Accounting Standards Board

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17 September 2008

Dear Stig

Discussion Paper 'Reducing Complexity in Reporting Financial Instruments'

This letter sets out the UK Accounting Standards Board's (ASB) comments on the draft EFRAG letter of comment to IASB on the above IASB Discussion Paper (DP).

We agree with the main points made in the draft EFRAG letter, and attach our response to IASB for your information.

The main points we make in our response to IASB are as follows:

- We agree that the current standard is complex, but we consider that this is to a large extent a result of the inherent complexity of financial instruments themselves. The mixed measurement model is one way of addressing the wide range of financial instruments and their uses in different businesses. However, IAS 39 then adds unnecessary complexity by its rules-based approach to implementing the mixed measurement model, and by failing to separate the simple principles that deal with most common financial instruments from the complex requirements that apply to only a few highly specialised financial institutions.

- We do not think that the IASB should adopt its proposed 'long term solution' without considerable further consultation and analysis – to do so is to prejudge the outcome of the debate. It is far from clear to us that a single measurement attribute is appropriate for all financial instruments, given the vast range of such instruments and the manner in which they are used by

- different entities in their businesses – we think that some types of business are more readily understood if financial instruments are measured at amortised cost. We also think that cash flow hedge accounting will continue to be necessary in a full fair value model.

- Furthermore, although we think that a current value measurement attribute is most likely to be appropriate for many financial instruments in a long term solution, we are not convinced that 'fair value' as defined in FAS 157 is necessarily the most appropriate current value in all cases.

- We also consider that the presentation in the performance statement of gains and losses arising from fair value (or current value) measurement is of critical importance, including the disaggregation of changes in value. Proposals on presentation need to be developed more fully before conclusions can be reached on whether complexity can be reduced by adopting a single measurement attribute.

- We therefore think that any long-term solution is many years away. Furthermore, we do not think that any of the intermediate proposals, with the exception of the simplification of hedge accounting, are likely to provide improvements in the foreseeable future. We therefore believe that a standard based on IAS 39 will remain current for a good number of years to come, and that the IASB should focus attention on improving the current standard, where we think there are several areas that could be revised to achieve simplification. We consider that this provides the opportunity for major improvements that would reduce costs for the many entities adopting IFRS for the first time over the next few years.

There are only two significant issues on which we disagree with the EFRAG draft response, which are as follows:

- Question 5, paragraphs 38 to 41: We do not see the fair value option as a realistic alternative to fair value hedge accounting. We view the fair value option as a simple way in which an entity can adopt fair value accounting for an instrument or a group of instruments (and would prefer to see the existing restrictions removed). In order for the option to provide a workable alternative to hedge accounting, it would need to permit fair valuing for portions of an instrument, and for designated periods only, and these extensions would require strict restrictions (along the lines of the designation and effectiveness rules) to prevent a 'free for all'. This would in our view severely affect the simplicity of the fair value option for non-hedging uses.

- Question 5, paragraphs 42 to 43: Similarly, we do not see the second intermediate alternative to fair value hedge accounting, permitting all hedge gains and losses to be shown in OCI, as being a likely way of reducing complexity. We dislike this approach because it would result in an increase in gains and losses that are recycled. Also, if this approach were adopted, it would be necessary to retain effectiveness testing; one of the advantages of the current fair value hedge accounting model is that ineffectiveness is automatically recognised in profit and loss, whereas under this proposed intermediate solution ineffectiveness would need to be explicitly calculated and excluded from the amount taken to OCI.

If you would like to discuss these comments, please contact Simon Peerless (020 7492 2424) or myself (020 7492 2434).

Yours sincerely

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