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The South African Institute of Chartered Accountants
Die Suid-Afrikaanse Instituut van Geoktrooieerde Rekenmeesters

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Sir David Tweedie
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Dear David

EXPOSURE DRAFT ON PROPOSED IMPROVEMENTS TO IAS 32 AND IAS 39

In response to your request for comments on the proposed improvements to IAS 32 and IAS 39, I attach the comment letter prepared by the South African Institute of Chartered Accountants (SAICA).

We would like to thank you for the opportunity to provide comments on this document. We have in addition to our response to the questions raised, also included general comments on aspects not specifically dealt with in the questions. Overall, we believe that adoption of many of the proposed improvements would remove certain measurement anomalies and make the two standards clearer and easier to implement. However, we are concerned that certain of the proposed changes may result in further removal of financial instruments from the principles formulated in the Framework. We agree that the measurement model for financial instruments should promote greater use of fair value and we appreciate the argument that a mixed measurement model has to give rise to application difficulties and problems. However, in our view, solutions to overcoming those problems and difficulties should be based on general existing principles and the fundamental concept of "substance over form", rather than piecemeal guidance and specific rules provided by the way of numerous examples.

Neither IAS 32 nor IAS 39 address the important issue of classification of different types of gains and losses in the income statement. The standards merely focus on whether or not gains/losses get taken to income, yet they are silent on their placing within the income statement. We recognise that this issue should be dealt with as part of the project on Reporting Financial Performance, but the IASB needs to resolve this issue urgently.

Please do not hesitate to contact me should you wish to discuss any of our comments.

Yours sincerely

Linda de Beer
Technical Director

cc: Peter Wilmot (Chairman of the Accounting Practices Board)
Pat Smit (Chairman of the Accounting Practices Committee)

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GENERAL COMMENTS

1. Scope of IAS 32 and IAS 39

The scope of the two standards is inconsistent, and the standards do not complement each other. In our opinion, greater consistency could be achieved by clarifying certain guidance and by reinforcing disclosure requirements, for example:

- commitments to buy or sell non-financial assets – the guidance on classification of commitments to buy or sell non-financial assets is included in different paragraphs of the standards with no clear references. Moreover, the guidance is not clear and creates considerable scope for discretion, due to use of such notions as “normal” sale and usage or “a practice of settling net”;

- loan commitments – the guidance about when they can be excluded from IAS 39 refers to “net settlement” without explaining the term. It is not clear why such commitments are scoped out of IAS 39;

- weather derivatives – such derivatives are scoped out of both standards, creating a gap in disclosure requirements.

2. Classification of derivatives on own shares

We find the guidance provided very complex and difficult to apply in practice. We are concerned that the guidance may not take into account the economic substance of the instrument.

3. Derecognition and pass-through arrangements

Whilst the majority view supported the continuing involvement approach due to its clarity and ease of use, a view was expressed that it does not represent an improvement and, by ignoring risks and rewards associated with the assets, it seems to give more opportunities for financial engineering. This commentator was also concerned that the guidance about pass through arrangements creates a rule that will allow for bypassing the consolidation requirements with respect to special purpose entities in SIC-12.

4. Classification of financial instruments

While we support a greater use of fair value, we are concerned that an opportunity to measure own liabilities at fair value may give rise to practical difficulties and, more importantly, may create room for management’s discretion and “cherry-picking”.

It should be considered whether instruments designated as “held for trading”, irrespective of intention, should represent a new category of financial assets and financial liabilities in order to avoid confusion around their presentation.

5. Fair value measurement consideration

We appreciate the additional guidance provided, however, it seems to focus on financial assets rather than liabilities. We believe that more guidance about fair valuing own liabilities is required in order to assist implementation.

6. Impairment of financial assets

We do not find the additional guidance about impairment of equity securities very useful. We are therefore concerned that the proposed requirement removing a possibility of a reversal of such impairment may discourage entities from recognising such impairment.

