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Corporate Center Group Accounting Policy

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LETTER OF COMMENT NO. 154

14 April 2009

Preliminary Views on Financial Statement Presentation

Dear Ms. Soto:

We appreciate the opportunity to provide our comments on the Discussion Paper, *Preliminary Views on Financial Statement Presentation* (the "DP"). UBS has followed the developments of this DP closely. We were involved in the initial development stages of the performance reporting project and participated in the recast exercise during the development of the DP. We therefore have first hand insight into the potential ramifications that any final standard could have on financial reporting.

We generally support any effort to provide users of financial statements with more decision-useful information. However, as a result of experience gained during the recast exercise, we are not convinced that the proposal would achieve this objective. We are specifically concerned about the impact on financial institutions as many of the requirements are not particularly relevant for such entities. Overall, we do not believe that the proposals significantly improve the information content for users of such financial statements. A distinction between investing, financing, and operating activities is not meaningful for financial institutions. Further, the current indirect method of preparing the statement of cash flows, which is employed by most financial institutions, provides more decision useful information than the direct method. Due to the nature of financial institution operations, where assets and liabilities are largely fungible and the interrelationships of the balance sheet items significant, we do not believe that the presentation of information according to categories and sections will enhance the financial statements.

Financial institutions do not currently prepare direct method cash flow statements. Any required system change to provide this format would necessitate significant time and money without providing any benefit to investors. This is due to the fact that cash flow statements for financial institutions are significantly less meaningful for evaluating an entity's liquidity position than the composition of the entity's balance sheet and capital position. Additionally, we are not aware of any requests by users of UBS's financial statements for direct cash flow information. The proposed reconciliation would take the statement of cash flow and require it to be reconciled to the income statement by way of adjustments for non-cash items. UBS currently accomplishes this reconciliation by preparing our statement of cash flow according to the indirect method, which begins with net income and makes adjustments to arrive at cash flow for the period. The DP essentially requires two statements where a single statement provides the level of detail and disaggregating that users require. We strongly urge the Boards not to require the use of the direct method for preparing the statement of cash flows for financial institutions.

In addition, due to the wave of new accounting standards that are expected to be issued over the next several years, we do not believe that now is the time to introduce another standard that will require significant time and money to implement. We believe that the Boards have done a good job addressing some very critical accounting issues in the wake of the recent financial crisis. Upcoming accounting changes in regard to consolidation, de-recognition, and simplification for the accounting of financial instruments will already require a significant amount of resources in order to be compliant. We do not

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believe that the current financial statement presentation model is sufficiently broken to require immediate change. We believe that any immediate shortcomings with regard to financial reporting for financial institutions can be addressed through enhanced disclosures. As a result we would strongly recommend that any final standard be delayed for several years and that the Boards consider the appropriateness of requiring financial institutions to follow this standard. Although we generally agree that industry-specific accounting standards should be avoided, we believe that an exception should be permitted in this instance for financial institutions.

We have responded to specific questions from the DP in the appendix to this letter. If you would like to discuss any of our comment in more detail, please contact Ralph Odermatt at +41 44 236 8410 or John Gallagher at +1 203 719 8164 to discuss.

Regards

UBS AG

Ralph Odermatt Managing Director Group Accounting Policy John Gallagher Managing Director Group Accounting Policy

Appendix

1. Would the proposed objectives of financial statement presentation improve the usefulness of the information provided in an entity's financial statements and help users make better decisions in their capacity as capital providers? Why or why not? Should the boards consider any other objectives of financial statement presentation in addition to or instead of the objectives proposed in this discussion paper? If so, please describe and explain.

UBS does not believe that the objectives result in more useful information being provided to users of financial statements. We understand that a number of the proposed changes may benefit users of nonfinancial entity financial statements, such as cash flow information or the breakdown of assets and liabilities into categories and sections. The benefit of these changes is largely lost as they relate to the financial statements of financial institutions because we believe that all non-discontinued items are operating by nature and that cash flows is not necessarily a meaningful indicator of financial institution liquidity. Other useful changes proposed in the DP are already provided by UBS, such as the short and long-term maturity schedules.

