LIBA

LONDON INVESTMENT BANKING ASSOCIATION
6 Frederick's Place, London, EC2R 8BT
Tel: 020 7796 3606 Fax: 020 7796 4345
E-mail: liba@liba.org.uk Website: www.liba.org.uk
Direct: 020 7367 5507 Email: ian.harrison@liba.org.uk

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International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

By email to: CommentLetters@iasb.org.uk

Dear Sir

Exposure Draft of Proposed
Improvements to International Accounting Standards

I am writing on behalf of LIBA (the London Investment Banking Association) to comment on five of the proposed standards in the above Exposure Draft. LIBA is, as you probably know, the principal UK trade association for investment banks and securities houses; a full list of our members is attached.

LIBA members take a great interest in the development of International Financial Reporting Standards, and we are therefore very pleased to have the opportunity to comment on this important Exposure Draft.

Our detailed comments (which relate to IAS 1, 21, 24, 27 and 28) are set out in the Appendices to this letter. Please note that we have in general followed the structure of the Questions set out in the "Invitation to Comment" section of each standard. We have however not responded to all of these Questions and have in some cases added further comments which are not specific to any particular Question.

We would add to these one important general comment. We believe IFRS should wherever relevant be drafted to accommodate the situation where the ultimate parent of an entity reporting under IFRS is itself reporting under a different accounting regime: this will be the case, for example, with many European subsidiaries of US parents once the EU Regulation comes into effect in 2005. This comment would apply, for example, to Paragraph 3 of IAS 24 and to Paragraph 8(d) of IAS 27.

I hope that our comments are helpful. We would of course be very pleased to expand on any particular points if there are aspects which you find unclear, or where you would like further details of our views.

Yours faithfully

Ian Harrison
Director

APPENDIX 1

LONDON INVESTMENT BANKING ASSOCIATION (LIBA): DETAILED COMMENTS ON EXPOSURE DRAFT OF PROPOSED IMPROVEMENTS TO INTERNATIONAL REPORTING STANDARDS

IAS 1 *Presentation of Financial Statements*

Question 1

Do you agree with the proposed approach regarding departure from a requirement of an International Financial Reporting Standard or an Interpretation of an International Financial Reporting Standard to achieve a fair presentation (see proposed paragraphs 13-16)?

We believe that the inclusion of a mechanism to permit, in rare circumstances, an override of accounting standards in order to present transactions or events fairly forms a vital part of an accounting system that is substance rather than rule based. In our view, it would be impossible for an accounting regime to reflect accurately the substance of transactions if preparers are simply given a set of rules to follow slavishly and are not afforded the opportunity to stand back and ensure that the end result reflects the economic reality. One of the principal qualitative characteristics of financial information identified in the Framework is reliability. The Framework explains that faithful representation and substance over form are both important components of reliability. We believe that in certain rare circumstances it would be impossible to deliver a set of fairly presented financial statements derived from a body of accounting literature that does not include a mechanism for an override in order for substance to prevail.

In addition, we feel strongly that it should be made explicit in the text that where an entity invokes this override, it is still in compliance with IFRS. Paragraph 13 *requires* such a departure is made in the rare circumstances described. Therefore, if an entity did not depart from the standards, it would not be in compliance with IFRS. It would be unfortunate if an entity suffered any negative consequences from financial statement users as a result of application of this paragraph in an effort to reflect faithfully the transactions undertaken. Inclusion in IAS 1 of a statement to the effect that departing from a standard, in the proper circumstances and if properly disclosed, results in compliance with IFRS would also be likely to help ease concerns of regulators or other bodies who might require financial statements prepared in accordance with IFRS.

However, we are concerned that the disclosure of the quantification of a departure proposed by paragraph 14(d) could be prohibitively expensive in some cases or lead to the disclosure of proprietary or even misleading information in others. Since a departure is only permitted where compliance with a standard would be misleading, by design, disclosure of the amount of the departure cannot provide useful information and may even be dangerous to disclose as it could mislead financial statement users. In addition, this requirement could lead to keeping two sets of records, one in strict accordance with IFRS and one in accordance with the substance of the transactions. The benefit of this extra cost is likely to be difficult, if not impossible, to justify given the misleading nature of the extra information being gathered.

