LIBA

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10 September2002

Mr. Stephen McEwan
Accounting Standards Board
Holborn Hall
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By email to: fred24@asb.org.uk

Dear Mr. McEwan

Financial Reporting Exposure Draft 24: The Effects of Changes in Foreign Exchange Rates; Financial Reporting in Hyperinflationary Countries

LIBA is pleased to comment on the above exposure draft. LIBA is, as you probably know, the principal UK trade association for investment banks and securities houses, and our members have considerable experience of, and interest in, the reporting of the effects of exchange rate movements under different accounting and reporting regimes. A full list of our members is attached.

Before responding to the detailed proposals, we wish to state an important general view of our members, which is set out in more detail in the attached letter to Allan Cook, that the overriding goal of the current exercise should be to achieve - as nearly as possible - full harmonisation between IAS and UK GAAP. It follows that any differences between the IASB and ASB standards which result, respectively, from IAS 21 and FRED 24 should be kept to the absolute minimum necessary.

The comments below follow the numbering and format of the "Questions for respondents" set out on pages 13-14 of the FRED; our responses to the IASB questions are extracted from our separate letter to the IASB on their Exposure Draft Improvements to International Accounting Standards. Please note that we have not responded to all of the questions.

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

No. While we see both sides of the technical argument in the case of recycling, we do not believe that application of the recycling concept is fundamentally misleading. It has been accepted and adopted by the IASB and the FASB for many years. In our view, this is not an area for departure from L&S that the ASB should be considering.

Of course, the issue is on the agenda at the TASB and if the IASB does indeed ban recycling,! that should be reflected in UK GAAP. Given that companies will not want to alter their accounting twice in the next few years, perhaps the best and most pragmatic way forward is to continue the current UK practice of not recycling but make it clear that the position will be revisited when the IASB completes its deliberations on reporting financial performance.

IASB (i)

Do you agree with the proposed definition of functional currency as "the currency of the primary economic environment in which the entity operates" and the guidance proposed in paragraphs 7-12 on how to determine what is an entity 's functional currency?

Yes. We agree that the definition of functional currency should be based on the concept of "the currency of the primary economic environment in which the entity operates". The changes proposed relating to the definition and guidance provided will harmonize these concepts with those contained in US GAAP (SFAS 52). We find particularly helpful the additional criteria that relate to the determination of the functional currency of a foreign operation. The relationship between an entity and its parent or the rest of its group is particularly important when determining its functional currency and additional factors such as those listed in paragraph 9 become relevant where they would not be for stand alone entities.

IASB (ii)

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

We agree that a reporting entity should be permitted to choose the reporting currency for its financial statements. This choice of a common reporting currency is essential for a group that includes several different individual entities with different functional currencies.

IASB (iii)

Do you agree that all entities should translate their financial statements into the presentation currency (or currencies) using the same method as is required for translating a foreign operation for inclusion in the reporting entity 's financial statements (see paragraphs 37 and 40)?

We agree that all entities within a reporting group should translate their financial statements using the same method. This is an essential element in providing consistent and comparable financial information.

IASB (v)

Do you agree that
(a) goodwill and
(b) fair value adjustments to assets and liabilities

that arise on the acquisition of a foreign operation should be treated as assets and liabilities of the foreign operation and translated at the closing rate (see paragraph 45)?

We disagree. The financial statements of a foreign operation should not be affected by the sale of its shares in the secondary market. This principle is fundamental to the integrity of stand-alone financial statements. These financial statements represent the results of operations and the financial position of the individual company for the period and at period end respectively, and should not be affected by transactions to which it is not a party, such as the sale of its shares. Further we do not believe that it is appropriate to require push-down accounting in a standard on foreign exchange. If the intention was not to require push-down accounting, but only to require translation of the items in (a) and (b) above at the closing rate on consolidation, this differentiation should be made clearer in the text.

We agree that fair value adjustments to assets and liabilities of an acquired foreign operation should be translated at the closing rate. This method ensures that the entire asset is treated consistently and translated at the same rate. Using different rates to translate parts of assets depending of their date of purchase would not lead to financial statement transparency.

However, we disagree with the proposition that goodwill should be translated at the closing rate. Unlike a fair value adjustment, goodwill is not an asset of the entity being acquired. It forms part of the cost of the acquisition and is an asset of the parent. As discussed i13 the Basis for Conclusions, the proposal would be impractical to implement when the acquired has multinational operations and subsidiaries with many functional currencies. The question of how far to 'push down' the goodwill is not merely a theoretical issue but a real concern in practice.

We recommend that the existing choice in IAS 21 remain until the Board has agreed an approach to the issue of push-down accounting in its project on Business Combinations. In our view, to force a change in the name of elimination of a difference in a foreign exchange standard before the issue has been fully considered and debated will lead to confusion both by preparers and users of financial statements.