7. Recognition and measurement of low-interest loans

We believe that IAS 39 should provide more guidance about recognition and subsequent measurement of low-interest and interest-free loans, specifically clarifying whether the requirements with respect to such loans apply to transactions between group entities, where repayments terms are often not specified.

IAS 32: FINANCIAL INSTRUMENTS - DISCLOSURE AND PRESENTATION

Question 1 - Probabilities of different manners of settlement (paragraphs 19, 22 and 22A)

Do you agree that the classification of a financial instrument as a liability or as equity in accordance with the substance of the contractual arrangements should be made without regard to probabilities of different manners of settlement? The proposed amendments eliminate the notion in paragraph 22 that an instrument that the issuer is economically compelled to redeem because of a contractually accelerating dividend should be classified as a financial liability. In addition, the proposed amendments require a financial instrument that and issuer could be required to settle by delivering cash or other financial assets, depending on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder of the instrument, to be classified as a financial liability, irrespective of the probability of those events or circumstances occurring (paragraph 22A).

We appreciate the intention to reduce the scope for discretion in the classification of instruments into debt or equity. As we understand, the objective of the proposed change is to provide a general framework that would result in a consistent classification of instruments, based on objective indicators as to their substance. We believe that Question 1 addresses two issues: economic compulsion and probability of different manners of settlement, therefore, we have commented on these two issues separately.

Economic compulsion

In our opinion, economic compulsion that may force cash settlement of an instrument by its issuer is not a matter of probability, but rather a matter of commercial substance of that instrument. In any event, classification of an instrument that can be redeemed at the option of the issuer involves considerable judgement as to the discretion of the issuer over the cash settlement. Economic compulsion represents an important objective indicator over which the issuer may have very little or practically no discretion. Therefore we do not agree with the proposal to delete guidance on economic compulsion as it may lead towards more legal-form-based and bright-line accounting. We believe that additional guidance should rather be provided on how to assess and interpret the impact of economic compulsion in the classification process.

Way of settlement depending on uncertain future events

We agree with the proposed change to remove the reference to the probability of cash settlement from paragraph 22A. If an issuer of an instrument has a contractual obligation to deliver cash that cannot be avoided, that instrument represent a liability even if cash settlement is contingent on uncertain future events or the outcome of uncertain circumstances that are beyond the control of the issuer and the holder. Due to general uncertainty of the outcome in such a situation, it would be extremely difficult to demonstrate the remoteness of the cash settlement.

Question 2 - Separation of liability and equity elements (paragraph 28 and 29)

Do you agree that the options in IAS 32 for an issuer to measure the liability element of a compound financial instrument initially either as a residual amount after separating the equity element or based on a relative-fair-value method should be eliminated and, instead, any asset and liability elements should be separated and measured first and then the residual assigned to the equity element?

We agree with the proposed amendment.

Question 3 - Classification of derivatives that relate to an entity's own shares (paragraphs 29C – 29G)

Do you agree with the guidance proposed about the classification of derivatives that relate to an entity's own shares?

We disagree with the guidance proposed about classification of derivatives that relate to an entity's own shares. Whilst we support some of changes that are being proposed, we have concerns about introducing yet another model for accounting for guarantees, in this case in the form of a written put on own shares. In our view the approach should take account of the probability of a call being made on the guarantee (consistent with the IAS 37 approach for providing for a guarantee), except that changes in the provision should be charged to equity.

Further, we do not agree with the proposals in paragraph 29E. As a matter of principle we do not believe that accounting conclusions should be dependent upon past behavior. In our view, if an entity has the right to settle a fixed obligation by issuing a fixed number of its own shares then the instrument should be treated as equity. If there is a net share settlement provision then we suggest that rules similar to hedge accounting are applied. Thus if the intention is to settle gross then this should be documented at the outset and the contract treated as equity only if it is highly probable that it will be settled gross in shares. If the intention changes or gross settlement is no longer highly probable then the backlog gain/loss should be reported immediately in income.