Question 3
Do you agree that a long-term financial liability due to be settled within twelve months of the balance sheet date should be classified as a current liability, even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue (see proposed paragraph 60)?

We disagree for several reasons. First, reliance on the stated maturity date in force at the balance sheet date is not necessarily helpful to users of financial statements in forecasting an entity's cash flows. The proposed approach ignores the substance of the funding structure of certain entities, particularly when maturing long-term debt is replaced with new long-term debt. The understanding of a financial statement user will not be enhanced by classification of such debt as short-term if the entity has refinanced before finalisation of the financial statements, and the debt will be repaid in more than one year. A strict maturity-date approach would deny that these borrowings are sometimes, in substance, long-term financing.

Second, we believe that where negotiations between an entity and a lender are ongoing at the balance sheet date that the outcome of those negotiations should be considered adjusting events under IAS 10. If negotiations to settle a lawsuit were ongoing at the balance sheet date, an entity would estimate its provision for loss on the date that the financial statements are signed. The situation is similar here since negotiations are ongoing regarding the financing structure of the entity at the balance sheet date and if they are resolved before the financial statements are signed, this resolution should be reflected.

Third, we find this change to be out of step with the stated goal of international convergence since it would change an existing IAS which is consistent with US GAAP to an approach which would be inconsistent with US GAAP.

Question 4
Do you agree that:

(a) a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date, even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach (see proposed paragraph 62)?

(b) If a lender was entitled to demand immediate repayment of a loan because the entity breached a condition of its loan agreement, but agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:

(i) the entity rectifies the breach within the period of grace; or

(ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified (see proposed paragraphs 63 and 64)?

We disagree with (a) for the reasons set out above in our answer to Question 3. Additionally, it is often the case that an entity may be unaware that it has breached a financial loan covenant until formal financial statements are prepared. In many cases, these breaches may be considered minor by the lender and relief granted immediately, although after the balance sheet date, since this is when the breach is discovered. It would not seem to add to financial statement transparency to require such borrowings to be treated as current due to a minor breach which the lender does not consider to be material.

Question 5
Do you agree that an entity should disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements (see proposed paragraphs 108 and 109)?

Yes. For a large majority of companies the application of judgement is an inherent part of the business model, and accordingly, such judgements form an underlying part of the financial statements. We therefore believe that a thorough discussion of the areas in which judgements are significant is critical to a user's understanding of the financial statements and to his ability to make informed investment decisions. As a result, we fully support the proposal to require a complete discussion of where and how judgements affect the financial statements.

Question 6
Do you agree that an entity should disclose key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year (see proposed paragraphs 110-115)?

Our views on disclosure of key assumptions used in preparing financial statements are similar to those expressed above on disclosure of judgement areas. We feel that a *qualitative* discussion of key assumptions will improve financial statement transparency. However, we have significant concerns around the proposal for sensitivity analysis.

Paragraph 112(b) states that a sensitivity analysis may be required as part of the discussion of key assumptions. In essence, sensitivity analysis provides financial statement users with a variety of potential outcomes, so that the readers can decide for themselves what net income should be. We believe that such an approach will actually create more confusion among investors as they attempt to determine which set of assumptions are the 'right' ones. This effort could ultimately undermine, rather than enhance, investor confidence in financial reporting.

We note that US SEC registrants currently include some similar types of information regarding risk sensitivities in Management's Discussion and Analysis ("MD&A"), and we do not believe that this information should be moved to the audited financial statements. We feel that the financial statements are not the appropriate vehicle for disclosing this type of information. Including this information in historical, audited financial statements may give the misleading impression that it is as robust as historical information. In fact, the information is fundamentally different, as it is hypothetical in nature – that is, it provides an assessment of the sensitivities of a portfolio to changes in market variables. In contrast, historical financial statements provide a snapshot of an enterprise's performance and position at a specific date.

In the United States, MD&A was developed to allow management to put the historical results in an appropriate context. To permit management to meaningfully discuss the historical information along with its future prospects, certain "safe harbour" laws have been enacted to relieve companies of liability for disclosure of forward-looking information in MD&A if the actual results or trends differ from the forward-looking disclosures. We question why the line between MD&A-type disclosures and those made in the financial statements is now being blurred. This is an unwelcome development, and we encourage the IASB to concentrate on including only historical financial information in the financial statements.