2. Would the **separation of business activities from financing activities** provide information that is more decision-useful than that provided in the financial statement formats used today? Why or why not?

No, separating business activities from financing activities would not provide any more decision useful information in the financial statements than those provided today. UBS believes that due to the nature of banking it is virtually impossible to draw a meaningful distinction between business and financing. Deposit-taking, lending, investing, and financing are all interrelated activities. As such, one activity cannot meaningfully be disconnected from another in order to segregate the information for presentation purposes. The Boards acknowledge in the DP that the business of banking is unique compared to other industries. We do not believe that it would be appropriate to require financial institutions to invest significant time and resources to produce a new financial statement format, if the new format does not improve financial reporting.

3. Should **equity** be presented as a section separate from the financing section or should it be included as a category in the financing section? Why or why not?

We believe that equity should be presented separately due to its importance to users and its difference from other activities of the entity. Equity represents the relationship between the owners of the entity and other external parties to the bank.

Equity is also used in a number of analytic calculations and combining equity with financing may obscure the information necessary to calculate those ratios. For this reason, UBS believes that the equity section should remain separate from the financing section to benefit users.

4. In the proposed presentation model, an entity would present its **discontinued operations** in a separate section. Does this presentation provide decision-useful information? Instead of presenting this information in a separate section, should an entity present information about its discontinued operations in the relevant categories (operating, investing, financing assets and financing liabilities)? Why or why not?

UBS believes that combining the presentation of discontinued operations with the continuing operations mischaracterizes its relationship to the continuing operations of the entity. Additionally, users have indicated a strong preference for information on continuing operations that may be hampered by the presentation of the discontinued operations information in those sections and categories.

5. The proposed presentation model relies on a management approach to classification of assets and liabilities and the related changes in those items in the sections and categories in order to reflect the way an item is used within the entity or its reportable segment. Would a management approach provide the most useful view of an entity to users of its financial statements? Would the potential for reduced comparability of financial statements resulting from a management approach to classification outweigh the benefits of that approach? Why or why not?

We agree that the management approach to classification provides the most meaningful view on the financial performance of an entity. Presenting the management approach provides investors with meaningful insight into how a company sees itself and how it is managed. We do not believe that it is appropriate to mandate a set approach to the classification of assets and liabilities and the related changes. We believe it is more insightful to understand how a company manages itself.

6. The DP proposes that both assets and liabilities should be presented in the business section and in the financing section of the **statement of financial position**. Would this change in presentation coupled with the separation of business and financing activities in the statements of comprehensive income and cash flows make it easier for users to calculate some key financial ratios for an entity's business activities or its financing activities? Why or why not?

Generally, we believe that the new format for the presentation of financial information does not communicate any additional useful information about the financial position of UBS. The expected classification of assets and liabilities as operating is similar to how they are treated in our published statement of financial position and would only make minor changes to our presentation of the income statement and cash flow statement. We do not believe that users would discern additional benefit from classifying items as operating.

We do not understand why income taxes are given such prominence in their own section. Income taxes and other taxes, such as value-added taxes, are a function of any entity's operating activities. Managing income tax obligations is just as important as managing operating obligations. Therefore, we see no reason to classify such assets/liabilities outside of the business section of the statement of financial position.

We believe that using short term versus long term segregation for our assets and liabilities is not as useful to users as that based on liquidity. "Liquidity" is a term that can be interpreted in various ways, for example, publicly traded equity securities are liquid assets but an entity may intend to hold those securities for some period of time. Consequently, we believe that liquidity should be based on management's view as to how that liquidity and those assets will be managed. We commend the Boards for continuing to allow for liquidity-based presentation for financial institutions because we believe it provides users with valuable information about how management views and employs those assets.

