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8 October 2004

Dear Sandra

ED: Cash Flow Hedge Accounting of Forecast Intragroup Transactions

1. With a membership of in excess of 37,000, the London Society of Chartered Accountants (LSCA) is the largest of the regional bodies that form the Institute of Chartered Accountants in England & Wales. London members, like those of the Institute as a whole, work in practice or in business. The London Society operates a wide range of specialist committees including Technical (accounting and auditing), Tax, Regulation and Ethics Review and Financial Services and Insolvency, which scrutinise and make representations to issuing bodies such as yourselves.

2. We are pleased to have the opportunity to comment on the IASB's proposals in relation to this issue.

Overall comments

3. We agree that the issues presented by the deletion in IAS 39 (revised 2003) of the exception given in IGC 137-14 need to be addressed. In particular we agree that clarity is needed on how IAS 39 (revised 2003) should be interpreted for forecast

intragroup transactions and we commend the intention to minimise IFRS/US GAAP differences. However we do not agree that the proposed approach addresses these concerns. Furthermore we have additional concerns that arise from the methodology and rationale proposed in the exposure draft.

4. IGC 137-14 permitted the hedging of forecast intragroup transactions providing the intragroup transaction resulted in the recognition of an intragroup monetary item for which exchange differences are not fully eliminated on consolidation. We do not necessarily agree with reinstating this exception on the grounds that this requirement does not reflect the economic exposure being hedged in a cash flow hedge – the variability in cash flows arising from foreign currency movements from the date on which the hedge is designated. Furthermore this requirement in IGC 137-14 presents a US GAAP difference.

5. Under US GAAP, 'SFAS 133, Accounting for derivative instruments and hedging activities' permits the designation of intragroup forecast transactions as a hedged item in a cash flow hedge in consolidated as well as individual financial statements. As a result under US GAAP cash flow hedging can only be applied where there is an economic exposure which meets the definition of a cash flow hedge i.e. where the hedged transaction is denominated in a currency other than the functional currency of the entity entering into the transaction. In our view the simple solution suggested in BC6, to extend the current exception in paragraph 80 of IAS 39 (revised 2003) to highly probable forecast intragroup transactions without the requirement for a corresponding external exposure, would address the concerns expressed by constituents in BC4 and would not lead to the additional issues we raise below.

6. The additional issues we see arising from the proposed solution in the exposure draft are as follows:

   a. The method proposed in the exposure draft extends cash flow hedge accounting to certain intragroup forecast transactions where the individual entity does not have an economic exposure, to variability in cash flows arising from foreign currency movements, but has an accounting exposure arising from selection of the group's presentation currency. As a result it would be possible for an entity to obtain cash flow hedge accounting for forecast transactions, in the absence of economic exposure, by changing its presentation currency. This treatment of the group's presentation currency as if it were a functional currency conflicts with the requirements set out in IAS 21 (revised 2003).

   b. The linking of intragroup exposures in the individual entity to external transactions does not reflect the economic reality of companies hedging policies in practice. The methodology set out in the exposure draft requires the creation of an artificial audit trail and linking of transactions.

These additional issues, along with the fact that the original concerns leading to the proposed amendment are not addressed, lead us to disagree with the methodology proposed in the exposure draft.

Response to specific questions

Question 1 – Do you agree with the proposals in this Exposure Draft? If not, why not? What changes to you propose and why?

7. As set out in paragraphs 3-6 above we agree that an amendment to IAS 39 (revised 2003) should be made, but we do not agree with the approach proposed in the exposure draft. Our proposed changes are as set out in paragraph 5 above.

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 concerns?

8. As set out in paragraphs 3-6 above we agree that an amendment to IAS 39 (revised 2003) should be made, but we do not agree with the approach proposed in the exposure draft. Our proposed changes are as set out in paragraph 5 above.

Question 3 – Do you have any other comments on the proposals?

9. We have no other additional comments on the proposals other than those set out in paragraphs 3-6 above.

We hope that you have found our comments helpful. Should you wish to discuss them further please contact me at the address above or on 020 7466 2686.

Yours sincerely

Kathryn Cearns
Chairman
LSCA Technical Committee