Finally, we strongly support the idea included in paragraph 115 that where another IAS, such as IAS 32 or IAS 37, requires a discussion of key assumptions, those more specific requirements take precedence over the requirements in IAS 1. This is helpful as it removes the possibility of overlapping requirements.

Other comments on IAS 1

1. Paragraph 6 states that a complete set of financial statements includes, *inter alia*, a cash flow statement. IAS 7 sets out the detailed requirements for such a statement. As you may be aware, in the UK there are certain exemptions from preparation of a cash flow statement. One of these is for entities where 90 percent or more of the voting rights are controlled within a group, provided that consolidated financial statements in which the entity is included are publicly available. We think this is a sensible, practical exception that the IASB should adopt. Most groups of a certain size with have a central treasury function that will manage cash and liquidity at a consolidated level rather than at a legal entity level. Therefore, the cash flow statement of an individual legal entity adds little value to a user of financial statements and could potentially even be misleading. Only by looking at the consolidated cash flows will a user have a complete picture of how the group generates and expends its cash. We urge the Board to consider adopting a similar exemption to that contained in UK GAAP.

2. Paragraph 20 states that an entity shall prepare its financial statements under the accrual basis of accounting. We are unsure how this requirement is consistent with certain requirements of IAS 39 and other standards that require or permit a fair value measurement basis of accounting in certain instances.

3. Paragraph 29 states that "items of income and expense shall be offset when, and only when, a Standard requires or permits it". In paragraph 31, netting would be

allowed where this relates to transactions that are "incidental to the main revenue-generating activities" and where a net presentation "reflects the substance of the transaction".

It is established practice within the broker-dealer industry for reimbursed expenses related to advisory fees and the underwriting of securities to be shown on a net basis. These costs are typically passed through to the client with no margin, and we fundamentally oppose the idea that such reimbursed expenses should affect various broker-dealer financial metrics such as revenue growth and compensation-to-revenue ratio. This same issue was considered in November 2001 by the staff of the Financial Accounting Standards Board ('FASB'). In issuing Topic D-103, the FASB staff concurred with comments raised by the industry and specifically scoped out transactions of broker-dealers that are within the scope of the AICPA Audit and Accounting Guide, *Brokers and Dealers in Securities*. Within existing IAS there is no such similar industry specific guidance and IAS 1 as currently drafted would therefore require such reimbursed expenses to be recognised as revenue unless the activity was incidental.

For these reasons we strongly urge the IASB to make specific scope exemptions to the requirements of paragraph 29 where – as with reimbursed expenses for broker-dealers - established industry practice differs from the approach proposed.

4. Paragraph 35 proposes that where the presentation or classification of an item in the financial statements is amended, comparative amounts shall be reclassified unless it would require undue cost or effort. Certain disclosures are also required. We recommend that it be explicitly stated that the disclosures are only made for reclassifications whose effect is material.

5. Paragraphs 50 through 64 appear to have been drafted with corporate rather than financial entities in mind. Broker dealers would have trouble applying either the liquidity presentation or the current/non-current presentation as discussed below.

   Paragraph 54 states that an asset shall be classified as current when it is held primarily for trading purposes. However, the equivalent paragraph addressing current liabilities, paragraph 57, does not include a similar statement for liabilities. This omission is troubling since trading books often include derivatives whose maturity may be longer than twelve months from the balance sheet date. However, given their trading nature, it would seem inequitable to classify such derivative trading liabilities differently from equal but opposite derivative assets that would be classified as current assets. We recommend that paragraph 57 should be amended to include trading liabilities.

   Paragraph 50 would require that whichever presentation method is chosen, where a line item combines items that are expected to be settled within one year and after one year, the amount expected to be settled in more than one year be disclosed. Our trading books appropriately include derivatives and other structured trades that will not be settled within twelve months. Capturing the information to distinguish between the two would be costly and, in our view, given the nature of the items in the trading book, would not lead to better information for the financial statement user. Items in the trading book should be exempt from this requirement.