7. The DP discusses classification of assets and liabilities by entities that have more than one reportable segment for segment reporting purposes. Should those entities classify assets and liabilities (and related changes) at the reportable segment level as proposed instead of at the entity level? Please explain.

UBS currently does not prepare and does not present segment statements of financial positions as management does not use the segment statements of financial position to manage or monitor the performance of the segments. Management, however, discloses the total assets, total liabilities and total capital expenditures for each of its segments for our users as prescribed by IFRS; that information is available in our reporting system.

8. The proposed presentation model introduces sections and categories in the statements of financial position, comprehensive income and cash flows. The boards will need to consider making consequential amendments to existing segment disclosure requirements as a result of the proposed classification scheme. For example, the boards may need to clarify which assets should be disclosed by segment: only total assets as required today or assets for each section or category within a section. What, if any, changes in segment disclosures should the boards consider to make segment information more useful in light of the proposed presentation model? Please explain.

At the moment, our reporting system has the ability to provide the segment balance sheets with all inter-company transactions including those generated between legal entities within each segment. However, the consolidation system does not have the functionality to eliminate the transactions generated between legal entities within the same segment. Such sub-consolidation would require significant systems modifications.

UBS prepares and presents a condensed version of the income statement for its segments. Some information related to internal charges and transfer pricing adjustments are reflected in the performance of each business but would not be appropriate in public financial statements.

Conceptually, we recognize the benefit that users would receive from better understanding the activities of the segments. Users of the financial statement may be able to see inter-segment dependencies, for example, how each segment contributes to the financial results of the group. This may be useful to investors in cases where a segment is being considered for a sale/spin-off and the users are looking for additional insight regarding the performance of this particular segment.

We do not use segment balance sheets in managing our business; therefore, we would argue that this information is not relevant to us. The same would be true for segment cash flow statement. Segment reporting for financial institutions is labor intensive due to the presence of intercompany transactions. This is particularly significant for financial institutions due to the fungible nature of financing and financial investments where capital may flow between segments easily and often.

There are currently limits to the information that is and can be produced, such as:

- 1. Cash flow statements for segments are not currently possible due to system limitations and would require significant investment to produce.
- 2. Income taxes are managed at the group level and, therefore tax allocation by segment is not readily available and would be difficult to produce.
- 3. Segment balance sheets do not include equity data and other comprehensive income data as it is reported at the consolidated group level by our system.

Given the limitations noted and management's views and use, we would encourage the Boards to not require segment reporting based on the proposed requirements for financial statements of the consolidated group.

9. Are the **business section** and the **operating and investing categories** within that section defined appropriately? Why or why not?

As previously noted, the classification of operating, financing and investing activities is not meaningful for banks. Given the industry-specific nature of banking operations, we recommend that the guidance should address the specialized nature of financial institutions in more detail by clarifying that an entity may only have an operating section.

10. Are the **financing section** and the **financing assets and financing liabilities categories** within that section defined appropriately? Should the financing section be restricted to *financial assets* and *financial liabilities* as defined in IFRSs and US GAAP as proposed? Why or why not?

UBS does not expect to utilize the financing category, but we note that under the management approach the Boards decided to take, management should probably have the flexibility to determine which assets and liabilities belong in the financing section.

11. The DP proposes that an entity should present a **classified statement of financial position** (short-term and long-term subcategories for assets and liabilities) except when a presentation of assets and liabilities in order of liquidity provides information that is more relevant. What types of entities would you expect **not** to present a classified statement of financial position? Why? Should there be more guidance for distinguishing which entities should present a **statement of financial position in order of liquidity**? If so, what additional guidance is needed?

We generally support the view presented in the project guidance regarding the classification of assets and liabilities, but believe that the presentation of assets and liabilities in order of liquidity provides more decision-useful information to users of financial institution reporting information. Thus, we would not expect financial institutions to present classified statements of financial positions.

We believe that any restrictions around applying a liquidity-based presentation would be necessarily rules-based and unlikely to benefit users. However, some additional clarity around the definition of liquidity, as noted previously, may be beneficial to ensure that all companies are applying the same approach to assessing liquidity.

