The Hundred Group
of Finance Directors

Financial Reporting Committee

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

24 February 2011

Dear Sir David

Request for Views: Effective Dates and Transition Methods

We are pleased to submit our comments on the above proposals.

Who we are

The Hundred Group represents the views of the finance directors of the UK's largest companies drawn largely, but not entirely, from the constituents of the FTSE100 Index. Our members are the finance directors of companies whose market capitalisation collectively represents over 80% of that of companies listed on the London Stock Exchange. The views expressed in this letter are not necessarily those of all of our individual members or of their respective employers.

Summary

We summarise our views below and set out our responses to the Board's specific questions in the Appendix.

<u>Method of adoption</u>
We strongly support the single effective date - the 'Big Bang' approach - for the new and revised standards considered in the Request for Views. However, we also consider that the IASB should permit early adoption for standards or groups of linked standards.

We believe that the impact of these standards should not be underestimated. Adoption of these standards is likely to cause significant disruption to businesses. It will be necessary for us to amend existing or implement new accounting systems and related processes and procedures and to conduct comprehensive training of our employees (including those without an accounting background). We will need to assist our investors and other stakeholders in adjusting their expectations and projections based on reported results that may change significantly as a result of the new standards. It may be necessary for us to renegotiate financial covenants in relation to our borrowing facilities. Moreover, the position of the Inland Revenue and industry regulators in relation to these standards is not yet known.

We expect that, for many UK companies, the proposed standards will have at least as great an impact as did the initial adoption of IFRSs back in 2005. We would therefore prefer to be able to model the adoption of the proposed standards on first-time adoption of IFRSs. We consider that the single date approach would be more efficient and cost effective because we could adopt a single coherent approach to the various accounting changes.

Timing of adoption

We are concerned that there may be further slippage of the Board's timetable and that the projects may not be completed by June 2011. On the assumption that the current timetable is met, for the reasons set our below, we believe that mandatory effective date should be no earlier than 1 January 2015.

In some jurisdictions, companies are required to present results and cash flows for two comparative years in their financial statements. In particular, those of our members who are US listed have to present two comparative years in their SEC filings. If the mandatory effective date was to be 1 January 2015, the beginning of the earliest period presented in such financial statements would be 1 January 2013. Even with this timetable we are aware that some of our members will encounter practical difficulties in gathering comparative information (in particular, in relation to the revenue recognition, financial instruments and leasing standards) because this will involve significant amendments to their global accounting systems and processes. We remind the Board that SEC registrants are required to provide in their selected financial data in their annual reports for four comparative years. We would encourage the Board to discuss with the SEC the possibility of allowing an accommodation with regard to restatement similar to that which was granted to foreign registrants on first-time adoption of IFRSs.

In our experience, it is more cost effective to prepare comparative information on a real-time basis than to try to do so retrospectively (this is particularly likely in the case of revenue recognition where a high number of transactions may be affected by the changes). We would therefore like to have reasonable time between the issuance of the standards and the date on which they become effective in order to be able to base our implementation projects around the final rules rather than the draft proposals. Furthermore, the relevant tax and regulatory authorities will need time to assess, respond to and implement mitigating measures. In turn, companies will need to devise their own responses to changes in their tax or regulatory positions and the measures the authorities put into place as a response to the changes.

Within the European Union, the European Commission will need sufficient time after the publication of the final standards to complete its due process. In the case of the financial instruments standard, we note that the proposals for transitioning in respect of impairment of assets held in open portfolios have not been finalised, which could mean that the endorsement process will not begin until 2012. Moreover, if the European Commission delays endorsement or carves out or amends any aspects of the new standards, preparers must be allowed sufficient time to address such amendments in their implementation processes.

We appreciate that too long a delay between the completion of the standards and mandatory adoption dates may be considered by the Board to be detrimental to the new standards, but given the considerations that we have outlined above, it would not be feasible to suggest a mandatory adoption date that is earlier than 1 January 2015.

Please feel free to contact me if you wish to discuss our comments on the proposals.

