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Paul Ebling
Accounting Standards Board
Holborn Hall
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17 October 2002

Dear Paul,

Fred 30 — Financial Instruments: Disclosure and presentation, Recognition and measurement

On behalf of the Quoted Companies Alliance (QCA) I am writing to comment on the above exposure draft dealing with financial instruments, based on the IASB's recently published proposals for revisions to IAS 32 'Financial Instruments: Disclosure and Presentation' and IAS 32 'Financia l Instruments: Recognition and Measurement'. Our detailed comments are included at Appendix A.

The QCA represents the interests of the smaller quoted companies defined as those outside the FTSE *350* Index, currently therefore companies with market capitalisations of less than some £300 million a constituency of some 2,000 quoted companies.

Overall, we support the decision not to require companies to adopt the fair value accounting requirements and not to adopt the recognition and derecognition requirements of the revised IAS 39. We also share the concerns about IAS 32's presentation requirements, particularly their approach to the classification of capital instruments into liabilities and equity.

We are also very concerned IAS 39's requirements on fair value accounting could be very onerous and costly for our members and we do not believe they will provide enhanced reporting. We believe smaller quoted companies should be exempt from these proposals when implemented and given longer to implement the other proposals in both IAS 32 and 39 (not already adopted as part of FRED 30).

We would also comment that in the transition to IAS there appears to be no recognition of the disproportionate burden that the changes will have for smaller quoted companies. The QCA supports its members' view that the transition to IFRS should involve the minimum of disruption, cost and confusion. We repeat our previous comment that this would not be best achieved by companies continuously changing their reporting basis between 2003 and 2005.

With kind regards.

Yours sincerely,

John Pierce

John Pierce
Chief Executive

FRED 30 - QCA Response Appendix A

(i) Treating IASs 32 and 39 as a package (Appendix III, paragraph 15) The ASB has concluded that it is best to view the requirements in IASs 32 and 39 as a single package of requirements that should, as far as is practicable, be implemented in the UK at a single point in time. Do you share this view?

Yes. However, we believe that smaller companies should have the opportunity to delay implementation until the IASB has issued its own guidance on the adoption of IAS for smaller quoted companies. In addition, The QCA supports its members' view that the transition to IFRS should involve the minimum of disruption, cost and confusion. We do not believe this would not be best achieved by companies continuously changing their reporting basis between 2003 and 2005.

(ii) Implementation in 2004 (Appendix III, paragraphs 17- 20) - Notwithstanding the general approach referred to in (i) above, the ASB is proposing to implement, at a single point in time, some parts of the standards in mandatory form, some in non - mandatory form and some not at all for the time being. At the same time, it is proposing to withdraw FRSs 4 and 13 (and related UITF Abstracts) and keep in place most parts of FRS 5 Do you believe that, in the circumstances, this represents the best possible approach of implementing in the UK the international requirements in this area?

No. As noted above we do not believe that we should adopt standards in a piecemeal manner and the requirements of IAS 39 in particular are complex and will be very onerous for smaller quoted companies.

(iii) Recognition and derecognition (Appendix III, paragraphs 23 - 29) - The FRED proposes that the proposed new IAS 39 approach to recognition and derecognition should not be implemented in the UK at the present time. Instead, when the direction of international convergence on this subject becomes clearer, a further consultation document will be issued. Do you agree with this approach?

Yes. However, as previously noted we believe that smaller quoted companies should be given further exemptions and additional time to implement any proposals.

(iv) Measurement (Appendix III, paragraphs 30-49) The ASB is proposing that, prior to 2005, companies should be required to adopt IAS 39's measurement requirements only if they choose to adopt the fair value accounting rules that will be set out in companies legislation. Entities that do not choose to adopt those rules will not initially be required by UK standards to adopt the measurement requirements at all.

(a) Do you agree with this approach?

Yes. For our members this could be very onerous and costly and we do not believe it will provide enhanced reporting. We believe smaller quoted companies should be exempt from these proposals.

(b) Do you agree that the recycling requirements of IAS 39 should not be implemented in the UK pending completion of the project on reporting financial performance and do you agree with the alternative treatment proposed in the FRED? (Appendix III, paragraphs 50-52)

Yes to the first point and No to the alternative. We are happy with current requirements.

(v) Hedge accounting The ASB is proposing a similar approach to IAS 32's hedge accounting requirements as to its measurement requirements. (Appendix III paragraphs 57-63, 69 and 70)

(a) Do you agree with this approach?

No. Whilst this may have limited impact on our members adoption will require additional documentation that could prove onerous.

(b) Do you agree with the approach being proposed in place of recycling? (Appendix III paragraphs 64-68)

No. Again this may have limited impact on our members but could be onerous for those who have to adopt.

(vi) Unlisted entities and individual financial statements

(a) The FRED proposes that, prior to 2005, entities should be required to comply with IAS 39's measurement and hedge accounting pro visions in certain circumstances only. That will change in 2005 for the consolidated financial statements of listed entities but, the FRED suggests, not for other entities or other types of financial statement Thus, from 2005 listed entities that do not prepare consolidated financial statements and unlisted entities will not be required to adopt IAS 39's measurement and hedge accounting provisions unless they choose to adopt the fair value accounting rules set out in the Companies Act 1985. Similarly, listed entities that prepare consolidated financial statements will not be required to adopt IAS 39's measurement and hedge accounting provisions in their individual financial statements unless they adopt the fair value accounting rules in those financial statements. Do you agree with this approach?

Yes.