APPENDIX 2

LONDON INVESTMENT BANKING ASSOCIATION (LIBA): DETAILED COMMENTS ON EXPOSURE DRAFT OF PROPOSED IMPROVEMENTS TO INTERNATIONAL REPORTING STANDARDS

IAS 21 *The Effects of Changes in Foreign Exchange Rates*

Question 1

Do you agree with the proposed definition of functional currency as "the currency of the primary economic environment in which the entity operates" and the guidance proposed in paragraphs 7-12 on how to determine what is an entity's functional currency?

Yes. We agree that the definition of functional currency should be based on the concept of "the currency of the primary economic environment in which the entity operates". The changes proposed relating to the definition and guidance provided will harmonize these concepts with those contained in US GAAP (SFAS 52). We find particularly helpful the additional criteria that relate to the determination of the functional currency of a foreign operation. The relationship between an entity and its parent or the rest of its group is particularly important when determining its functional currency and additional factors such as those listed in paragraph 9 become relevant where they would not be for stand alone entities.

Question 2

Do you agree that a reporting entity (whether a group or a stand-alone entity) should be permitted to present its financial statements in any currency (or currencies) that it chooses?

We agree that a reporting entity should be permitted to choose the reporting currency for its financial statements. This choice of a common reporting currency is essential for a group that includes several different individual entities with different functional currencies.

Question 3

Do you agree that all entities should translate their financial statements into the presentation currency (or currencies) using the same method as is required for translating a foreign operation for inclusion in the reporting entity's financial statements (see paragraphs 37 and 40)?

We agree that all entities within a reporting group should translate their financial statements using the same method. This is an essential element in providing consistent and comparable financial information.

Question 5
Do you agree that
(a) goodwill and
(b) fair value adjustments to assets and liabilities
that arise on the acquisition of a foreign operation should be treated as assets and liabilities of the foreign operation and translated at the closing rate (see paragraph 45)?

We disagree. The financial statements of a foreign operation should not be affected by the sale of its shares in the secondary market. This principle is fundamental to the integrity of stand-alone financial statements. These financial statements represent the results of operations and the financial position of the individual company for the period and at period end respectively, and should not be affected by transactions to which it is not a party, such as the sale of its shares. Further we do not believe that it is appropriate to require push-down accounting in a standard on foreign exchange. If the intention was not to require push-down accounting, but only to require translation of the items in (a) and (b) above at the closing rate on consolidation, this differentiation should be made clearer in the text.

We agree that fair value adjustments to assets and liabilities of an acquired foreign operation should be translated at the closing rate. This method ensures that the entire asset is treated consistently and translated at the same rate. Using different rates to translate parts of assets depending of their date of purchase would not lead to financial statement transparency.

However, we disagree with the proposition that goodwill should be translated at the closing rate. Unlike a fair value adjustment, goodwill is not an asset of the entity being acquired. It forms part of the cost of the acquisition and is an asset of the parent. As discussed in the Basis for Conclusions, the proposal would be impractical to implement when the acquiree has multinational operations and subsidiaries with many functional currencies. The question of how far to 'push down' the goodwill is not merely a theoretical issue but a real concern in practice.

We recommend that the existing choice in IAS 21 remain until the Board has agreed an approach to the issue of push-down accounting in its project on Business Combinations. In our view, to force a change in the name of elimination of a difference in a foreign exchange standard before the issue has been fully considered and debated will lead to confusion both by preparers and users of financial statements.

Other comments on IAS 21

1. Paragraph 30 proposes that exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation should be recognised as income or expense in the separate financial statements of the reporting entity. This treatment seems inequitable if the parent entity is equity accounting for its investment or carrying it at historical cost. (We realise that there are proposals to ban the use of the equity method, but we disagree with these proposals – see our comment in Appendix 4 on Paragraph 13A of IAS 27). If the parent accounts using the equity method, its share of the assets and liabilities of the foreign operation will be included in its financial statements at the closing rate

and the exchange differences will be reflected in equity whilst the foreign exchange gains or losses on the hedge would be included in the income statement. This seems inappropriate.