Yours sincerely

Chris Lucas

Chris Lucas
Chairman
The Hundred Group - Financial Reporting Committee

APPENDIX

Q1. Please describe the degree to which each of the proposed new IFRSs is likely to affect you and the factors driving that effect (for example, preparers of financial statements might explain the frequency or materiality of the transactions to their business and investors and creditors might explain the significance of the transactions to the particular industries or sectors they follow).

We are a representative group and the diversity of our membership makes it impossible to generalise about the frequency and materiality of the transactions on individual entities. However, we expect that one or more of the new or revised standards considered in the request for views are likely to have a material impact on most of our members.

Q2. Focusing only on those projects included in the table in paragraph 18:

(a) Which of the proposals are likely to require more time to learn about the proposal, train personnel, plan for, and implement or otherwise adapt?

We believe that this will depend on an entity's circumstances, including its financing structure and the industry in which it operates.

In general, however, we believe that:

- Financial institutions, including bank assurers, will be most affected by the proposals on financial instruments and insurance;
- Telecommunications, Construction, defence, aerospace, software and other industries with complex multi-year contracts together with the pharmaceutical industry will be most affected by the revenue recognition changes; and
- Retail, airline and mining sectors will be the most significantly affected by the leasing proposals (but most entities will be impacted to some extent).

(b) What are the types of costs you expect to incur in planning for and adapting to the new requirements and what are the primary drivers of those costs? What is the relative significance of each cost component?

We expect the following types of cost to be incurred:

<u>Systems changes</u>

We expect that certain of the new standards, particularly those on leases, financial instruments and, in some cases, revenue recognition, will require the amendment or existing or the implementation of new accounting systems and processes. Such change projects can be very costly and are likely to require significant lead time, particularly when they need to be rolled out across global businesses. We suggest that the Board bears in mind the costs associated with gathering information when determining the disclosure requirements that will accompany the new standards.

<u>Education and training</u>

We expect that our staff will require significant training in the new standards both at head office and in the field (where the focus of our accounting teams tends to be on managing their businesses rather than on financial reporting). We believe that for many companies the effects of the new standards may be more significant and far-reaching than the adoption of IFRSs back in 2005.

Investor education and future projections

We recognise that the new standards are likely to bring significant change to both the timing and profile of reported profits and to the assets and liabilities reported on balance sheets. We will need to brief our investors on the effect of the changes on our reported profits and other performance measures, profit forecasts and financial covenants.

Contracts with financial institutions

Given the potential impact of the new standards on our financial covenants it may be necessary for companies to revise loan agreements and other contracts with financial institutions. If this is not possible, it will be necessary to report to our lenders and others in accordance with unamended IFRSs which will require two sets of accounting records to be maintained (some companies experienced this following the adoption of IFRSs back in 2005 when they had to continue to provide financial covenant information based on unamended UK GAAP).

Increased audit fees

We expect that the increase both in complexity and in disclosure requirements will increase audit costs.

Taxation and regulatory impacts

It is unclear what the attitude of the UK tax authority will be to the new accounting standards. Generally, we have found, in areas such as financial instruments, there has been a tendency for the tax treatment to follow the accounting treatment but there are situations in which this is not the case and separate accounting records need to be maintained to provide the necessary information for tax purposes. For financial institutions, similar considerations apply to regulatory reporting and capital ratios.

While we recognise that the Board cannot be held responsible for the response of third parties to its standards, it should recognise that there are potential adverse tax and regulatory implications for companies of adopting new accounting standards and, at the very least, time is required after the publication of any new accounting standard for the relevant authorities to consider the implications of the new rules.

Q3. Do you foresee other effects on the broader financial reporting system arising from these new IFRSs? For example, will the new financial reporting requirements conflict with other regulatory or tax reporting requirements? Will they give rise to a need for changes in auditing standards?

It is clear that some of the proposed changes, if adopted as currently drafted, will have significant implications for the regulatory and tax regime. In some cases the implications may be far-reaching. For example, UK tax legislation contains over 100 references to operating or finance leases many or all of which may need to be revisited in the light of the new standard on leases. Similarly, any change to expected loss provisioning will have implications for regulatory capital requirements. Regulators who will need to assess the financial instrument proposals and consider the impact for regulation.

