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Sir David Tweedie
Chairman
International Accounting Standards Board
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Monday, September 16, 2002

Improvements to International Accounting Standards

Sir,

The International Swaps and Derivatives Association (ISDA) appreciates the opportunity to comment on the Exposure Draft of Proposed Improvements to International Accounting Standards.

Our members represent leading participants in the privately negotiated derivatives industry and include most of the world's major financial institutions, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities. As such we believe ISDA brings a unique and broad perspective to the IASB's work on accounting for financial instruments.

We fully support the Board's objectives in the Improvements Project as set out in the Invitation to comment and overall we believe that the IASB has achieved many of its objectives. It has reduced or eliminated many of the alternatives, redundancies and conflicts within existing standards. Notwithstanding this there are a small number of areas where ISDA has particular concerns that we wish to bring to the Board's attention.

Minority Interest (IAS 27.27)

ISDA believes that minority interest is unique in that it does not fit the definition of either a liability or equity. Minority Interest does not represent an obligation that can be settled by the conveyance of an asset nor is it an equity instrument that is residual within the parent entity.

ISDA agrees that in the consolidated accounts the minority interest should be shown separately from the equity of the parent. However, ISDA believes that inclusion in the equity section of the consolidated balance sheet, even though separate from the parent's equity, could be misleading to investors. For example, it could be seen to overstate the residual interest attributable to group shareholders in the group accounts.

ISDA notes that in addition to having potential implications for the recognition and measurement of minority interests mentioned in the proposed basis for conclusions as being under consideration in Phase II of the Business Combinations project, classification as equity may have other implications. For example, calculations of earnings per share figures and the presentation of changes in minority interest within earnings or within equity - as changes in equity amounts are not normally taken in earnings. Finally, it is not clear whether this proposal represents a resolution by the Board to adopt an Economic Entity approach over a Parent Entity approach. Evidence of both approaches is present within IAS. At a minimum, ISDA believes that the additional potential consequences of specifying the classification of minority interests should be resolved prior to proceeding with any change in this area.

ISDA believes that minority interests should be presented in a mezzanine category between the liability and equity sections of the balance sheet.

Private Equity Investment (IAS 27.13A, IAS 28.1 and IAS 31.1)

IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures:

‘do not apply to investments that otherwise would 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 IAS 39, when such measurement is well-established practice in those industries’

However, IAS 27.13A specifically scopes in ‘venture capital organisations, mutual funds, unit trusts or similar entities’ when they are held as subsidiaries. This amendment to IAS 27, along with the change to IAS 27.13 to redefine temporary control as being ‘under one year’, have a significant impact on organisations that

conduct substantial private equity business where they take a majority shareholding. Such investment is for a period of time, frequently three to five years, during which time the business is developed with an eye towards an exit strategy that typically involves a public offering, sale to management or sale to a strategic buyer. At no stage is the intention to fold the venture into the operations of the organisation and frequently the venture will be a business which is diverse from the organisation.

ISDA believes that the Board should remove the inconsistency between the treatment of private equity investments held as joint ventures or associates compared to those held as subsidiaries. In addition, ISDA believes that to include Private Equity investments held as subsidiaries in the group accounts of the investor would make the financial statements less meaningful. For a short period of time a distinct investment's assets and liabilities would be included alongside those of genuine operating subsidiaries of the group and the most valuable piece of information, the fair value, is lost. In addition, the cost of obtaining the information on the investee company for consolidation purposes could well exceed any benefit.

Further, ISDA is concerned about any 'bright light' definition of the holding period temporary investments because, whilst providing an objective criteria, such definitions can prevent the genuine substance of the transaction being represented.

Consolidated financial statements - exemptions

ISDA agrees with the proposal to provide exemptions from the requirement to prepare consolidated financial statements. However, ISDA has identified a potential issue with the exemption condition in Paragraph 8(d) of draft IAS 27: this states that, for a subsidiary to be exempt, its "immediate or ultimate parent (must publish) consolidated financial statements that comply with International Financial Reporting Standards". For certain groups the ultimate parent may not itself be required or able to report using International Financial Reporting Standards (where, for example, the ultimate parent is based in the US). In these situations, the proposal as drafted would require each entity in the chain to prepare consolidated financial statements, which would be both onerous to prepare and of little value to the various parent entities where the subsidiaries were wholly owned. We therefore propose that the IASB should slightly amend the wording to read: "the immediate, intermediate, or ultimate parent publishes consolidated financial statements that comply with International Financial Reporting Standards".

We would be pleased to discuss our comments with the Board or staff. Please contact either Sue Harding, Chair, ISDA European Accounting Committee, at 7888-2664 or Ed Duncan, Assistant Director of European Policy for ISDA, at 7330 3574.

Yours faithfully

A handwritten signature in black ink, appearing to read "Sue D. Harding", with a stylized, sweeping flourish at the end.

Sue Harding
Chair of the ISDA Accounting Committee
and

A handwritten signature in black ink, appearing to read "Ed Duncan", with a long, horizontal, wavy line underneath it.

Ed Duncan
Assistant Director of European Policy at ISDA