In addition, if a reporting entity carries its investment at cost, the portion of the net investment represented by equity shares will remain at the exchange rate at the date of the purchase of the shares but the receivable for which settlement is neither planned nor likely (in substance equity) is revalued to the closing rate through the income statement. This treatment seems inconsistent and ignores the equity-like substance of the receivable.

2. Paragraph 50 proposes that an entity disclose the amount of exchange differences included in profit or loss for the period. Whilst we are not opposed to this disclosure for most foreign exchange gains and losses, we would draw your attention to the fact that most of our members are dealers in foreign exchange and other financial instruments. Whilst certain gains or losses from dealer transactions include an exchange difference that are required to be recognised in the income statement, we feel that the more appropriate disclosure of such trading gains and losses is to include them in trading revenues rather than group them with dissimilar foreign exchange transaction gains and losses recognised on other non-trading items. This treatment is standard industry practice for broker dealers in the UK and would be consistent with US GAAP (SFAS 52 paragraph 30).

iwh – 5/9/02

APPENDIX 3

LONDON INVESTMENT BANKING ASSOCIATION (LIBA): DETAILED COMMENTS ON EXPOSURE DRAFT OF PROPOSED IMPROVEMENTS TO INTERNATIONAL REPORTING STANDARDS

IAS 24 *Related Party Disclosures*

Question 1
Do you agree that the Standard should not require disclosure of management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations (see paragraph 2)?

We commend the Board's decision not to require the disclosure of management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations. We recognise that it may be appropriate for listed companies to be required to disclose this type of information, but believe that it should be for the appropriate listing or regulatory authorities, rather than the IASB, to impose any such requirements.

Question 2
Do you agree that the Standard should not require disclosure of related party transactions and outstanding balance in the separate financial statement of a parent or a wholly-owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs (see paragraph 3)?

We support the inclusion of an exemption from disclosure of related party transactions in the financial statements of a parent or subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs.

We also note that the UK Accounting Standards Board's recently issued FRED 25 Related Party Disclosures proposes a requirement to disclose the name of direct and ultimate controlling parties. We consider that this disclosure has merit, as it provides useful information that may otherwise not be available to users of financial statements. For example, a creditor can gain useful information about the creditworthiness of an entity by reviewing the financial statements of its parent or group. This is important where the content of the entity's financial statements is significantly affected by its membership of a wider group, for example where it has utilised the exemption from related party disclosures afforded to members of a wholly-owned group.

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APPENDIX 4

LONDON INVESTMENT BANKING ASSOCIATION (LIBA): DETAILED COMMENTS ON EXPOSURE DRAFT OF PROPOSED IMPROVEMENTS TO INTERNATIONAL REPORTING STANDARDS

IAS 27 *Consolidated and Separate Financial Statements*

Question 1

Do you agree that a preparer need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?

We fully agree that consolidated financial statements should not be required in all situations and we generally support the criteria for exemption stated in paragraph 8. However, we believe the exemption in paragraph 8(d), as currently worded, is too restrictive. When entities are part of a group where the ultimate parent publishes consolidated financial statements under a GAAP other than International Financial Reporting Standards, IAS 27 as currently drafted would require consolidated financial statements to be prepared for all intermediate entities. This requirement would be highly onerous for any complex group and would be of no benefit to the owners. Indeed the Board, in paragraph A6 of the Basis for Conclusions, already recognises the fact that an exemption should be appropriate 'when all the owners are content not to have consolidated financial statements'. We strongly urge the Board to change paragraph 8(d) to include exemption from preparation of consolidated accounts where "the immediate, **an intermediate,** or the ultimate parent publishes consolidated financial statements in accordance with International Financial Reporting Standards".

Question 2

Do you agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity (see paragraph 26)?

We disagree with the Board's proposal to reclassify minority interest to the equity section of the balance sheet. We agree that minority interest does not meet the definition of a liability as defined in the Framework for the Preparation and Presentation of Financial Statements. Although minority interest can be considered as a residual interest in the assets of a group, we do not believe equity classification is appropriate either, as a minority interest does not represent an owner's interest in the consolidated company as a whole. We do not see the benefit that will be accomplished by this proposed change, and indeed believe that it is premature to make this change in advance of considering recognition and measurement as part of Business Combinations phase II. Therefore we urge that the current classification in the mezzanine section should be retained.