In the UK, guidance on distributable profits will also need to be reviewed and updated to reflect the new standards (this guidance already runs to 168 pages).

Not only will the relevant tax and regulatory authorities need time to assess, respond to and implement mitigating measures, but companies will need to devise their own responses to changes in their tax or regulatory positions and the measures the authorities put into place as a response to the changes.

Where the new accounting treatment is not accepted by either tax or regulatory authorities, there is a risk that entities will have to maintain dual accounting records.

For European companies and for companies in many other jurisdictions, EU or other national endorsement is required in order for companies to be able to adopt the standards. Generally, the EU endorsement process moves slowly and we recognise that there are specific issues that may cause certain of the new standards not to be adopted without carve out or amendment In particular, the EU has not yet endorsed IFRS 9 and may not do so until portfolio hedging is available for review as part of the replacement of IAS39.

We therefore believe that the Board must allow sufficient time after the publication of the final standards for the EU to complete its due process. Moreover, if the EU delays endorsement or carves out or amends any aspects of the new standards, preparers must be allowed sufficient time to address such amendments in their implementation processes. For US listed companies, the effects of such carve outs or amendments could be to introduce dual reporting – EU IFRS for local statutory reporting and full IFRS for the SEC.

Q4. Do you agree with the transition method as proposed for each project, when considered in the context of a broad implementation plan covering all the new requirements? If not, what changes would you recommend, and why? In particular, please explain the primary advantages of your recommended changes and their effect on the cost of adapting to the new reporting requirements.

We address below the proposals for each of the standards:

Consolidation

We agree with the proposed limited retrospective transitional arrangements.

Fair value measurement

We agree with the proposed prospective transitional arrangements.

Financial instruments

This is a complex transition because the different aspects may require different transition reliefs or completely different approaches because, for example, hedge accounting is not applied retrospectively. The difficulty of thinking through the transition is increased since not all the proposals are finalised and the IFRS 9 transition that exists at present is based on allowing a phased approach with classification and measurement able to be applied from November 2009. Regardless of whether the approach is amended or not, it would be helpful for the final IFRS 9 that incorporates all phases to have a more coherent approach to transition as at a single date.

The existing transition requirements for classification and measurement of financial assets work differently to a full retrospective application. This is because the classification is meant to be determined as at the date of the opening balance sheet of the current reporting period (based on facts and circumstances at that time) and then this classification is applied (with some modifications) to the opening balance sheet for the first comparative period presented. As a result, the IFRS 9 classifications cannot be applied to financial assets that do not exist at the date of initial application but that need to be included in the comparative financial statements. These financial assets continue to be accounted for under IAS 39. As a result the opening balance sheet for the earliest comparative period presented will include a mix of financial assets under both IFRS 9 and IAS 39. This results in practical difficulties in separating the comparative balance sheets into assets that exist at the date of transition and those that do not. The practical difficulties are likely to become greater the further back in time the first opening balance sheet must be prepared. For example assuming an application in January 2015, under IAS 1 (revised) a balance sheet as at 1 January 2014 would be needed. Some entities may be required to produce three or five years of comparatives in which case, the first opening balance sheet would be 1 January 2013 or even 2011. Tracking the existence of assets across open portfolios for five years could be a considerable task. A simplification could be for the final standard to put some limit to the length of the retrospective period.

Perhaps more importantly, we are not convinced of the value to users of comparatives that include a mix of financial assets under IFRS 9 and IAS 39, particularly coupled with some of the other potential exceptions to retrospective application such as using the fair value of financial assets as a proxy for amortised cost in the comparative periods.

An alternative would be to require classification and measurement as at the date of the opening balance sheet of the earliest comparative period presented. Such an approach would allow for more meaningful comparatives, particularly as business models are not expected to change on a regular basis. However, the approach has its drawbacks in that it may involve an inappropriate amount of hindsight to be used.