(b) FRS 13 disclosure requirements apply only to entities, other than insurance entities, that are listed or have publicly traded securities and all banks. The ASB is proposing to revise the disclosure requirements on 1 January 2004 and to apply those new requirements to all listed entities, all other entities that have publicly traded securities and all banks (in other words, the exemption for listed insurance entities will be removed, but otherwise the scope will be unchanged). Do you agree with this approach or do you believe that, from 2004, the requirements should apply to some other entities (for example, unlisted insurance companies) or, alternatively, to a narrower range of entities?

No. We believe that smaller listed entities should be exempted from some of the more onerous disclosure requirements, particularly in relation to fair value disclosure.

(c) FRS 13's disclosure requirements apply both to consolidated financial statements and to individual financial statements, except that they do not need to be applied in the individual financial statements of entities that are preparing FRS 13- compliant consolidated financial statements. The FRED proposes to retain a similar exemption. Do you agree with this approach?

Yes.

IAS 32 (i) Probabilities of different manners of settlement (paragraphs 19, 22, and 22A) Do you agree that the classification of a financial instrument as a liability or as equity in accordance with the substance of the contractual arrangements should be made without regard to probabilities of different manners of settlement? The proposed amendments eliminate the notion in paragraph 22 that an instrument that the issuer is economically compelled to redeem because of a contractually accelerating dividend should be classified as a financial liability. In addition, the proposed amendments require a financial instrument that the issuer could be required to settle by delivering cash or other financial assets, depending on the occurrence or nonoccurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder of the instrument, to be classified as a financial liability, irrespective of the probability of those events or circumstances occurring (paragraph 22A).

No. We believe that the current treatment of preference stock is appropriate.

IAS 32 (ii) Separation of liability and equity elements (paragraphs 28 and 29) - Do you agree that the options in IAS 32 for an issuer to measure the liability element of a compound financial instrument initially either as a residual amount after separating the equity element or based on a relative -fair - value method should be eliminated and, instead, any asset and liability elements should be separated and measured first and then the residual assigned to the equity element?

No. We believe that separating the elements is judgemental and will be too onerous for our members.

IAS 32 (iii) Classification of derivatives that relate to an entity's own shares (paragraphs 29C 29G) Do you agree with the guidance proposed about the classification of derivatives that relate to an entity's own shares?

Yes

IAS 32 (iv) Consolidation of the text in IAS 32 and IAS 39 into one comprehensive Standard Do you believe it would be useful to integrate the text in IAS 32 and IAS 39 into one comprehensive Standard on the accounting for financial instruments? (Although the IASB Board is not proposing such a change in this Exposure Draft, it may consider this possibility in finalising the revised Standards.)

We are not convinced of the benefit.

IAS 39(i) Scope: loan commitments (paragraph 1(i)) Do you agree that a loan commitment that cannot be settled net and the entity does not designate as held for trading should be excluded from the scope of IAS 39?

Yes.

IAS 39 (ii) Derecognition: continuing involvement approach (Appendix I, paragraphs 35-57) Do you agree that the proposed continuing involvement approach should be established as the principle for derecognition of financial assets under IAS 39? If not, what approach would you propose?

No. These proposals are too complicated

IAS 39 (iii) Derecognition: pass through arrangements (Appendix I, paragraph 41) Do you agree that assets transferred underpass - through arrangements where the cash flows are passed through from one entity to another (such as from a special purpose entity to an investor) should qualify for derecognition based on the conditions set out in paragraph 41 of the Exposure Draft?

Yes

IAS 39 (iv) Measurement: fair value designation (paragraph 10) Do you agree that an entity should be permitted to designate any financial instrument irrevocably at initial recognition as an instrument that is measured at fair value with changes in fair value recognised in profit or loss?

Yes. However, we believe that this will be too onerous for our members and may lead to inconsistent treatment.

IAS 39 (v) Fair value measurement considerations (paragraphs 95— 100D) Do you agree with the requirements about how to determine fair values that have been included in paragraphs 95- 100D of the Exposure Draft? Additional guidance is included in paragraphs A32 — A42 of Appendix A. Do you have any suggestions for additional requirements or guidance?

No. We believe that the fair value considerations are too complex for our members

IAS 39 (vi) Collective evaluation of impairment (paragraph 112 and 113(a) 113(d)) Do you agree that a loan asset or other financial asset measured at amortised cost that has been individually assessed for impairment and found not to be individually impaired should be included in a group of assets with similar credit risk characteristics that are collectively evaluated for impairment? Do you agree with the methodology for measuring such impairment in paragraphs 113A - 113D?

No.

IAS 39 (vii) Impairment of investments in available-for-sale financial assets (paragraphs 117— 119) - Do you agree that impairment losses for investments in debt and equity instruments that are classified as available for sale should not be reversed?

Yes.

IAS 39 (viii) Hedges of firm commitments (paragraphs 137 and 140) **Do you agree that a hedge of an unrecognised firm commitment (a fair value exposure) should be accounted for as a fair value hedge instead of a cash flow hedge as it is at present?**

No.

IAS 39 (ix) 'Basis adjustments' (paragraph 160) Do you agree that when a hedged forecast transaction results in an asset or liability, the cumulative gain or loss that had previously been recognised directly in equity should remain in equity and be released from equity consistently with the reporting of gains or losses on the hedged asset or liability?

Yes.

IAS 39 (x) Prior derecognition transactions (paragraph 1 71B) Do you agree that a financial asset that was derecognised under the previous derecognition requirements in IAS 39 should be recognised as a financial asset on transition to the revised Standard if the asset would not have been derecognised under the revised derecognition requirements (ie that prior derecognition transactions should not be grandfathered)? Alternatively, should prior derecognition transactions be grandfathered and disclosure be required of the balances that would have been recognised had the new requirements been applied?

Prior derecognition transactions should be grandfathered.