasons given in our response to Question 3 above.

   Do you agree that 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 & 64)

Yes. We agree for the reasons given in our response to Question 3 above.

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 (paragraphs 108 and 109).

Whilst this proposal has some appeal, we question how it might be applied in practice. In particular, we question whether it could be applied consistently across the cultural differences in the judgement process which exist worldwide.

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 (paragraphs 110-115)?

Again, we believe that this has some appeal, but could be difficult to apply and enforce, in practice. This could result in a statement similar to the US risk statement (item 7A of statement 10-K) and the assumptions disclosed underlying forward-looking statements (safe harbour rules). These assumptions tend to be either bland or so all embracing that they are of no value to the users. Although such disclosure might be of interest, it will be difficult to regulate, leading to considerable variations in quality and quantity of information between financial statements. Paragraphs A27 to A30 of the IASB's Basis for Conclusions do not give much additional insight to resolve these concerns. We believe that such disclosures may be better dealt with on a case-by-case basis by specific disclosure requirements in individual standards.

Other Matters

Income Statement Format

Paragraph 76 includes wording changes relating to the required minimum information presented on the Income statement, particularly affecting lines (f) profit or loss (previously profit or loss from ordinary activities) and (h) net profit or loss. For users, the distinction between these two items is unlikely to be clear. For groups, we propose that these lines, at the very least, be expanded to (f) 'profit or loss of all entities in the group' and (h) 'net profit or loss for shareholders of the parent company'. For individual companies items (f) and (g) could be deleted.

Information Outside the Financial Statements

We are disappointed to see the changes made to paragraphs 8 and 9 of the old IAS 1 (which have now become paragraphs 7 and 8 of the revised IAS 1) which remove the explicit encouragement to present certain specified information outside the financial statements.

it seems to be a highly retrograde step, at a time when social and environmental issues are becoming more widely reported, to de-emphasise them in this way. While we appreciate the point, made in the new paragraph 9, that the "reports and statements described in paragraphs 7 and 8 are outside the scope of International Financial Reporting Standards", we feel that this need not preclude their being encouraged by the IASB. In the case of environmental issues, in particular, the removal of this encouragement appears to be entirely against the spirit of the *European Commission Recommendation of 30 May 2001 on the recognition, measurement and disclosure of environmental issues in the annual accounts and annual report of companies (200 1/453/EC).*

Other Deletions

We are disappointed to see that the following key principles or requirements are proposed to be removed from IAS 1:

Old paragraph 12: Disclosures cannot rectify inappropriate accounting treatment;

Old paragraph 52: Timeliness.

Old Appendix: Illustrative Financial Statement Structure

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 2 "Inventories"
September 2002

Responses to IASB Questions

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?

Yes. This would ensure consistency with general practice internationally and result in a fairer reflection of the cost of the physical inventory items actually held.

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). Do you agree with retaining those requirements?

Yes.

Other Matters

When the IASB comes to consider updating IASs 11 and 18, we ask that the following comments be taken into account:

Analysis of Construction Contract Balances

IAS 11 contains little or no requirement or guidance on the analysis of the balance sheet items relating to construction contracts. We suggest that the IASB includes a requirement for such analysis (along the lines of paragraph 30 of UK SSAP 9).

Early Stages of a Contract

Paragraph 33 of IAS 11 seems contradictory. It opens by indicating that at the early stages of a contract, "… it is often the case that the outcome cannot be estimated reliably." The fourth sentence states categorically that "… the outcome of the contract cannot be estimated reliably…" We believe that the standard should not be prescriptive and should not prohibit the recognition of profit in the early stages of a contract. Instead, some discussion of prudence in the assessment of the outcome of the contract may be helpful.

Long Term Non-construction contracts

IAS 18 does not cater well for long term non-construction contracts, such as PPP / PFI contracts in the UK. We suggest that either IAS 11 be broadened to include such long term facilities management and service contracts or additional material be added to IAS 18 to cover these.