We suggest that the IASB should discuss the transition to IFRS 9 with any companies (and their analysts) that have applied the existing standard. Further outreach with users may be helpful in determining how they would interpret comparatives that were not, in fact, comparable. An analysis of the research into the initial transition to IFRS in Europe may also be helpful. It is our understanding that users were generally content with the information they received under IFRS 1 even though comparatives were not required for IAS 39. If the costs of producing comparatives are likely to exceed the benefit to users, there would be strong arguments for the prospective application of IFRS 9. While the impairment proposals are not yet final, we have previously expressed concerns about the practical difficulties of applying them retrospectively. Hedge accounting is, by its nature, prospective. It may be that an approach based on the IFRS 1 transition for IAS 39 would provide users with understandable information at a more reasonable cost.

We consider that, as drafted, the transitional provisions are impracticable. We have identified the following difficulties:

- The date of initial application is not clear.
- While the requirements for hedge accounting in comparative periods are clear, they could result in comparatives that are not meaningful since continuing hedge accounting would be based on classifications and measurements that are no longer applicable.
- The proposed simplification for the accounting treatment of hybrid instruments classified as fair value (previously amortised cost) is complex.
- The effort involved in restating up to five comparative periods for entities with US listings will be considerable and cannot meet a reasonable cost/benefit test.

Therefore, we support an approach to transition based on the IFRS 1 requirements for entities that first adopted IAS 39. In all cases, and not just on early adoption, there should be a reconciliation between the closing balance sheet using the existing IAS 39 and the opening, restated balance sheet with explanations for the main changes in classification and measurement. In our view, this reconciliation would provide more useful and understandable information than restated comparatives.

If financial liabilities are included in the financial reporting standard applicable for 2009 year ends, it may be appropriate to allow bifurcation to continue for embedded derivatives that exist on the date of transition, particularly for liabilities such as issued long-term debt securities, where the derivative is currently separated and accounted for at fair value through profit or loss and the host contract is carried at amortised cost. It may be appropriate to grandfather such contracts. The embedded derivatives would continue to be carried at fair value and the host contracts at amortised cost, assuming they contain basic loan features.

Future contracts entered into will be accounted for under the new standard but this would give entities the opportunity to change the types of arrangements in order to remove the embedded derivatives or otherwise change their financing strategies.

ED/2009/12 – Amortised cost and impairment

We do not believe that the proposed transition requirements are clear or can be practically achieved without the use of undue hindsight. The difficulty in determining achievable transition requirements is evidence that the ED as a whole may not be capable of practical implementation as drafted. Since reporting entities do not generally calculate effective interest rates, it seems unlikely that they will be able to determine what rate they would have used in the past or be able to use this rate in the accounting going forward. As for the general proposal, an opening estimate of expected and incurred to-date credit losses would need to be determined and then somehow spread to approximate the use of an effective interest rate.

The alternative simplified transition approach that would use the original effective interest rate determined in accordance with IAS 39 seems more achievable. Since we are unconvinced that presenting the portion of initial expected credit losses allocated to the period separately from changes in estimates of credit losses is meaningful, we would be content with the alternative transition approach.

Based on experience of transition to IFRS in 2005, we believe many entities would approach restating comparatives as a separate work stream from determining the opening balance sheet and posting this to the main accounting system for use going forward. While these separate work streams do not need to be performed sequentially, it obviously entails more work. This additional work adds to the cost and complexity of the transition and, if comparatives required for disclosure are not truly comparable, it is unlikely that the benefits exceed the costs. This is particularly the case if restatement is required for five or ten year summaries of results and financial position. Users seemed to be well served by the transition to IFRS in 2005 which provided reconciliations and explanations of the differences between closing and opening balance sheets without restated comparatives. Restating comparatives seems likely to add to the lead-time, costs and complexity of transition without corresponding benefit.

The proposals for impairment of assets held in open portfolios have also not yet been finalised.

ED/2010/4 – Fair value option

We agree with the proposed transition requirements for this limited section of the financial instruments proposals. In this situation, it seems clear that the benefits of achieving consistency between periods outweigh the costs. We believe that the disclosures prepared for IFRS 7 provide a useful starting point in computing the amounts to be recognised on adoption, however, we would not suggest prescription of the use of the IFRS 7 amounts where a more faithfully representative number can be obtained.