12. The DP proposes that **cash equivalents** should be presented and classified in a manner similar to other short-term investments, not as part of cash. Do you agree? Why or why not?

UBS does not believe that distinguishing between cash and cash equivalents provides users with more valuable information than currently available in the financial statements. We note that there are different types of cash accounts such as deposits at banks, deposits at central banks, etc. If the Boards decide to keep this restriction in place, additional guidance around what cash balances can be included in "cash" may be beneficial to prevent differences in practice.

13. The DP proposes that an entity should present its similar assets and liabilities that are measured on different bases on separate lines in the statement of financial position. Would this disaggregation provide information that is more decision-useful than a presentation that permits line items to include similar assets and liabilities measured on different bases? Why or why not?

UBS believes that it is informative to segregate information about similar assets measured on different bases. This may, however, present a divergence from what is required by regulators as the US Securities and Exchange Commission requires combined presentation if a single asset is measured under different bases, for instance when there is an embedded derivative requiring bifurcation and measurement at fair value while the host instrument is carried at amortized cost.

14. Should an entity present comprehensive income and its components in a **single statement of comprehensive income** as proposed? Why or why not? If not, how should they be presented?

We have specific concerns about two items: foreign currency translation and cash flow hedging. We would categorize both items as operating. Foreign currency translation is a consequence of being a global financial institution with operations in different functional currencies, whereas cash flow hedging is a consequence of risk management activities for assets and liabilities, in our case, that are not reflected on the statement of financial position and for which fair value changes are not reflected in the statement of comprehensive income. While we understand the Boards' rationale for including such items in the statement of comprehensive income, we do not believe that their inclusion provides more useful information related to UBS's performance. We understand that analysts following UBS ignore such items today and would ignore such items in the future.

UBS believes that users may be confused by the inclusion of other comprehensive income in the same statement as net income. We commend the Boards for retaining a subtotal for net income in its current form as this is a key measurement item for many users.

15. The DP proposes that an entity should indicate the category to which items of **other comprehensive income** relate (except some foreign currency translation adjustments). Would that information be decision-useful? Why or why not?

As noted above, UBS expects to utilize only the operating category, so indicating a single category for every item in other comprehensive income is unlikely to be useful to users of our financial statements.

16. The DP proposes that an entity should further disaggregate within each section and category in the statement of comprehensive income its revenues, expenses, gains and losses by their function, by their nature, or both if doing so will enhance the usefulness of the information in predicting the entity's future cash flows. Would this level of disaggregation provide information that is decision-useful to users in their capacity as capital providers? Why or why not?

As UBS believes that all items of income related to continuing operations would be classified in the operating category, we do not believe that the proposed presentation will enhance users' understanding over the information currently presented in our income statement.

Management considered the definitions presented by the Boards for the classification of assets and liabilities and concluded that it is not inappropriate to segregate the banking activities separately into operating, investing and financing. However, financial institutions are unique in that there business model is to take in deposits from customers and make loans with those deposits. In addition, UBS's investment bank underwrites securities, originates derivatives, and carries on proprietary trading activities. Thus, deposit-taking, lending, investing and financing are interrelated activities. For example, items that other entities would view as financing, are part of the funding activities of our treasury department that are directly linked to providing specified products to customers. Therefore, we have classified such assets and liabilities in the operating category.

Overall, we believe that classification of most assets and liabilities as operating faithfully represents how management views and manages UBS's activities.

17. The DP proposes that an entity should allocate and present **income taxes** within the statement of comprehensive income in accordance with existing requirements. To which sections and categories, if any, should an entity allocate income taxes in order to provide information that is decision-useful to users? Please explain.

As noted above, UBS expects to utilize only the operating category, so the allocation of income taxes as indicated in the question would not provide additional informational value to users.