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 8 "Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies"
September 2002

Responses to IASB Questions:

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, subject to the requirement for disclosure of the effects of changes in accounting policies and correction of errors (in paragraphs 15, 23 and 35). The proposed changes will result in these disclosures becoming more important.

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

Yes. However, we are concerned at the potential scope for abuse in the proposed treatment of errors. It might not always be possible to determine if a material change is due to a material error or because figures were based on accounting estimates. We can envisage a biased situation where companies seek to justify profit-reducing errors as belonging to the prior year but profit-increasing errors to the current year.

Paragraph A13 of the IASB's Basis for Conclusions indicates that the main reason for the change is that the distinction between fundamental errors and material errors was difficult to identify. The proposed approach merely moves the difficulty further down the line - in distinguishing between an error and a change in an accounting estimate.

Other Matters

Other Characteristics

Paragraph 5 only refers to the qualitative characteristics of relevance and reliability in deciding on an accounting policy. It seems odd that the other qualitative characteristics of understandability and comparability in the Framework are not mentioned. We would have thought that these were equally important.

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 10 "Events after the Balance Sheet Date"
September 2002

Proposed Dividends

We believe that it is inappropriate to be so definitive in paragraphs 11 and 12 of the revised standard to the effect that dividends declared after the balance sheet date should not be recognised as a liability. In our view, there will be many occasions where a proposed dividend will satisfy the recognition criteria in paragraph 14 of IAS 37 because there will be a constructive obligation. For example, for a company which has a stated dividend policy, or merely follows the practice, of distributing a certain proportion of its profits, it may have a constructive obligation at the balance sheet date to make such dividend payments as a result of the profit generated before that date. In our view, the proposed standard needs to clarify what distinguishes the proposed treatment for dividends from that illustrated in paragraph 8(d).

Non-adjusting Events

We suggest that paragraph 21 of IAS 10 includes a further example of a non-adjusting post-balance sheet event: ie the declaration of a dividend by a subsidiary or associated company after the parent's balance sheet date is a non-adjusting event for the parent. (The reason why this is a non-adjusting event under IAS is that IAS 18 ("Revenue") requires that dividends (receivable) are recognised when the shareholders' right to receive payment is established.)

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 15 "Information Reflecting the Effects of Changing Prices"
September 2002

Withdrawal of IAS 15

We support the proposed withdrawal of IAS 15.

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 16 "Property, Plant and Equipment"
September 2002

Response to IASB Questions:

1. ***Do you agree that all exchanges of hems 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?***
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?***

No. We do not agree with the above proposals. Property, plant and equipment, and intangible assets are very different from other assets in that there is often no ready market and therefore insufficient evidence to determine the fair value of an item. This does not provide sufficient reliability to measure exchanges at fair value and recognise a resulting profit or loss on exchange.

We also consider it inappropriate to consider intangible assets in a standard relating to property, plant and equipment, which are tangible assets.

3. ***Do you agree that depredation 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 agree that where the asset becomes temporarily idle then depreciation of the item should continue. However, where the asset is retired and held for disposal, we believe that depreciation of the asset should cease.

Other Matters

Revision of Residual Values

The proposed changes to the definition of "residual value" in paragraphs 6 and the content of paragraph 46 of IAS 16 require residual values used in the calculation of depreciable amount to be reviewed at each balance sheet date and revised to reflect current estimates. Hence, depreciation expense on a historical cost basis would be reduced by inflation in residual values.

Conceptually we disagree with this proposed approach. Carrying an asset at historical cost but updating assessments of residual value based on year end values seems to be an illogical mixture of historical cost and current/exit value accounting.

Practically, however, updating residual values based on current estimates does avoid the "over-depreciation" of fixed assets and the consequent large gain which may arise when sold. It may therefore result in a more realistic allocation of the loss in value of the fixed asset in the income statement.

