14 October2002

Paul Ebling
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
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Our ref: ASB responses
Direct line: 01635 677737

Dear Mr Ebling

FRED 30, "FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION. RECOGNITION AND MEASUREMENT"

We refer to FRED 30, "Financial Instruments: Disclosure and Presentation. Recognition and Measurement" issued by the ASB during June 2Q02 and on which comments were invited by 14 October 2002.

Vodafone Group Plc is listed on Stock Exchanges in London, Frankfurt and New York, with a significant overseas shareholder base. We presently prepare our published accounts using UK GAAP but with a reconciliation to US GAAP for profit and loss and balance sheet items and prepare a combined Annual Report and Accounts & Form 20-F to cover both our UK and US statutory filing obligations. We believe there is a compelling case for international harmonisation of accounting standards and welcome the ASB's efforts to assist in the convergence process in the run up to 2005.

Our responses to the detailed questions on which you and the IASB have collectively invited comment are set out in the attached Appendix, however, there are two issues that we would like to bring to your attention regarding the methods for determining hedge effectiveness and the rules in respect of netting, as described below:

i) Short cut method of measuring hedge effectiveness

We strongly object to the requirement to measure both the underlying transaction and the hedging transaction in determining hedge effectiveness and believe that the 'shortcut method' principles from U.S. accounting standard SFASI 33, "Accounting for derivative instruments and hedging activities" should form part of the text of IAS39. Under this method the change in fair value of the hedged item is assumed to be equal to the change in fair value of the hedging instrument the hedge is deemed to be 100% effective. Having the ability to make such assumptions avoids the onerous requirements of ongoing effectiveness testing and the requirement to separately calculate fair values for both the hedged item and the hedge itself.

Our conclusion is based on the belief that where the terms of the hedging instrument and the underlying asset or liability are the same, the changes in fair value or cash flows attributable to the risk being hedged are completely offset at inception and on an ongoing basis. For example, interest rate swaps are often on identical terms to the underlying asset, liability or position being

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hedged i.e. interest rate, principal amounts and maturity are completely matched. In these situations, we can see no merit in the requirement to fair value both the underlying item and the swap.

ii) *Netting*

We have two concerns with the netting requirements of FRED30 - a) the use of central treasury netting and b) Exposure netting. In respect of (a) we believe that, where Groups operate with a central treasury function and undertake hedging transactions centrally, such transactions should still qualify for hedge accounting.

In respect of (b), the aggregation of internal exposures into one overall exposure which is then the subject of an external transaction is undertaken for administrative efficiency and does not alter the purpose of the transaction which is to hedge the Group's exposure to risk. As an example, a Group with an asset valued at 100 and a liability valued at 80 should be permitted to undertake a hedge to the value of 20, rather than two distinct hedges of 100 and 80, respectively.

Yours sincerely

G D Bacon BSc, ACA, MBA, FCT
Group Treasurer

Questions for respondents

30 **The ASB would particularly welcome comments on the following issues:**

ASB (i) *Treating IASs 32 and 39 as a package (Appendix Ill, 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?

Agree. One standard will be preferable to save time on implementation and ensure that adoption dates are aligned, and would also allow time for further debate and consultation on the issues raised by IASs 32 and 39 and work towards single step implementation. However, if the IAS decide to publish two standards, then the ASB should also publish separate documents.

ASB (ii) *Implementation in 2004 (Appendix Ill, paragraphs* 17-20)-Notwithstanding the general approach referred to in (1) 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. We believe that the UK's best interests are served by adopting the approach that achieves full convergence with IAS, We do not want to be faced with a situation of keeping records under three sets of GAAP (UK,US and IAS), especially where the replacement GAAP only does not deal fully with aspects of current GAAP.

ASB (iii) *Recognition and derecognition (Appendix Ill, 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. We would prefer the UK to wait until the IAS position becomes clearer so that we may achieve full convergence without any need for transitional measures. However, notwithstanding the delay in implementing a UK standard, sufficient time should be allowed to consider implications and embed its requirements into processes.

ASB (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.

(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)***

We agree that it is in our interests to defer implementation pending an outcome from a separate convergence issue however, if the IAS settle in favour of recycling, we believe the UK should adopt those provisions in order to achieve full convergence.

We also agree with the proposed alternative where the reporting framework requires the use and publication of a STRGL as we can see no logic to reporting a number in the profit and loss account that has already been presented in another primary financial statement.

ASB (v) ***Hedge*** **accounting—The ASB is proposing a similar approach to IAS 39's hedge accounting requirements as to its measurement requirements.** ***(Appendix III, paragraphs 57-63, 69 and 70)***

(a) Do you agree with this approach?

