

Alan Teixeira
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

28 October 2005

Dear Mr Teixeira

Exposure Drafts of Proposed Amendments to:
IFRS 3 Business Combinations
IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits
IAS 27 Consolidated and Separate Financial Statements

The Royal Bank of Scotland Group is one of the world's largest banks with shares listed on the London and New York Stock Exchanges. The Group's financial statements are prepared under IFRS and reconciled to US GAAP for its US filings. We support the IASB at its aim of global harmonisation of accounting standards.

Before responding to the Board's invitation to comment, we wish to record our disappointment that the proposals have appeared in exposure drafts without first being the subject of discussion papers. Included amongst the proposed amendments are major changes that, in our view, should have been the subject of the additional debate with the Board's constituents that a discussion paper allows.

Two areas in particular are of concern to us:

The introduction of the entity model for consolidated accounts seems to us unjustified. The entity model results in additional complexity with no perceptible improvement in financial reporting.

We do not support the Board's proposed change to the recognition and measurement of liabilities. We are unpersuaded that the changes are consistent with the framework and view their practical results as unhelpful to the user of financial statements.

Our replies to the specific questions raised in the exposure drafts are presented in the annex.

Yours sincerely

R Kapoor
Group Chief Accountant

Issues raised in the invitation to comment

ED OF PROPOSED AMENDMENTS TO IFRS 3 BUSINESS COMBINATIONS

Question 1 – Objective, definition and scope

Are the objective and the definition of a business combination appropriate for accounting for all business combinations? If not, for which business combinations are they not appropriate, why would you make an exception, and what alternative do you suggest?

As our view that mergers do occur practice is not held by the Board, we see no compelling reason not to subject combinations involving only mutual entities and business combinations achieved by contract alone to the principles in IFRS 3.

Question 2 - Definition of a business

Are the definition of a business and the additional guidance appropriate and sufficient for determining whether the assets acquired and the liabilities assumed constitute a business? If not, how would you propose to modify or clarify the definition or additional guidance?

We agree that the Board's view that it should refine its definition of when a group of assets or net assets constitute a business as the accounting differs. However, we do not consider that the Board definition is sufficiently operable. We suggest that the key the criterion for determining whether assets and liabilities constitute a business should be the existence of activities that require day-to-day management; in contrast, for example, to an SPE with pre-determined financial and operating policies which is not a business. Additionally, the Board should review the guidance in paragraphs A2 through A7. Suitable examples might well improve its usefulness; for example the treatment of entities that own a single major asset for example an investment property.

Questions 3 - 7 - Measuring the fair value of the acquiree

Question 3—In a business combination in which the acquirer holds less than 100 per cent of the equity interests of the acquiree at the acquisition date, is it appropriate to recognise 100 per cent of the acquisition-date fair value of the acquiree, including 100 per cent of the values of identifiable assets acquired, liabilities assumed and goodwill, which would include the goodwill attributable to the non-controlling interest? If not, what alternative do you propose and why?

We see no decisive argument in favour of the Board's view. We concur with the comments of the dissenting Board members. We oppose moving to the entity model. It is in any event a change of such importance that it should not be undertaken without extensive discussion with constituents.

Question 4 - Do paragraphs A8-A26 in conjunction with Appendix E provide sufficient guidance for measuring the fair value of an acquiree? If not, what additional guidance is needed?

We believe that in practice there will be significant difficulties in arriving at a fair value of the acquiree as a whole when the transaction results in the acquisition of a majority stake. We are unpersuaded by the Board's view that its approach represents an improvement in the relevance and reliability of financial information.

Question 5 - Is the acquisition-date fair value of the consideration transferred in exchange for the acquirer's interest in the acquiree the best evidence of the fair value of that interest? If not, which forms of consideration should be measured on a date other than the acquisition date, when should they be measured, and why?

Yes.

Question 6 - Is the accounting for contingent consideration after the acquisition date appropriate? If not, what alternative do you propose and why?

Yes.

Question 7 - Do you agree that the costs that the acquirer incurs in connection with a business combination are not assets and should be excluded from the measurement of the consideration transferred for the acquiree? If not, why?

No. We support the views of the dissenting members.

Questions 8 and 9—Measuring and recognising the assets acquired and the liabilities assumed

Question 8 - Do you believe that these proposed changes to the accounting for business combinations are appropriate? If not, which changes do you believe are inappropriate, why, and what alternatives do you propose?

Yes.

Question 9—Do you believe that these exceptions to the fair value measurement principle are appropriate? Are there any exceptions you would eliminate or add? If so, which ones and why?