Question 3 (first part)
Do you agree that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS39, Financial Instruments: Recognition and Measurement, in the investor's separate financial statements (paragraph 29)?

We welcome the Board's proposal to retain optional accounting treatments for the presentation of investments in the investor's separate financial statements. In some circumstances IAS 39 will best reflect the benefit of the investment to the investee, for example where the investment is expected to be sold, or where the investment is in listed securities and is hedged. In other cases, for example where the return to the investor arises primarily from distributions from the investee, a cost basis is more appropriate. It could also be onerous for many reporting entities to obtain valuations in accordance with IAS 39 and may not be appropriate in situations where, for example, the reporting entity itself is wholly owned.

However, we are disappointed that, despite retaining a choice of accounting as described above, the Board has proposed to remove the option to use equity accounting. In certain situations this is the best reflection of an entity's involvement in its investment, and the removal of the option creates a new difference to US GAAP that we do not believe is justified.

Paragraph 29 also states that 'the same method shall be applied for each category of investments'. We strongly believe that the appropriate accounting treatment should be determined on a case by case basis for each investment rather than for each category. This will enable management to use the most appropriate method to reflect both management intent and expectation of how value will be realised from that specific investment.

Question 3 (second part)
Do you agree that if investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments should be accounted for in the same way in the investor's separate financial statements (paragraph 30)?

This treatment will only apply to subsidiaries, jointly controlled entities and associates that are "acquired and held exclusively with a view to … subsequent disposal". We agree with the logic of adopting the same accounting treatment in the individual financial statements, but note that the treatment envisaged by IAS 27 in this circumstance is to record gains and losses through net income (IAS 27, paragraph 13), which is more restrictive than the treatments proposed by the exposure draft for IAS 39. We recommend deletion of the final phrase in paragraph 13 "at fair value with changes in fair value included in profit or loss for the period of the change". This will allow the same flexibility of treatment that is proposed by the exposure draft for IAS 39.

Other comments on IAS 27:

1. Paragraph 9 requires that, for a parent to be exempt from preparing consolidated financial statements, in addition to complying with the requirements listed in paragraph 8 the entity also does not prepare any other financial statements. There may be various marketing and other customer and relationship reasons which require an entity to prepare additional financial statements under a GAAP different to that under which its primary reporting is prepared. For example, a customer of an entity may request to see financial statements of the entity prepared under US GAAP, although the entity's legally required financials followed IAS. We do not believe that the IASB intended this requirement to cover these situations and suggest changing the wording of paragraph 9 as follows: "The financial statements of such a parent as is described in paragraph 8, and prepared in accordance with paragraphs 29, 30 and 33, are the only financial statements prepared **under International Financial Reporting Standards** for the entity."

2. Paragraph 12B states that "... The existence and effect of potential voting rights that are presently exercisable or presently convertible, including potential voting rights held by another entity, are considered when assessing whether an entity has the power to govern the financial and operating policies of another entity". We disagree with this approach because potential voting rights do not give an enterprise the ability to vote and therefore to govern or significantly influence financial operating policies. Potential voting rights such as those arising from a call option merely provide an indication of what level of control or significant influence *might* be possible in the future. To introduce rules based on uncertain events is inconsistent with the control model and would necessitate subjective judgements on many other factors, including the investor's practical ability to exercise an option and the investor's intentions, which will continually be re evaluated in an ever-changing market. The result would be inconsistent treatment among enterprises. We believe that the current consolidation rules, which look to actual rather than potential voting rights, are clearly understood by users and preparers and will be more consistently applied. Therefore we recommend that the basis for evaluating significant influence continues to rest on an investor's current ability to participate in voting matters.

3. Paragraph 13 states that "a subsidiary shall be excluded from consolidation when control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal within twelve months from acquisition". We believe that the key consideration is the *intention* to dispose of the investment and the addition of a fixed time criterion is both unnecessary and arbitrary. It may also cause companies such as venture capitalists and unit trusts to consolidate certain companies but not others, where the underlying assets are incidental to the investment and completely unrelated to the core businesses of these reporting entities. The accounting treatment for these entities is discussed further below.