18. The DP proposes that an entity should present **foreign currency transaction gains and losses**, including the components of any net gain or loss arising on remeasurement into its functional currency, in the same section and category as the assets and liabilities that gave rise to the gains or losses. Would this provide decision-useful information to users in their capacity as capital providers? Please explain why or why not and discuss any alternative methods of presenting this information. What costs should the boards consider related to presenting the components of net foreign currency transaction gains or losses for presentation in different sections and categories?

UBS does not believe that further disaggregation of foreign currency transaction gains and losses provide additional useful information for users of financial institution financial statements. As noted above, this is partly because UBS expects to apply a single category to all items such that there would be no significant disaggregation. We also do not believe that users would benefit from FX gain or loss disaggregation according to whether as asset or liability was monetary or nonmonetary or unrealized versus realized.

19. The DP proposes that an entity should use a direct method of presenting cash flows in the statement of cash flows. Would a direct method of presenting operating cash flows provide information that is decision-useful? Is a direct method more consistent with the proposed cohesiveness and disaggregation objectives than an indirect method? Why or why not? Would the information currently provided using an indirect method to present operating cash flows be provided in the proposed reconciliation schedule? Why or why not?

UBS believes that while a direct method statement of cash flows may benefit users of nonfinancial institutions' financial statements, it would not provide a similar benefit to users of financial institutions' information. UBS does not believe that the direct method is more consistent with the proposed objectives that the indirect method. This is because the indirect method does a superior job of linking the income statement directly to changes in cash position on the balance sheet.

We understand that our investors look for other information, such as the detailed liquidity tables currently presented in our financial statements, to assess the future cash flows of UBS. To elaborate further, liquidity tables and other disclosures on the contractual maturity of obligations and derivative instruments provides a better understanding of future cash flows than an indirect or direct cash flow statement (which cannot provide that type of understanding). Perhaps, the best mechanism to improve information on future cash flows is to permit direct/indirect cash flow statements and require detailed liquidity footnote information that provides information on when assets and liabilities are expected to be realized/settled. We support the DP proposals to accomplish this through the maturity analysis footnotes.

We neither believe that a direct cash flow statement is necessary to understand an entity's cash flows nor believe that its provision in the financial statements results in improved estimates of amounts, timing and uncertainty of future cash flows. We understand that the Boards have a preference for direct cash flow statements but we note that users have worked successfully with indirect cash flow statements for many years. We are not aware of any requests by users of UBS's financial statements for direct cash flow statements. We strongly urge the Boards to not require use of the direct method cash flow statement.

20. What **costs** should the boards consider related to using a direct method to present operating cash flows? Please distinguish between one-off or one-time implementation costs and ongoing application costs. How might those costs be reduced without reducing the benefits of presenting operating cash receipts and payments?

The Boards need to evaluate the cost/benefit of the proposed changes from the aspect of investors. Are the costs of the changes justified by the value of the information provided? The Boards also need to consider the time and costs for system changes to comply with the proposal. UBS has hundreds of entities that would require system work to provide the information required in the proposal. As a result, the Boards should provide a reasonable transition period to enable companies to comply with any final standard.

In order to prepare a direct cash flow statement, the bank would need to invest a significant amount of resources in making system changes at the hundreds of entities that we currently have. We have agreed to perform a detailed analysis of the costs associated with preparing a direct cash flow statement. We hope to finish this exercise over the next several weeks. We will forward to you this detailed analysis once complete.

21. Should the **effects of basket transactions** be allocated to the related sections and categories in the statement of comprehensive income and the statement of cash flows to achieve cohesiveness? If not, in which section or category should those effects be presented?

UBS does not believe this is meaningful for a financial institution based on our expectation of utilizing a single category for most items.

22. Should an entity that presents assets and liabilities in order of liquidity in its statement of financial position disclose information about the **maturities of its short-term contractual assets and liabilities** in the notes to financial statements as proposed? Should all entities present this information? Why or why not?