Yes. No, none.

Questions 10-12 - Additional guidance for applying the acquisition method to particular types of business combinations

Question 10 - Is it appropriate for the acquirer to recognise in profit or loss any gain or loss on previously acquired non-controlling equity investments on the date it obtains control of the acquiree? If not, what alternative do you propose and why?

We believe that measuring the acquisition date fair value of the non-controlling interest will be problematic. We do not regard the proposed accounting as conceptually or practically superior to current accounting.

Question 11 - Do you agree with the proposed accounting for business combinations in which the consideration transferred for the acquirer's interest in the acquiree is less than the fair value of that interest? If not, what alternative do you propose and why?

We believe that the approach in UK FRS 10 to negative goodwill to be conceptually superior to that proposed by the Board.

Question 12 - Do you believe that there are circumstances in which the amount of an overpayment could be measured reliably at the acquisition date? If so, in what circumstances?

These circumstances are, in our view, very rare.

Question 13 - Measurement period

Do you agree that comparative information for prior periods presented in financial statements should be adjusted for the effects of measurement period adjustments? If not, what alternative do you propose and why?

Yes.

Question 14 - Assessing what is part of the exchange for the acquiree

Do you believe that the guidance provided is sufficient for making the assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree? If not, what other guidance is needed?

Yes. Our response to question 7 explains our view that transaction costs are an integral element of the purchase consideration.

Question 15 - Disclosures

Question 15 - Do you agree with the disclosure objectives and the minimum disclosure requirements? If not, how would you propose amending the objectives or what disclosure requirements would you propose adding or deleting, and why?

Yes.

Questions 16-18—The IASB's and the FASB's convergence decisions

Question 16 - Do you believe that an intangible asset that is identifiable can always be measured with sufficient reliability to be recognised separately from goodwill? If not, why?

Do you have any examples of an intangible asset that arises from legal or contractual rights and has both of the following characteristics:

- (a) the intangible asset cannot be sold, transferred, licensed, rented, or exchanged individually or in combination with a related contract, asset, or liability; and*
- (b) cash flows that the intangible asset generates are inextricably linked with the cash flows that the business generates as a whole?*

We do not have examples of intangibles of the type described by the Board. However, we are unclear precisely what point the Board wishes to make - either an intangible asset is reliably measurable or not. If not, it cannot be recognised.

Question 17 - Do you agree that any changes in an acquirer's deferred tax benefits that become recognisable because of the business combination are not part of the fair value of the acquiree and should be accounted for separately from the business combination? If not, why?

Yes.

Question 18—Do you believe it is appropriate for the IASB and the FASB to retain those disclosure differences? If not, which of the differences should be eliminated, if any, and how should this be achieved?

No. These differences should be reduced to a minimum.

Question 19 - Style of the Exposure Draft

Question 19—Do you find the bold type-plain type style of the Exposure Draft helpful? If not, why? Are there any paragraphs you believe should be in bold type, but are in plain type, or vice versa?

No. We believe that as there is no difference in status it would be preferable for all paragraphs to be plain.

ED OF PROPOSED AMENDMENTS TO IAS 27 CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

Question 1

Draft paragraph 30A proposes that changes in the parent's ownership interest in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as transactions with equity holders in their capacity as equity holders. As a result, no gain or loss on such changes would be recognised in profit or loss (see paragraph BC4 of the Basis for Conclusions).

Do you agree? If not, why not and what alternative would you propose?

No. We favour the parent entity approach and agree with the alternative view.

Question 2

Do you agree that the remaining non-controlling equity investment should be remeasured to fair value in these circumstances? If not, why not and what alternative would you propose ?

Do you agree with the proposal to include any gain or loss resulting from such remeasurement in the calculation of the gain or loss arising on loss of control? If not, why not, and what alternative would you propose?

No. We would propose that where the retained interest qualifies as an associate or joint venture it should be accounted for as such. We do not understand why a reduction in stake is a remeasurement event.

Question 3

Do you agree that it is appropriate to presume that multiple arrangements that result in a loss of control should be accounted for as a single arrangement when the indicators in paragraph 30F are present? Are the proposed factors suitable indicators? If not, what alternative indicators would you propose?

Yes.

Question 4

Do you agree with the proposed loss allocation? Do you agree that any guarantees or other support arrangements from the controlling and non-controlling interests should be accounted for separately? If not, why not, and what alternative treatment would you propose?