In conclusion, we would accept this proposal, but only in relation to categories of fixed assets which are carried at annual valuation. Where fixed assets are carried at historical cost, we believe that residual values should not be reassessed at each balance sheet date.

Renewals Accounting

The proposed standard does not address the use of renewals accounting in respect of certain infrastructure assets and we believe that this may prevent entities from using renewals accounting. We see renewals accounting as a pragmatic means of estimating fixed asset values in steady state infrastructures, which is commonly used by utilities and public sector entities.

Therefore, we suggest that it be made clear in the standard that renewals accounting is still permitted. We believe that it is also necessary for there to be guidance, either within the standard or in an Appendix, to explain how renewals accounting operates and how it complies with the main principles in the standard. In particular strong guidance is needed as to when renewals accounting might be appropriate and, where it is used, what expenditure should be written off and what expenditure should be capitalised.

Valuation Principles

We do not support the IAS 16 focus on exit value, but prefer valuations to be based on deprival value. Deprival value is more relevant to the business than exit value. Exit values are irrelevant to the company where it continues to use the assets in its continuing operations as a going concern.

The impracticability of exit value is demonstrated in our "Making Corporate Reports Valuable" follow-up research publications: "Melody plc" (1990); "Orchestra plc" (1993); and "A Feasibility Study: The Post Office" (1993). The opposition to exit value is probably best expressed in Chapter 4 of the Post Office Feasibility Study and in the Group Finance Director's and Researcher's commentaries on pages 41, 48 and 49 of "Orchestra plc". A copy of "Orchestra plc" (1993) and "A Feasibility Study: The Post Office" (1993) are included, for further information.

Environmental Benefits

We support the thrust of paragraph 13 of IAS 16, which makes reference to property plant and equipment acquired for environmental reasons. However, we feel that environmental expenditure should be considered more widely in the standard. In particular, consideration should be given to incorporating some of the provisions contained in the *European Commission Recommendation of 30 May 2001 on the recognition, measurement and disclosure of environmental issues in the annual accounts and annual report of' companies (200 1/453/EC).* Capitalisation of environmental expenditure is covered in paragraphs 12 to 18 of this recommendation.

Donated Assets

We suggest that the proposed standard be broadened to cover the accounting treatment of donated assets.

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 17 "Leases"
September 2002

Responses to IASB Questions:

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 building element is classified as an operating or finance lease by applying the conditions in paragraphs 3 - 10 of IAS 17.

We are sceptical as to how meaningful it is to disaggregate a single lease agreement into two separate parts and account differently for those two parts. We can envisage that there will be many cases where minimum lease payments cannot be allocated reliably between land and buildings at the inception of a lease.

Furthermore, where these minimum lease payments cannot be allocated reliably, paragraph 11B states that the entire lease will then automatically be a finance lease, unless both are clearly operating leases. In our opinion this introduces mote subjectivity, and does not represent an improvement over the old IAS.

We do not find paragraphs A3 to A6 convincing in the IASB's Basis for Conclusion and, consequently, are not convinced that the IASB is pursuing the most appropriate revisions.

In summary, we are doubtful as to whether the proposed "improvements" will actually result in greater comparability. We believe that these issues should be deferred for consideration under the IASB's project on 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?

Yes. We are happy with the proposal that initial direct costs are capitalised and allocated over the lease term.

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 21 "The Effects of Changes in Foreign Exchange Rates"
September 2002

Response to IASB Questions:

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 definition and the supporting guidance. However, we suggest that paragraphs 7 & 8 of the proposed standard should be combined, as the current presentation seems to emphasise the paragraph 7 provisions over those in paragraph 8.

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?

Yes, subject to there being a requirement to disclose the presentation currency and the reasons for choosing a different currency from the functional currency (as in paragraph 51), and disclosure of the exchange rates used for translation. It should be noted, however, that the flexibility to present financial statements in different currencies may be overridden by legal requirements.