In general, our approach to presenting liquidity information is consistent with the project guidance. Our liquidity tables in our financial statements include the contractual maturities and also provide explanations for certain differences between the contractual and expected maturities. We believe that the disclosures required by IFRS 7 provide information about the liquidity risk and about our strategies to managing liquidity. We believe that the qualitative aspects of that liquidity management note are very informative and provide a strong foundation for understanding how liquidity risk is managed.

It should be noted that the determination of expected maturities for certain financial instruments, such as variable mortgages, etc., is complex and requires using assumptions about the variables that impact the repayment pattern. These variables include the anticipated rate of early repayments, market factors including interest rates, refinancing options, etc. Similar factors would typically be taken into consideration when we would determine the fair value of these instruments and to determine what the expected cash flows for these instruments are. Consequently, we think that the Boards should consider that expected maturities should be consistent with expectations and assumptions made in calculating their respective fair values, if applicable. In addition, some estimates are based on portfolios of similar instruments; guidance should be broad enough to encompass portfolio measurements and expectations.

23. The DP proposes that an entity should present a schedule in the notes to financial statements that reconciles cash flows to comprehensive income and disaggregates comprehensive income into four components: (a) cash received or paid other than in transactions with owners, (b) accruals other than remeasurements, (c) remeasurements that are recurring fair value changes or valuation adjustments, and (d) remeasurements that are not recurring fair value changes or valuation adjustments. Would the proposed **reconciliation schedule** increase users' understanding of the amount, timing and uncertainty of an entity's future cash flows? Why or why not? Please include a discussion of the costs and benefits of providing the reconciliation schedule. Should changes in assets and liabilities be disaggregated into the components described in the DP? Please explain your rationale for any component you would either add or

omit. Is the guidance provided the DP clear and sufficient to prepare the reconciliation schedule? If not, please explain how the guidance should be modified.

It is not clear that this statement provides any more information on the amounts, timing, and uncertainty of UBS's future cash flows. Our liquidity disclosures do a much better job of communicating the liquidity of the bank. We think that any reconciliation would have to be accompanied by a detailed explanation of its purpose and benefit. Potentially, it may be necessary to provide illustrative examples for reconciliation line items to fully educate users on what the table attempts to communicate. Taken together with a direct method statement of cash flows, we do not think that the amounts, timing, and uncertainty of future cash flows are more readily understandable.

24. Should the boards address further disaggregation of **changes in fair value** in a future project? Why or why not?

It is currently very difficult and time consuming for UBS to develop the valuations for current disclosure and IFRS 7 requires much of this information. To provide much additional information would require a deal more work with no clear incremental benefit to users.

25. Should the boards consider other **alternative reconciliation formats** for aggregating information in the financial statements, such as the statement of financial position reconciliation and the statement of comprehensive income matrix described in Appendix B, paragraphs B10–B22? For example, should entities that primarily manage assets and liabilities rather than cash flows (for example, entities in the financial services industries) be required to use the statement of financial position reconciliation format rather than the proposed format that reconciles cash flows to comprehensive income? Why or why not?

We do not believe that an alternative reconciliation is any more beneficial to users. The most beneficial reconciliation, in terms of cost and content, is the indirect method of cash flows, which we already prepare and against which the Board has decided.

- 26. The FASB's preliminary view is that a memo column in the reconciliation schedule could provide a way for management to draw users' attention to unusual or infrequent events or transactions that are often presented as special items in earnings reports. The IASB is not supportive of including information in the reconciliation schedule about unusual or infrequent events or transactions.
- A) Would this information be decision-useful to users in their capacity as capital providers? Why or why not?
- B) APB Opinion No. 30 Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, contains definitions of unusual and infrequent (repeated in paragraph 4.51). Are those definitions too restrictive? If so, what type of restrictions, if any, should be placed on information presented in this column?
 - C) Should an entity have the option of presenting the information in narrative format only?

We currently provide additional information related to unusual or infrequent events or transactions in our MD&A discussion. We do not believe that additional benefit to users would result from requiring separate presentation in the reconciliation schedule.