No. We consider that a minority's share of net liabilities should only be allocated to it where it is committed to making them good.

Question 5

Do you agree that proposed paragraphs 30A, 30C and 30D should apply on a prospective basis in the cases set out in paragraph 43B? Do you believe that retrospective application is inappropriate for any other proposals addressed by the Exposure Draft? If so, what other proposals do you believe should be applied prospectively and why?

We agree with paragraph 43B.

ED OF PROPOSED AMENDMENTS TO IAS 37 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS IAS 19 EMPLOYEE BENEFITS

PROPOSED AMENDMENTS TO IAS 37 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Question 1 – Scope of IAS 37 and terminology

(a) *Do you agree that IAS 37 should be applied in accounting for all non-financial liabilities that are not within the scope of other Standards? If not, for which type of liabilities do you regard its requirements as inappropriate and why?*

Yes.

(b) *Do you agree with not using 'provision' as a defined term? If not, why no?*

Yes.

Question 2 – Contingent liabilities

(a) Do you agree with eliminating the term 'contingent liability'? If not, why not?

Yes.

(b) Do you agree that when the amount that will be required to settle a liability (unconditional obligation) is contingent on the occurrence or non-occurrence of one or more uncertain future events, the liability should be recognised independently of the probability that the uncertain future event(s) will occur (or fail to occur)? If not, why not

No. We agree with the alternative view. We believe that the Board's proposals are incompatible with the Framework definition of a liability.

Question 3 – Contingent assets

(a) Do you agree with eliminating the term 'contingent asset'? If not, why not?

Yes.

(b) Do you agree that items previously described as contingent assets that satisfy the definition of an asset should be within the scope of IAS 38? If not, why not?

Yes.

Question 4 – Constructive obligations

(a) Do you agree with the proposed amendment to the definition of a constructive obligation? If not, why not? How would you define one and why?

The minor amendments to the definition do not in our view change its meaning to any significant degree.

(b) Is the additional guidance for determining whether an entity has incurred a constructive obligation appropriate and helpful? If not, why not? Is it sufficient? If not, what other guidance should be provided?

It would be of most use if the Board were to explain more fully the changes in practice that the amendments to the definition should bring about.

Question 5 – Probability recognition criterion

Do you agree with the analysis of the probability recognition criterion and, therefore, with the reasons for omitting it from the Standard? If not, how would you apply the probability recognition criterion to examples such as product warranties, written options and other unconditional obligations that incorporate conditional obligations?

No. See our response to question 2.

Question 6 – Measurement

Do you agree with the proposed amendments to the measurement requirements? If not, why not? What measurement would you propose and why?

No. We consider that existing requirements of IAS 37 are superior to those proposed.

Question 7 – Reimbursements

Do you agree with the proposed amendment to the recognition requirements for reimbursements? If not, why not? What recognition requirements would you propose and why?

We find the discussion in paragraph 47 hard to follow. We are unconvinced by the analysis into unconditional and conditional rights

Question 8 – Onerous contracts

(a) Do you agree with the proposed amendment that a liability for a contract that becomes onerous as a result of the entity's own actions should be recognised only when the entity has taken that action? If not, when should it be recognised and why?

Yes.

(b) Do you agree with the additional guidance for clarifying the measurement of a liability for an onerous operating lease? If not, why not? How would you measure the liability?

Yes.

(c) If you do not agree, would you be prepared to accept the amendments to achieve convergence?

Question 9 – Restructuring provisions

(a) Do you agree that a liability for each cost associated with a restructuring should be recognised when the entity has a liability for that cost, in contrast to the current approach of recognising at a specified point a single liability for all of the costs associated with the restructuring? If not, why not?

Yes.

(b) Is the guidance for applying the Standard's principles to costs associated with a restructuring appropriate? If not, why not? Is it sufficient? If not, what other guidance should be added?

Yes.

PROPOSED AMENDMENTS TO IAS 19 EMPLOYEE BENEFITS

Question 1 – Definition of termination benefits

Do you agree with this amendment? If not, how would you characterise such benefits, and why?

Yes.

Question 2 – Recognition of termination benefits

Is recognition of a liability for voluntary and involuntary termination benefits at these points appropriate? If not, when should they be recognised and why?

Yes.

Question 3 – Recognition of involuntary termination benefits that relate to future service

Do you agree with the criteria for determining whether involuntary termination benefits are provided in exchange for future services? If not, why not and what criteria would you propose? In these cases, is recognition of a liability over the future service period appropriate? If not, when should it be recognised and why?

Yes.