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)?

Yes (because the average rate is used for translating the income statement, and this preserves the consistency between the individual and consolidated accounts).

4. Do you agree that the allowed alternative to capitalise certain exchange differences in paragraph 21 of IAS 21 should be removed?

Yes.

5. 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 (see paragraph 45)?

Yes. We agree with the analysis in paragraphs A21 to A27 in the IASB's Basis for Conclusions.

Other Matters

Definition of 'foreign operation'

We believe that the definition of a foreign operation should be phrased in terms of it having a functional currency different from that of the reporting entity; it is die currency of its operations that make it 'foreign' not the country in which it is based. This will require a consequential change to paragraph 9 such that all references to ‘foreign operation’ are deleted since the factors set out in that paragraph are to be used in determining whether the entity is a ‘foreign operation’.

Examples of Monetary Items

Paragraph 14 of the draft standard provides examples of monetary items. However, it does not deal with the more difficult items such as investments in bonds, convertible loans, redeemable preference shares etc. Some guidance on the treatment of such items would be desirable.

Shares expressed in Foreign currency

The draft standard does not seem to deal with the accounting treatment of shares which are denominated in a currency other than the functional currency.

Monetary Items forming Part of a Net Investment in a Foreign Operation

Paragraph 30 addresses the treatment of foreign exchange differences on monetary items which form part of a net investment in a foreign operation. It requires foreign exchange gains and losses on these items to be recorded in the income statement in the separate financial statements of the investor, but (initially) in a separate component of equity in the investor’s consolidated financial statements (and recycled to the consolidated income statement on eventual disposal). We do not agree with this inconsistency of treatment. In our view, the foreign exchange gains and losses on these items should be recorded in the statement of changes in equity in both sets of financial statements.

Recycling of Gains and Losses

As noted in the preceding paragraph, foreign exchange differences on monetary items which form part of a net investment in a foreign operation should be recorded initially in a separate component of equity in die investor’s consolidated financial statements, and recycled to the consolidated income statement on eventual disposal of the foreign operation. We strongly believe that gains and losses, once recognised in a component of equity, should not be recycled back to the income statement. Recycled items distort the entity’s performance as shown in the income statement.

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 24 “Related Party Disclosures”
September 2002

Responses to IASB Questions

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?***

No. We believe that management compensation, expense allowances and similar items paid in the ordinary course of an entity’s operations etc should be disclosed, at least in aggregate, and we see no reason to exempt this. Management compensation is clearly a related party item, where huge conflicts of interest can arise, and which is of prime concern to shareholders and regulators. We note that national regulators often require further detail of management compensation, but do not believe that this is a valid reason for excluding management compensation from the scope of the standard.

Given the significance of incentive-based remuneration and its role in motivating management, we recommend that aggregate remuneration of key management be required to be split between fixed salary and performance related remuneration. In the light of recent high profile corporate collapses, we believe that this is a vital disclosure in giving accounts users an understanding of the incentives and possible conflicts of interest to which management are subject. Accordingly the IASB should provide some basic disclosure requirement on which national requirements can build.

The rationale for excluding management compensation (but not expense allowances and similar items paid in the ordinary course of an entity’s operations!) is included in the IASB's Basis for Conclusions in Appendix A of the draft standard. In our view, the three reasons given for excluding management compensation (in paragraph A3) are poor. In particular:

(a) The fact that there are <u>some</u> jurisdictions where approval processes for management compensation involve other parties such as shareholders or investors, does not justify removing the required disclosures across all jurisdictions. Furthermore, although approval processes for management compensation may involve other parties such as shareholders or investors, management may still have a significant input;

(b) Privacy issues relating to management compensation can be avoided by disclosing remuneration in aggregate for all management, as the approach of the proposed standard would require; and

(c) In our view, the fact that defining “management” and “compensation” may be contentious is not a valid reason to avoid requiring appropriate disclosure. Indeed, in order for the proposed standard to exempt ‘management compensation’ from disclosure, the term(s) would need to be defined to clarify what the exemption was intended to cover.