Other comments on IAS 21

1. Paragraph 30 proposes that exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation should be recognised as income or expense in the separate financial statements of the reporting entity. This treatment seems inequitable if the parent entity is equity accounting for its investment or carrying it at historical cost. (We realise that there are proposals to ban the use of the equity method, but we disagree with these proposals - see our comment in Appendix 4 *(of our 10 September letter to the IASB)* on Paragraph 13A of IAS 27). If the parent accounts using the equity method, its share of the assets and liabilities of the foreign operation will be included in its financial statements at the closing rate and the exchange differences will be reflected in equity whilst the foreign exchange gains or losses on the hedge would be included in the income statement. This seems inappropriate.

In addition, if a reporting entity carries its investment at cost, the portion of the net investment represented by equity shares will remain at the exchange rate at the date of the purchase of the shares but the receivable for which settlement is neither planned nor likely (in substance equity) is revalued to the closing rate through the income statement. This treatment seems inconsistent and ignores the equity-like substance of the receivable.

2. Paragraph *50* proposes that an entity disclose the amount of exchange differences included in profit or loss for the period. Whilst we are not opposed to this disclosure for most foreign exchange gains and losses , we would thaw your attention to the fact that most of our members are dealers in foreign exchange and other financial instruments. Whilst certain gains or losses from dealer transactions include an exchange difference that are required to be recognised in the income statement, we feel that the more appropriate disclosure of such trading gains and losses is to include them in trading revenues rather than group them with dissimilar foreign exchange transaction gains and losses recognised on other non-trading items. This treatment is standard industry practice for broker dealers in the UK and would be consistent with US GAAP (SFAS 52 paragraph 30).

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We would of course be very pleased to elaborate on any or all the views set out above
- either in writing or at an informal meeting — if you would find that helpful.

Yours sincerely

Ian Harrison
Director

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LONDON INVESTMENT BANKING ASSOCIATION LIST OF MEMBERS

Ansbacher & Co Limited
ABN AMRO Bank N.V.
Arbuthnot Latham & Co., Limited
BNP Paribas
Bank Insinger de Beaufort plc
Barclays Capital
Bear, Stearns International Limited
Beeson Gregory Limited
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Mizuho International plc
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Old Mutual
Robert W. Baird Group Limited
Singer & Friedlander Limited
Société Générale
3i Group plc
The Toronto-Dominion Bank
UBS Warburg
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10 September 2002

Allan Cook Esq CBE
Accounting Standards Board
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By email to: a.cook@asb.org.uk

Dear Allan

Current FREDs and the ASB programme of convergence with IFRS

I am writing to express a general LIBA concern about one aspect of the ASB programme to bring about convergence between UK Accounting Standards and International Financial Reporting Standards. This concern has been highlighted by our current work on preparing responses to the IASB Improvements Project Exposure Draft, to the proposed amendments to IAS 32 and IAS 39, and to certain of the related FREDs.

A recurrent topic in the course of our discussions on these various exposure drafts is a worry that we appear to risk ending up with an unnecessarily large number of differences between the amended IAS/IFRS and the amended UK FRS.

While we share a number of the ASB's reservations on aspects of the IASB proposals, we would stress that we believe the overriding objective of the ASB 's current programme should be to achieve - as nearly as possible - full convergence between UK GAAP and IAS.

We would, for example, strongly support the approach taken by the ASB in its efforts to simplify hedge accounting, which we believe offers a way to achieve a significant improvement to IAS 39. We presume you will be making representations to the IASB to encourage them to adopt this approach in their current revision of IAS 39, and very much hope that you - and others expressing similar views - will be able to persuade them to accept this change. Should this pressure be unsuccessful, however, we would have considerable difficulty in supporting an ASB standard which conflicted with the revised IAS 39, in whatever form it finally emerges. <u>In the final analysis we would regard a UK standard which is consistent with an inherently unsatisfactory IAS as a lesser evil than an inherently better UK standard which is incomp atible with such an IAS.</u>

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A closely related point is that we think the ASB should wherever possible avoid proposing FRS which contain slight differences from the corresponding IASB proposals. Such small changes risk creating a 'UK version of IAS which, if not defeating the purpose of harmonisation entirely, will certainly decrease its benefits. For example, one such 'minor' difference in each standard would result in around 40 differences between IAS as promulgated by the IASB and as applied in the UK.

We recognise that in certain instances it may be appropriate for UK GA AP to require a departure from IAS but we believe this should happen only when application of the published IAS would be inadequate or misleading, or in contravention of UK company law. Given the due process and experience of the IASB, we would expect few such departures to be necessary.

We would of course be very pleased to elaborate on our views - either in writing or at an informal meeting - if you would find that helpful.

With kind regards

Yours sincerely

Ian Harrison
Director