If these proposals were to be decoupled from the rest of IFRS 9 as suggested in the response to question 9 in ED/2010/4, we also suggest that consideration should be given to allowing entities to reconsider their use of the fair value option for liabilities on transition. Before the recent market dislocation, the fair value option was used for financial liabilities with substantive embedded derivatives, which resulted in significant gains and losses relating to own credit. To reduce this problem, some entities made efforts to bifurcate embedded derivatives for similar liabilities issued after the market dislocation. If gains and losses related to the liability's credit risk are to be included in OCI, entities are likely to use the fair value option for subsequent liabilities. Entities may wish to use the fair value option for all similar liabilities and it would be helpful if the fair value option could be reopened to facilitate this.

Such an approach would not only have operational benefits for these entities but it would make their financial reporting less complex as like items would be treated in the same way.

Insurance contracts

We disagree with the proposals for transition. They are inconsistent with the treatment of residual margin on new business and would provide results similar to that of a start-up operation which is not an appropriate reflection of the economic reality.

Where it is practicable, we favour full retrospective application. Entities using the premium allocation approach should certainly be able to adopt full retrospective application for their pre-claims liabilities, as the insurer will be able to rely on the existing systems to generate the unearned premium reserve to be brought forward at the date of transition.

However, we recognise that for many entities it would be impracticable to do this and even where possible, the costs of calculating the retrospective adjustment would be prohibitive. In our view, alternative proposals on transition should be developed. These might require a partial retrospective approach that sets out some acceptable methods and approaches to achieving this partial application (for example using some current information).

It is likely that the old and new book of business may need to be shown separately. This would certainly be the case if the current proposals are taken forward (which we do not advocate), and may also be the case if an improved approach were to be developed.

Joint arrangements

We agree with the proposed limited retrospective transitional arrangements.

Leases

We agree that mandatory full retrospective application would be too onerous in many cases and therefore agree that some simplified transitional arrangements are necessary. However, we are not convinced that what the boards are proposing is a suitable solution.

We share the concerns raised in the alternative view on the exposure draft that the proposed approach will lead to a misleading reduction in lessees' profits on transition and increased profit growth in subsequent periods with the opposite effect for lessors. In common with the alternative view, we believe other transitional provisions should be considered for both lessees and lessors. Full retrospective application should be permitted or the transitional provisions adjusted so that the right-of-use asset is not necessarily set equal to the transition liability, but instead takes account of the impact of the remaining lease term compared to the original lease period.

Post-employment benefits

We agree that the requirements should be applied retrospectively. In most cases the information necessary to apply the new requirements should be accessible relatively easily; therefore we see no reason why the normal IAS 8 approach of retrospective application should not be required.

Presentation of items of other comprehensive income

We agree with the proposed retrospective transitional arrangements.

Revenue from contracts with customers

We agree that the requirements should apply retrospectively, otherwise comparability will be impaired during the transition period. However, the practicality of retrospective application will depend upon the profile of contracts that a company has and the ease of data collection in order to make the required adjustments. For those companies with contracts that span several years, the re-examination of these contracts to determine the effects of adoption is likely to be an extensive exercise.

In addition, for some of our members the proposed changes will require significant amendments to global financial reporting systems and a fundamental change to how revenue information is collated. This exercise should not be underestimated both in terms of implementation timetables and of cost.

We would welcome an extension of paragraph 85 of the exposure draft, acknowledging that significant estimation may sometimes be required in full retrospective application, that this is acceptable and that, where it is significant companies should disclose the approach they have taken in determining the retrospective amounts.

Q5. In thinking about an overall implementation plan covering all of the standards that are the subject of this Request for Views:

(a) Do you prefer the single date approach or the sequential approach? Why? What are the advantages and disadvantages of your preferred approach? How would your preferred approach minimise the cost of implementation or bring other benefits? Please describe the sources of those benefits (for example, economies of scale, minimising disruption, or other synergistic benefits).

We strongly prefer the single date approach the single date (or 'Big Bang'), approach to adoption of the standards that are the subject of the Request for Views.

We believe that, because of the similarity between IFRSs and UK GAAP at the time, for many UK companies the proposed standards will have at least as great an impact as did the initial adoption of IFRSs back in 2005. We would therefore like to be able to model the adoption of the proposed standards on the approach that we used towards the initial adoption of IFRSs.