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 wholly owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs?***

We agree that an exemption should be allowed to parents and wholly owned subsidiaries from the requirement to disclose intra-group related party transactions only, on the above condition and on the further condition that the consolidated financial statements for the group are also prepared under IASs/IFRSs. That is, we do not agree with the proposed blanket exemption for parents and wholly owned subsidiaries.

Other Matters

Materiality

As standards are not intended to apply to immaterial items, disclosure would only be required of material related party transactions. We note that some guidance on materiality already exists in paragraphs 29 and 30 of the "Framework for the Preparation and Presentation of Financial Statements". However, this could usefully be expanded to include the qualitative aspects of materiality which are particularly important for the purposes of deciding whether related party transactions should be disclosed under this standard.

Clarification Paragraph 4

It should be made clear that the items mentioned in the final paragraph are therefore not required to be disclosed in the consolidated financial statements.

Inappropriate Example - Paragraph 7

The example quoted in the final sentence is one of 'control' not 'significant influence'.

Definition of 'Related Party - Paragraph 9

The definition of "related party" would not catch transactions between a subsidiary and an associate of the same parent/investor. We presume that such a relationship should be included within the scope of this standard.

Definition of "Close Members of Family" - Paragraph 9

By including the examples of 'close members of the family of an individual' this might suggest that other family relationships are not included, eg, brothers/sisters/parents. We believe that transactions with such parties should be disclosed.

Controlling Parties - Paragraphs 12 and 13

We believe that the proposed standard should require disclosure of the name of the entity's controlling party and, if different, that of the ultimate controlling party. In our view, the proposed disclosure, in paragraph 12, of the relationships between parents and subsidiaries is too narrow. In particular, it fails to achieve the broader objective (discussed in paragraph 13) of allowing users to understand the effect on the entity of related party relationships where control exists, other than as a result of a traditional parent-subsidiary relationship. We strongly favour the disclosure of the controlling entity and the ultimate controlling entity, irrespective of whether there have been transactions with those parties.

Other Related Parties . Paragraph 15(g)

We believe this category of 'other related parties' is too broad since it will embrace transactions with fellow subsidiaries and close family members.

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 27 “Consolidated and Separate Financial Statements”
September 2002

Responses to IASB Questions:

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

Yes. However, this is subject to the following two comments.

Paragraph 8(a) requires some wording changes in order to clarify in which situations a parent need not prepare consolidated financial statements if that parent is itself a subsidiary which is not a wholly owned subsidiary. *Inter alia,* the current wording is confusing in its use of “parent”.

Paragraph 8(d) refers only to the <u>immediate</u> or <u>ultimate</u> parent publishing consolidated financial statements complying with IFRSs. We see no reason why this should not be broadened to include any intermediate parent which publishes consolidated financial statements complying with IFRSs.

2. ***Do you agree that minority interests should be presented in the consolidated balance sheet*** *within* ***equity, separately from the shareholders’ equity (see paragraph 26)***

Yes. The nature of minority interests is more akin to equity than to a liability. In particular, minority interests do not satisfy the definition of a liability in the Framework and IAS 37.

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 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)?

Yes. However, we feel that some aspects of the section ‘Accounting for Investments in an Investor’s Separate Financial Statements’, paragraphs 29 to 30A, may be confusing. For example:

- It is not clear how paragraph 29A would apply paragraphs 29 and paragraph 30 to a parent which has subsidiaries only but does not prepare consolidated financial statements; and
- Paragraph 30 is unclear. The paragraph appears to relate to cases where consolidated financial statements are prepared. However, the last part of the sentence refers to a parent that need not prepare consolidated financial statements.