4. Paragraph 13A states that "A subsidiary is not excluded from consolidation simply because the investor is a venture capital organisation, mutual fund or similar entity". We believe that this clause, taken with the other criteria in

paragraphs 13 and 14, will result in a requirement for these types of businesses to consolidate some of their investments, rather than carry these investments at fair value. We strongly believe that this will result in the financial statements for these entities being less meaningful to users. The nature of these businesses is that investments are temporary and the objective return to the investor arises through the subsequent resale of the investment. The underlying assets and liabilities in the investments will differ in nature to those of the investor and are not part of the structure through which the investor group operates its business, or gets its intended return on its investment. Including these entities in consolidated accounts is misleading to users and will distort comparability year on year and/or between similar entities. We agree with the IASB (in the IAS 28 Basis for Conclusions, paragraph A4), that "fair value measurement for these entities produces more relevant information". We also note that the IASB concluded (in paragraph A6) that fair value was an appropriate basis for investments in associates "by venture capital organisations ... and similar entities ... when such measurement is well-established practice in the industries involved". It is inconsistent to change a well-established industry practice only for certain types of investment. Finally, we note that the Joint Working Group of Standard Setters, in determining an appropriate valuation basis for private equity investments, specifically excluded "venture capital investment enterprises" from carrying such investments at anything other than fair value (December 2000 consultation paper - paragraph 122).

If, however, the Board decides not to amend the proposals to permit investments made by venture capital organisations, mutual funds, unit trusts and similar entities to be carried at fair value, we urge that it recognise the practical difficulties that firms may encounter in sourcing the necessary historical information, and that application for these entities be required on a prospective basis. Since there was no expectation that consolidation would ever be required for these investments, certain historical information may not be available, or available only at significant cost and effort. It is also unclear how useful the information produced by restating prior periods for the results of investments already disposed of would be to a financial statement user. We therefore ask that, if the Board rejects our call for such investments to be carried at fair value, then adoption for the types of entities referenced above should be made on a prospective basis, rather than by restating previous periods, and that the difference between the carrying amounts before and after the change in accounting policy be recognised as an adjustment of the balance of retained earnings at the beginning of the financial year in which this change is made.

5. Paragraph 19 requires that "the difference between the reporting dates of the subsidiary and the parent shall be no more than three months". The reporting dates for certain entities are driven by a number of factors, including jurisdictional requirements, that are likely to be outside the direct control of the parent. It is totally impractical for an accounting standard to impose such restrictions and the accounting guidance should be restricted to ensuring that the consolidated financial statements include appropriate adjustments for any material changes between the subsidiary's reporting date and the date at which the consolidated financial statements are prepared.

6. Paragraphs 6 and 29B define the cost method and state that "the investor recognises income only to the extent that it receives distributions from the accumulated net profits of the investee arising after the date of acquisition by the investor. Distributions received in excess of such profits are regarded as a recovery of the investment and are recognised as a reduction of the cost of the investment." We believe this approach would be difficult to administer and recommend that a better approach would be to require an evaluation of the carrying value of an investment on receipt of any dividend. This would ensure that any dividend received, which had reduced the net assets of the investee to an amount less than the investor's cost, would be offset in the investor's income statement by an asset impairment charge. The resulting treatment would also be analogous to the way in which dividends received on a trading investment are recorded.

7. Paragraph 32(e) requires disclosure when subsidiary financial statements have been prepared at a different date to that of the consolidated financial statements. Consistent with our comment on paragraph 19 above, we do not understand what benefit this additional disclosure will serve, as the consolidated financial statements should include adjustments for any material differences identified.

8. Paragraph 32(f) proposes that the nature and extent of any restrictions, including regulatory restrictions, on the ability of subsidiaries to transfer funds to the parent be disclosed. We understand the need for such a disclosure and agree that a *qualitative* discussion of such restrictions would improve the transparency of financial reporting. However, we are concerned that the *quantification* of such restrictions will, in the case of regulated financial institutions, lead to the disclosure of regulatory capital. This disclosure is contentious given its proprietary nature and, given the current work on IAS 30 and co-ordination between the IASB and the Basle Committee, we think that such a disclosure requirement is premature. We recommend that the reference to regulatory capital is removed and a reference to the IAS 30 project is inserted.

