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Deloitte Touche Tohmatsu

6 October 2004

Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir David,

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

Deloitte Touche Tohmatsu is pleased to comment on the International Accounting Standards Board's Exposure Draft - IAS 39, *Financial Instruments: Recognition and Measurement), Cash Flow Hedge Accounting of Forecast Intragroup Transactions* (the exposure draft).

Deloitte Touche Tohmatsu welcomes the clarification in the Exposure Draft that, in the consolidated financial statements a group can designate as the hedged item in a foreign currency cash flow hedge, a highly probable external transaction denominated in the functional currency of the entity (e.g. subsidiary) entering into the transaction, provided it gives rise to an exposure that will have an effect on consolidated profit or loss.

The proposed treatment is consistent with the definition of consolidated financial statements, as "the financial statements of a group presented as those of a single economic entity," set out in IAS 27 *Consolidated and Separate Financial Statements,* i.e. that those financial statements comply with the requirement that the group is treated as if it is a single economic entity.

We therefore agree with the conclusions reached in paragraphs 13 and 14 of the Basis of Conclusions that the group, consistent with the IAS 27 concept of a group as a single economic entity, has a foreign exchange exposure that arises because the group's costs are denominated in a currency different from its sales and will affect profit or loss whatever presentation currency the group chooses. In the appendix to this letter, we suggest some changes to paragraph AG99A of IAS 39 to accommodate this issue.

We appreciate the opportunity to provide our comments. If you have any questions concerning our comments, please contact Ken Wild in London at (020) 7007 0907.

Sincerely,

Deloitte Touche Tohmatsu

Deloitte Touche Tohmatsu

APPENDIX – Responses to Questions in Exposure Draft

Question 1

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

Yes. We welcome the clarification in the Exposure Draft that, in the consolidated financial statements a group can designate as the hedged item in a foreign currency cash flow hedge, a highly probable external transaction denominated in the functional currency of the entity (e.g. subsidiary) entering into the transaction, provided the transaction gives rise to an exposure that will have an effect on consolidated profit or loss.

The proposed treatment is consistent with the objective of preparing consolidated financial statements as though the group was a single economic entity. Consolidated financial statements are defined in IAS 27 *Consolidated and Separate Financial Statements* as "the financial statements of a group presented as those of a single economic entity". Consolidation mechanics set out in IAS 27 aim to achieve this objective. IAS 21 *The Effects of Changes in Foreign Exchange Rates*, in our view, simply provides guidance how this objective should be achieved when the entity is exposed to more than one economic environment and as a result transacts in different currencies. Therefore, we believe that concepts and techniques introduced by IAS 21 should not override the objective set out in IAS 27.

Whether the group is structured as one single entity, operates through branches overseas or individual legal entities overseas, it, as a single economic entity, has an exposure to all the economies it operates in and to the currencies of those economies. Where the 'group' (eg comprising 33.3% of its operations in the United States, 33.3% in France and 33.3% in the United Kingdom) is structured as one economic entity, it is the other facts, eg financing, that will support the choice of one of these three currencies as the functional currency of that 'group'/entity and as a result the foreign currency exposure on its sales to external customers in the other two currencies would exist. Since the consolidation model effectively requires the preparer to reconstruct the consolidated entity as though it was one economic entity operating in three economies, the outcome should be the same as described above.

We therefore find the reference to presentation currency in the proposed amended paragraph AG99A inappropriate and potentially confusing. The fundamental reason why the foreign currency exposure exists in the consolidated entity when it is viewed as a single economic entity, clearly explained in paragraphs 13 and 14 of the Basis of Conclusions, is that the group's costs are denominated in a currency different from its sales and will affect profit or loss whatever presentation currency the group chooses. Therefore, we believe that the proposed paragraph AG99A should drop the reference to presentation currency and use the rationale and words used in BC13 and BC14.

The following examples help to illustrate the difference between the intended outcome of BC13 and BC 14 as opposed to the potential interpretation of proposed AG99A if the current reference to presentation currency is retained:

- If a single entity with a functional currency of euro has euro-denominated sales, chooses the US $ as its presentation currency, and enters into a receive US $/ pay euro swap, it should not be able to designate the swap as a hedging instrument in a cash flow hedge of 'foreign currency' exposure in its forecast sales even though these will be reported in US $, as it has no genuine foreign currency exposure.

- Where a group entity has a yen-functional currency subsidiary that sells products denominated in euros to another subsidiary (functional currency of euro) which in turn sells these products to third parties for euros, and the parent has a functional currency of yen but the presentation currency of the consolidated group is the US $, it should be clear from the proposed revision to the Standard that the consolidated entity could not obtain hedge accounting for any hedges of either a yen/US $ or a euro/US $ foreign currency exposure in its forecast sales. However, the consolidated entity should be able to hedge account for the hedges of the yen/euro exposure in its forecasted sales to third parties.

We note that there are currently two different interpretations that have developed in the marketplace and will lead to divergence in application of IAS 39: one allowing the hedges of the forecast transactions in question on the basis of the rationale set out in BC13 and BC14, and the other prohibiting such hedges on the basis of the withdrawal of the old IGC 137-14. Hence, the status quo cannot remain and a clarification along the lines proposed in the Exposure Draft is preferable to the re-introduction of the old IGC 137-14. As discussed above, in our view, the clarification as proposed with our modifications set out above is consistent with the objective of consolidation.

Question 2

Do the proposals contained in the 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?

Yes, the exposure draft does adequately address the concerns of constituents as described in paragraph 3 of the Background, for the reasons given in our answer to Question 1.

However, we disagree with postponing the effective date of the proposed amendment to 1 January 2006. We think an effective date of 1 January 2005 is more appropriate. It is also consistent with the intention of the Exposure Draft, as discussed in the Basis of Conclusions, to continue to allow a group to designate as the hedged item in a foreign currency cash flow hedge, a highly probable external transaction denominated in the functional currency of the entity (e.g. subsidiary) entering into the transaction, provided it gives rise to an exposure that will have an effect on consolidated profit or loss.

Question 3

Do you have any other comments on the proposals?

We believe that, as part of the proposed amendment, the Standard should state clearly that a commitment between two group entities without another commitment to an outside party does not meet the definition of a firm commitment and that, therefore, in the consolidated financial statements a group cannot designate as the hedged item in a foreign currency fair value hedge or cash flow hedge, a firm commitment between two group entities i.e. that is internal to the group.