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Paul Ebling
Accounting Standards Board
Holborn Hall
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18 October 2002

Dear Mr. Ebling

Financial Instruments: Disclosure and Presentation & Recognition and Measurement (FRED3O)

We have reviewed the exposure draft, issued in June this year following the issue of an exposure draft by the International Accounting Standards Board (IASB) proposing amendments to IAS32, Financial Instruments: Disclosure and Presentation and IAS39, Financial Instruments : Recognition and Measurement.

We have attached our responses to the questions for which comments were requested. As you will see from these responses we are not in agreement with a number of both the Board's and the IASB's proposals. We are concerned about proposals to introduce accounting standards, such as IAS32 and IAS39 whose requirements result in conflict with the manner in which companies operate their business. In particular, in the case of IAS39, our concern centres on the reporting volatility which can occur and which may not reflect the substance of the reporting entity's risk strategies. We have also added comments on two additional matters.

As you will have gathered from our response last month regarding the IASB's Improvements Project, we are concerned about the Board's approach to the timing of the introduction of changes to incorporate international standards into UK GAAP. The proposals set out in FRED3O d, nothing to alleviate our concern; indeed it would seem that they will increase, given that the Board is proposing to introduce with effect from 1 January 2004 the following:

- the entire requirements of the revised IAS32 for all listed entities and all other banks;
- the presentation but not the disclosure requirements of the revised IAS32 for all other unlisted entities; and
- the requirements of the revised IAS39, excluding those relating to recognition and derecognition, for those entities that choose to adopt fair value accounting in preparing their financial statements.

In paragraph 15 of Appendix III of the exposure draft, it is stated that piecemeal implementation in the UK of IAS32 and IAS39 would result in accounting for financial instruments being in a state of almost constant flux for the next few years. While better than that scenario, we still fail to see how the above proposals avoid creating similar confusion for preparers and users.

We believe that it is recognised by many parties, including the Board itself, that the existing international standards on financial instruments, particularly IAS39 are complex and controversial and would benefit from further revision and simplification over and above the current proposals. We believe that concerted efforts should be made to resolve as many of these differences as soon as possible. However to the extent they cannot be agreed by end 2003, then any fundamental changes should only be mandatory after 2005.

We strongly suggest that no change should be made to the UK' s existing requirements in relation to financial instruments before 2005 and that there should be a determined effort by the Board (and other standard setters) to work with the IASB to produce a set of requirements that are more likely to gain acceptance with the relevant interested parties.

Another area concerns the proposals for hedge accounting. We share the concerns expressed by EFRAG in their initial views on the IASB proposals which they issued for comment in July this year. We agree that the IASB approach to hedge accounting is too complicated and detailed and should be simplified. Gains and losses arising on the hedged item should be offset, as far as possible, in the same performance statement and reporting period as those relating to the hedging instrument.

However, it seems to us that an approach such as that proposed by EFRAG does require the use of recycling. We acknowledge that the Board is strongly opposed to recycling but we believe that in some cases recycling is necessary to provide more relevant and helpful disclosure. We believe that the Board's alternative, for example, in the case of cash flow hedges (of creating "assets" and "liabilities" described as 'gains and losses arising on effective cash flow hedges not yet recognised in the profit and loss account') extremely difficult to justify. As the Board has noted in FRED3O, the current project on reporting financial performance may result in the international prohibition of recycling. However in the meantime we remain convinced that recycling is appropriate in some circumstances.

One other issue that we would like to mention concerns the question of materiality. We note that the IASB no longer includes an opening paragraph to its standards which contained a sentence that said that international standards were not intended to apply to immaterial items and made reference to a statement in the IASB' s preface. We also understand that the IASB removed the statement in the preface subsequent to exposing a revised version for comment earlier this year. We believe that such a statement is a useful addition to accounting standards and suggest that the Board should include a standard opening paragraph, along similar lines to that previously used by the IASB, in UK standards. We also believe that the JASB should be asked to reconsider its stance on this subject.

In conclusion we believe that the Board should reconsider its approach to the introduction of the requirements of IAS32 and IAS39 into UK GAAP. As the Board has itself said, implementation of these requirements in their entirety in 2005 has the advantage of simplicity and would not impact significantly on the comparability of information between entities. If the Board is concerned about such a delay, then it can continue with its usual practice of encouraging early adoption.

We believe that the delay will allow time for national standard setters to work with the IASB to bring about changes to the requirements that will hopefully deal with the inconsistencies of existing approaches to recognition and derecognition and simplify hedge accounting. However, given the need to ensure sufficient time for preparers to amend systems, the IASB should be encouraged to avoid bringing in changes after the end of 2003, in the run-up to implementation in 2005.

We hope that you find our comments useful and thank you for giving us the opportunity to comment on the Board's proposals.

Yours faithfully

D C POTTER
Head of Finance and Accounting