We consider that the single date approach would be more efficient and cost effective because we could adopt a single coherent approach to the various accounting changes. We would be able to conduct comprehensive training to convey knowledge within our businesses. We would need to amend our internal processes and procedures (including internal financial controls) and implement or amend our systems once rather than on a number of occasions. A single date approach would also enable us to assist more effectively our stakeholders in adjusting their projections and expectations and would facilitate the renegotiation of financial covenants in relation to our borrowing facilities.

(b) Under a single date approach and assuming the projects noted in the introduction are completed by June 2011, what should the mandatory effective date be and why?

We are concerned that there may be further slippage of the Board's timetable and that the projects may not be completed by June 2011. However, on the assumption the current timetable is met, we believe that the mandatory effective date should be no earlier than 1 January 2015.

We are mindful that in certain jurisdictions companies are required to present results and cash flows for two comparative years in their financial statements. In particular, those of our members who are US listed have to present two comparative years in their SEC filings. If the mandatory effective date was to be 1 January 2015, the beginning of the earliest period presented in such financial statements would be 1 January 2013. We remind the Board that SEC registrants are required to provide in their selected financial data in their annual reports for four comparative years. We would encourage the Board to discuss with the SEC the possibility of allowing an accommodation with regard to restatement similar to that which was granted to foreign registrants on first-time adoption of IFRSs.

In our experience, more cost effective to prepare information on a real-time basis than to try to do so retrospectively (this is particularly likely in the case of revenue recognition where a high number of transactions may be affected by the changes). We would therefore like to have reasonable time between the issuance of the standards and the date on which they become effective in order to be able to design our systems and processes around the final rules rather than the draft proposals.

In certain jurisdictions, such as the US, companies have to present selected financial data for four comparative periods. It would be helpful if the Board could encourage the local regulators would give dispensation from full retrospective application of the new standards beyond the comparative periods contained in the financial statements.

We appreciate that too long a delay between the completion of the standards and mandatory adoption dates may be considered by the Board to be detrimental to the new standards, but given the considerations that we have discussed above, we would suggest to the Board that it may be sensible to delay mandatory adoption until 1 January 2015.

(c) Under the sequential approach, how should the new IFRSs be sequenced (or grouped) and what should the mandatory effective dates for each group be? Please explain the primary factors that drive your recommended adoption sequence, such as the impact of interdependencies among the new IFRSs.

We do not support a sequential approach for the reasons that we give in support of the single date approach.

(d) Do you think another approach would be viable and preferable? If so, please describe that approach and its advantages.

We believe that the only alternative to the single date approach or the sequential approach is a piecemeal approach. We do not support a piecemeal approach for the reasons that we give in support of the single date approach.

Q6. Should the IASB give entities the option of adopting some or all of the new IFRSs before their mandatory effective date? Why or why not? Which ones? What restrictions, if any, should there be on early adoption (for example, are there related requirements that should be adopted at the same time)?

Entities should be allowed to early adopt some of the standards if they believe that such an approach would be preferable to the single date approach and is in the interests of users of their financial statements. However, we consider that if an individual standard is adopted early then related standards should be adopted at the same time. For example, if the insurance standard is adopted early, so should that on financial instruments and, if the leasing standard is adopted early, so should that on revenue recognition.

We believe that limited early adoption may be be particularly helpful to first time adopters in countries that will be making the transition to IFRSs during the next few years.

Q7. Do you agree that the IASB and FASB should require the same effective dates and transition methods for their comparable standards? Why or why not?

We consider that it would be preferable for the IASB and FASB to have the same effective dates and transition methods for their comparable standards as this would facilitate global comparability of financial statements. We hope, however, that the US will decide to permit the use of IFRSs by US companies.

Q8. Should the IASB permit different adoption dates and early adoption requirements for first-time adopters of IFRSs? Why, or why not? If yes, what should those different adoption requirements be, and why?

We believe that first time adopters of IFRSs should be allowed to adopt all the standards on first time-adoption in order that they are not faced with the burden of making further changes to their financial statements during the early years of reporting under IFRSs.