Other Matters

Control

The last sentence of the introduction to paragraph 12 and the subsequent items marked (a) to (d) seem restrictive and overly prescriptive. We suggest that this be broadened so that items (a) to (d) are presented as examples of situations where control may exist when the parent owns half or less of the voting power.

Potential Voting Rights

Paragraph 1 5A considers the situation where potential voting rights exist which may change the respective voting rights of the parent and minority interests in the future. Essentially, this requires the proportions of profit or loss and changes in equity to be allocated between the parent and minority interests on the basis of present ownership rights only. However, there may be situations where the terms of the instruments containing potential voting rights and the probability of one party exercising its rights under that instrument mean that, in substance, the proportions of profit or loss and changes in equity which accrue to each party are different from those based on the present ownership rights. We suggest that this paragraph be broadened to require the substance to be reflected in the consolidated accounts.

This might be the case where the parent has an option to purchase 10,000 shares for £5 from the minority on 1 March 2003. At 31 December 2002, the share price is £8 and still rising, and it is virtually certain that the option will be exercised. Clearly the minority is unable to benefit from the share of retained profits or changes in equity attaching to these 10,000 shares. These benefits will accrue to the parent by virtue of the fixed strike price.

Paragraph ISA is purported to be based on SIC 33. However, the Basis of Conclusions and the Appendix to the Interpretation which illustrated how it was to be applied in certain situations have not been incorporated into IAS 27. We think these should be included.

Different Reporting Dates

Paragraph 19 requires reporting date of a subsidiary to be within three months of that of the parent. It also requires that where the reporting dates are different, adjustments should be made for the effects of significant transactions or events that occur in the intervening period.

We are concerned that paragraph 19 suggests that non-coterminous year ends is the norm. In our view, the emphasis of this paragraph should be changed to establish the principle that coterminous periods and year ends should be used, and that this will normally be achieved by subsidiaries having the same reporting date as the parent. Where this is not the case, then it should allow financial statements of a subsidiary made up to a date within 3 months of that of the parent to be used, provided that adjustments are made for the effects of significant transactions or events.

Paragraph 23

This paragraph should be in bold since it introduces new principles.

Pre-Acquisition Dividends

Paragraphs 6 and 29B requires that distributions out of pre-acquisition profits should be regarded as a recovery of investment and recognised as a reduction of the cost of the investment. We prefer that all dividends should be recognised in the income statement of the investor, subject to an impairment test on die carrying value of the investment in the subsidiary. Therefore, where the pre-acquisition dividend reduces the value of the investment in the subsidiary below its carrying value in die parent’s financial statements, a write down in the carrying value of the investment would be made.

Disclosures

We believe that the disclosure required by the old paragraph 32(a) is an important disclosure for users, in determining the major components of the group. Consequently we strongly recommend that the proposed deletion of this paragraph is reversed.

Separate Financial Statements

"Separate Financial Statements" are defined in paragraph 4, which also refers to paragraphs 8 and 9. The latter paragraphs bring into the definition those financial statements prepared by an investor which does not need to prepare consolidated financial statements. Paragraph 33 refers to "financial statements of a parent that need not prepare consolidated financial statements" in addition to "separate financial statements" - ie in a manner which differs from the definition in paragraphs 4, 8 and 9.

Effective Date – Early Adoption

Paragraph 34, in its last sentence, states that "If earlier adoption affects die financial statements, an entity shall disclose that fact." We suggest that this statement be clarified: does it mean "If earlier adoption would affect die financial statements, an entity shall disclose that fact." or
"If the standard is adopted early and this affects the financial statements, an entity shall disclose that fact.". It may also be appropriate to use the term "materially affects" rather than merely "affects".

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 28 "Accounting for Investments in Associates"
September 2002

Responses to IASB Questions:

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 measurements is well-established practice in those industries (see paragraph 1)?***

   Yes, but provided these are not strategic holdings. That is, this should only be allowed where the investors are passive investors and do not exercise their significant influence or their share of the joint control. We suggest that more detailed guidance is required regarding in what circumstances IAS 28 and IAS 31 should not apply.

