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International Accounting Standards Board
30 Cannon Street
London
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For the attention of: Ms Sandra Thompson

Exposure Draft: Amendments to IAS 39 Financial Instruments: Recognition and Measurement Cash Flow Hedge Accounting for Forecast Intragroup Transactions

The global organisation of Ernst & Young is pleased to submit its comments on the Exposure Draft: ("the ED") *Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement, Cash Flow Hedge Accounting of Forecast Intragroup Transactions*. In summary, Ernst & Young supports the ability to designate a highly probable forecast transaction that will result in a foreign currency exposure to a consolidated group as a hedged item. However, while we support the proposal in the ED as a pragmatic solution, we have particular concerns about the introduction of the notion of "group presentation currency", which we regard as having limited conceptual merit, and transition issues, which in our view should be addressed prior to issuance of a final Standard.

Our responses to the specific questions posed in the ED are set out in the appendix to this letter.

Should you wish to discuss this letter with us, please contact David Lindsell on 020 7980 0106 or Tony Clifford on 020 7951 2250.

Yours faithfully

Ernst & Young

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Appendix: Responses to specific questions:

QUESTION 1

Do you agree with the proposals in this Exposure Draft? If not, why not? What changes do you propose and why?

Until IAS 39 was revised, IGC question 137-14 – *Forecasted intra-group foreign currency transactions that will affect consolidated net income,* permitted an intragroup forecast transaction to be designated as a hedged item for a foreign currency hedge. This IGC was deleted when IAS 39 was revised in December 2003. The ED permits an entity, in its consolidated financial statements, to designate as the hedged item in a foreign currency cash flow hedge, a highly probable forecast transaction with a party external to the group, provided that the transaction is denominated in a currency other than the group's presentation currency. This designation is permitted even if the forecast external transaction is denominated in the functional currency of the entity (ie, subsidiary or business unit) concerned.

We agree that there is economic merit in permitting hedge accounting for these circumstances and accept the proposals in the ED, as a pragmatic solution, with reservations listed below.

The selection of a group's presentation currency is voluntary and may or may not be the same as the currency into which the net assets and earnings of the group are hedged with the objective of maximising shareholder value (which, typically, is the functional currency of the parent of the group). Also, a group may have different presentation currencies in different sets of accounts that are provided for different purposes (for example a Europe-based entity which normally prepares its financial statements in Euros, may also prepare dollar financial statements for use in the United States). The proposals could result in a particular hedge relationship qualifying in one set of financial statements and, perhaps, not qualifying in another set of financial statements, just because of the different presentation currency.

As a result, we do not believe the ED should refer to the group presentation currency but instead should refer to the currency in which shareholder value is maximised and into which the net assets and earnings of the group are hedged.

However, there will be situations where entities will not be able to achieve the hedge accounting that they would have used under Question 137-14, viz. when a forecast intra-group transaction is highly probable but a forecast external transaction is not. Accordingly, we are not certain that the ED will "broadly achieve the same accounting result" as noted in paragraph BC10 of the ED.

We have concerns about the transition issues for those entities already reporting under IAS 39. The withdrawal of Question 137-14 during the final drafting of IAS 39 (Revised 2003) means that it is, currently, not possible to hedge forecast intragroup transactions. Presumably any hedge accounting for such transactions will need to be retrospectively reversed with the introduction of IAS 39 (Revised 2003). It will be possible to hedge a highly probable external transaction, but it is not possible to designate a hedge retroactively (IAS 39 paragraphs 88(a) and 104). This would result in hedge accounting only beginning from the moment of redesignation, and past hedge accounting will need to be eliminated. This will be a particular problem for entities that have implemented IAS 39 (Revised 2003) early, since it will affect the determination of profit or loss for 2004.

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Should the IASB decide to issue these proposed amendments in their current form, we recommend that special transition rules are introduced which address this transition issue.

QUESTION 2

Do the proposals contained in this Exposure Draft appropriately address the concerns set out in paragraph 3 of the Background on this Exposure Draft? If not, why not and how would you address these concepts?

We have set out a number of practical issues with the ED proposals in response to question 1, above.

QUESTION 3

Do you have any other comments on the proposals?

We urge the Board to finalise this (and other outstanding IAS 39 amendments) prior to 31 December 2004 so that entities may take advantage of applicable first-time adoption provisions in their 2004 financial statements.