9. Paragraph 32B requires disclosure of "summarised financial information of subsidiaries that are not consolidated, either individually or in groups, including the amounts of total assets, total liabilities, revenues and profit or loss". We disagree with this disclosure requirement. We believe that it is important that disclosures in financial statements contain relevant information for users, and that the most relevant information for subsidiaries not consolidated because control is temporary is the fair value of the investment under IAS 39.

iwh – 5/9/02

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APPENDIX 5

LONDON INVESTMENT BANKING ASSOCIATION (LIBA): DETAILED COMMENTS ON EXPOSURE DRAFT OF PROPOSED IMPROVEMENTS TO INTERNATIONAL REPORTING STANDARDS

IAS 28 *Accounting for Investments in Associates*

Question 1

Do you agree that IAS 28 and IAS31, Financial Reporting of Interests in Joint Ventures, should not apply to investments that would otherwise be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with IAS39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries (see paragraph 1)?

Consistent with our comments on IAS 27, we agree with these provisions. We fully support the Board's comments (in the Basis for Conclusions, paragraph A4) that "the use of the equity or proportionate consolidation method for investments by venture capital organisations, mutual funds, unit trusts and similar entities often produces information that is not relevant to their management and others and that fair value measurement produces more relevant information".

Question 2

Do you agree that the amount to be reduced to nil when an associate incurs losses should include not only investments in the equity of the associate but also other interests such as long term receivables (paragraph 22)?

We agree with the proposal on the understanding that it only applies to interests that are in substance akin to equity holdings.

Other comments on IAS 28

1. Paragraph 5(a) states that "The existence and effect of potential voting rights ... are considered when assessing whether an entity has the power to have significant influence in the financial and operating policy decisions of the investee". In line with our comments on IAS 27 paragraph 12B in Appendix 4, we strongly disagree that potential voting rights should be included in the evaluation of significant influence.

2. Paragraph 8 states that "an investment in an associate shall be accounted for under the equity method except when the investment is acquired and held exclusively with a view to its subsequent disposal within twelve months from acquisition". We believe, consistent with our comments on proposed revised IAS 27 in Appendix 4, that the use of a fixed twelve-month timeframe is not helpful in determining the relevance of such information for users and that the amendment to 8(a) should not be made.

3. Paragraph 27(b) requires disclosure of "summarised financial information of associates, including the aggregated amounts of assets, liabilities, revenues and profit or loss". Similar to our comments on IAS 27 in Appendix 4, we believe that this information is not as relevant to users as the fair value of investments held for resale under IAS 39.

iwh – 5/9/02

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LONDON INVESTMENT BANKING ASSOCIATION

LIST OF MEMBERS

Ansbacher & Co Limited
ABN AMRO Bank N.V.
Arbuthnot Latham & Co., Limited
BNP Paribas
Bank Insinger de Beaufort plc
Barclays Capital
Bear, Stearns International Limited
Beeson Gregory Limited
Cazenove & Co. Ltd
CIBC World Markets Plc
Citigroup Inc.
Close Brothers Corporate Finance Ltd
Collins Stewart Limited
Commerzbank AG
Credit Suisse First Boston (Europe) Ltd
Daiwa Securities SMBC Europe Limited
Dawnay, Day & Co., Limited
Deutsche Bank AG London
Dresdner Kleinwort Wasserstein
Goldman Sachs International
Greenhill & Co. International LLP
Hawkpoint Partners Limited
HSBC Investment Bank plc
ING Bank N.V.
Instinet Europe Ltd
Investec Bank (UK) Limited
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KBC Peel Hunt Ltd
Lazard
Lehman Brothers
Merrill Lynch Europe PLC
Mizuho International plc
Morgan Stanley International Ltd
Nomura International plc
N M Rothschild & Sons Limited
Old Mutual
Robert W. Baird Group Limited
Singer & Friedlander Limited
Société Générale
3i Group plc
The Toronto-Dominion Bank
UBS Warburg
Westdeutsche Landesbank Girozentrale

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