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.

Other Matters

Separate Financial Statements

One of the changes to IAS 28 is to require the use of the equity method for an investment in an associate irrespective of whether the investor has subsidiaries or whether the financial statements are consolidated financial statements or the separate financial statements of the investor (paragraph 8A). This appears to be inconsistent with paragraph 8 (which allows the use of fair value in certain circumstances) and the proposed paragraphs 29 or 30 in IAS 27 (which arc effective by virtue of paragraph 24A of IAS 28, and seem to require the investment in the associate to be carried at cost or fair value). We suggest that the inter-relating provisions of IAS 27 and 28 are re-examined to ensure that they are self-consistent.

Different Reporting Dates

Proposed paragraph 18 requires die use of financial statements for the associate drawn up to a date which is no more than three months from the reporting date of the investor. We question whether this would be workable in all die jurisdictions worldwide in which it is to be applied. In particular, we question whether significant influence would always be sufficient to obtain the necessary financial information from the associate as at a specific date.

Impairment Losses

Paragraph 23 states how the value in use of an investment in an associate should be calculated, using two alternative approaches. We agree with the approach set out in sub-paragraph (b), based on dividends receivable and ultimate disposal proceeds. We are concerned that the approach in sub-paragraph (a) involves some double counting of cash flows: it needs to be recognised that die cash flows from the operations of the investee, to the extent they are undistributed, will also increase the amount of the proceeds from the ultimate disposal of the investment.

Disclosures

We believe that the disclosure required by the old paragraph 27(a) is an important disclosure for users, in determining the major associates in the group. Consequently we strongly recommend that the proposed deletion of this paragraph is reversed.

Effective Dale - Early Adoption

Paragraph 29, in its last sentence, states that “If earlier adoption affects the financial statements, an entity shall disclose that fact.” We suggest that this statement be clarified: does it mean “If earlier adoption would affect the financial statements, an entity shall disclose that fact.” or “If the standard is adopted early and this affects the financial statements, an entity shall disclose that fact.”. It may also be appropriate to use the term “materially affects” rather than merely “affects”.

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 33 "Earnings per Share"
September 2002

Responses to IASB Questions

(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. 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 7 and 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.

Other Matters

Additional BPS Figures

We see no reason why additional earnings per share figures should be prohibited from the face of the income statement, and would be happy for such additional figures to be disclosed on the face of the income statement 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, in the UK).

Dilutive Options and Dilutive Potential Ordinary Shares

Paragraph 35 lays down a principle which is then not followed in the rest of the document. The principle in paragraph 35 has been applied to options, hut 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.

Institute of Chartered Accountants of Scotland

Accounting Standards Committee
Comments on IAS 40 “Investment Property”
September 2002

Responses to IASB Questions:

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 pro vided 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 have considered the IASB's Basis for Conclusions relating to the proposed revisions, but we are not convinced that the IASB has chosen the most appropriate course of action to deal with the problems identified. In particular, the proposed changes to IASs 17 and 40 seem somewhat lacking in principle. We note that an alternative coarse of action would be merely to delete paragraph 11 of IAS 17. Another alternative may be to amend the definition of investment property from “property ...” to “an interest in property ...” We suggest that further consideration be given to these proposed revisions.

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?***

   As indicated above, we are pot convinced that the IASB has chosen the most appropriate course of action to address the problems identified. In particular, it appears odd that following the supposed “substance over form” principles of IAS 17 would lead to a classification of such a property interest as an operating lease, but that IAS 40 requires it to be accounted for 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. Although we agree with the principle of removing alternative treatments allowed under standards, for the reasons explained in paragraph A8, we agree that the Board should not eliminate the choice between the cost model and the fair value model at the present time, but should keep the matter under review.