Yes.

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

Yes.

ASB (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 provisions 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's 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?

Agree with approach.

(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.

31 The ASB would also welcome comments on the questions that the IASB has asked in its exposure draft, which are as follows:[1]

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 non-occurrence 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).

We disagree with the proposal to classify such items as financial liabilities without regard for the probability of the event or circumstance occurring. We would prefer the option for management to exercise judgement in determining whether or not an item should be included in the financial statements, backed up with adequate disclosure. This would avoid distorting the financial statements with the inclusion of items the occurrence of which is considered extremely remote.

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

1 In this paragraph, the references to paragraphs in IAS 32 are references to paragraphs in the proposed standard on disclosure and presentation (before ASB amendments). The references to paragraphs in IAS 39 are references to paragraphs in the proposed standard on measurement (before ASB amendments) and the paragraphs in Appendix I of the FRED.

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?

We agree with the proposal to eliminate the options in IAS 32 and value the equity portion of a compound financial instrument as the residual.

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 would prefer the text on financial instruments to be integrated into one comprehensive standard as this would be easier to review and implement upon first adoption, and be easier to reference going forward.

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 1, para graphs 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?

Whilst we agree in principle with the continuing involvement approach as described in paragraphs 35-57, we await the outcome of further consultation between the IASB and ASB as the direction of international convergence on this subject becomes clearer.

IAS 39 (iii) Derecognition: pass-through arrangements (Appendix 1, paragraph 41)— Do you agree that assets transferred under pass-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.

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?**
Agree with the requirements.

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?**
Yes.

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?**[2]
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?
Yes. However, we believe that this is only feasible with the ability to use the shortcut method (see covering memo) of valuation as the initial and ongoing testing and documentation requirements will prove extremely difficult to fully comply with, particularly in connection with the unrecognised commitment, and will therefore prevent hedge accounting techniques from being applied even though the transaction is economically hedged.

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

2 Note: The FRED proposes that IAS 39, paragraphs 117-119 should be amended for implementation in the UK in 2004 so that no losses on an available-for-sale financial asset will be reversed.

released from equity consistently with the reporting of gains or losses on the hedged asset or liability?[3]

Yes. Subject to consensus view on recycling of gains and losses.

IAS 39 (x) ***Prior derecognition transactions (paragraph 171B)—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?**[4]

We prefer the latter proposal involving the grandfathering of prior transactions except for the requirement to provide disclosure as if the requirements had been applied retrospectively as we believe the costs incurred in providing such disclosure would not be outweighed by the benefits.

Respondents commenting on aspects of the international standards on which the proposed UK standards are based should note the following introductory comments made by the IASB in its exposure draft:[5]

"2 The objective of the proposed amendments is to improve the existing requirements in IAS 32 and IAS 39. These amendments deal with issues identified by audit firms, national standard-setters, regulators, or others, and other issues identified in the IAS 39 implementation guidance process or by IASB staff.

3 The Board does not intend to reconsider at this time the fundamental approach to the accounting for financial instruments established by IAS 32 and IAS 39. Some of the complexity in those Standards is inevitable in a mixed-attribute model based in part on intent and given the complexity of finance concepts and valuation issues. The Board expects that the proposed amendments will reduce some of the complexity by clarifying and adding guidance, eliminating internal inconsistencies, and incorporating into the Standards key elements of existing Standing Interpretations Committee (SIC) Interpretations and IAS 39-Implementation guidance.

4 The Board will continue its consideration of issues related to the accounting for financial instruments. It expects, however, that the basic principles in the improved IAS 32 and IAS 39, once finalised, will be in place for a considerable period."

"7 As noted above, the Board is not considering changes to the basic principles in IAS 32 and IAS 39 at this time. Therefore, the Board is not requesting comments on matters relating to the basic principles for which no changes have been proposed

3 Note: The FRED proposes that IAS 39, paragraph 160 should be amended for implementation in the UK in 2004 so that such gains and losses are reported amongst assets and liabilities on the balance sheet rather than in equity.

4 Note: The FRED proposes that IAS 39, paragraph 171B should be deleted for implementation in the UK in 2004.

5 These comments, which are not repeated elsewhere in the FRED, are contained in the IASB's

To summarise, the objective of the IASB's current work is to improve the existing requirements in IAS 32 and IAS 39 without carrying out a fundamental review of the standards. For that reason, the extent of the changes that the IASB is inclined to make to the two standards at this time is somewhat limited. Respondents should bear this in mind if suggesting changes not proposed by the IASB.