If the Board believes that an anti-abuse provision is necessary, then it should deal with this in a consistent manner to the rules on held-to-maturity assets. The Board should not invent another new model.

We find the proposed guidance about the classification of derivatives based on an entity's own shares complex. Transactions in own equity are becoming increasingly common and therefore, it is necessary that classification of such instruments be based on a general principle, rather than on a set of rules tailored to simplistic types of transactions.

The approach prescribed for instruments with multiple settlement alternatives seems very difficult to apply in practice. It gives rise to similar issues such as the classification of instruments into liability or equity. We would appreciate more guidance on that issue. For example, on what basis can it be determined whether an entity has an established practice of settling gross?

Question 4 - Consolidation of the text in IAS 32 and IAS 39 into one comprehensive Standard

Do you believe it would be useful to integrate the text in IAS 32 and IAS 39 into one comprehensive Standard on the accounting for financial instruments? (Although the Board is not proposing such a change in this Exposure Draft, it may consider this possibility in finalising the revised Standards.)

While we agree with the intention to consolidate IAS 32 and IAS 39, we are concerned that the scope of the two standards is not yet entirely consistent. Certain financial instruments are scoped out of IAS 39, but remain within the scope of IAS 32, for example loan commitments. The integration of the text, and applying the scope of IAS 39, may result in excluding some instruments from the presentation and disclosure requirements. Furthermore, a consolidation of the two Standards will result in a single long and complex document. The combined Standard may be difficult to use and interpret, purely due to its size.

We are also uncertain regarding the status of the implementation guidance and to what extent this will be incorporated as well. The status of IGC Q&As that have not been incorporated into the revised standards needs to be clarified. The status is even further unclear in view of the inconsistencies between some of the IGC guidance and the requirements of the standard.

IAS 32 - Other comments

1. *Paragraph 1(a) scope - interests in subsidiaries*

   The scope should be amended to include derivatives on the equity interests in a subsidiary, where these instruments are concluded with an external party.

2. *Paragraph 1(a) scope - insurance contracts*

   The definition of an insurance contract needs amendment to bring it into line with the thinking that the Board has developed on its insurance project. If the Board decides not to adopt this approach then guidance is necessary to clarify the meaning of “principally” when used to determine the boundary between financial instruments and insurance contracts.

3. *Paragraph 1(a) scope – climatic, geological or physical variables*

   We disagree that the definition excludes these contracts. We suggest that they be included and that the definition of a derivative be expanded such that it is not limited to financial indicators. We also point out that there are often liquid markets in these instruments and the fact that the underlying is non-financial should not change the principles of accounting to be applied.

4. *Paragraph 1(e) – contracts that require payments based on climatic, geological or other physical variables*

We are uncertain of the reason for excluding such contracts from the disclosure requirements. We appreciate that they often address insurance risk and additional guidance will need to be provided with respect to their recognition and measurement. However, lack of detailed guidance should not prevent entities involved in such contracts from disclosing the associated risk exposure in the financial statements.

5. *Paragraphs 4A and 4B – Contracts to buy or sell non-financial assets*

In our opinion, the guidance about commitments to buy or sell non-financial assets is not sufficiently clear. We would appreciate additional guidance on how to interpret "expected purchase, sale or usage". If an entity takes physical delivery of an item and then immediately sells that item to a third party – does it represent a practice of "selling within a short period of time", and consequently, does the contract become a derivative?

Many entities that enter into commodity-based contracts do so to fix the acquisition price of their inventories. In many cases they will forecast usage needs and enter into the commodity-based contracts at the beginning of the cycle. By the end of the cycle they realise that they have acquired more contracts than required for expected production purposes and then settle the excessive contracts on a net basis. It is not always clear at inception of such contracts how the entity will settle them. Should they be classified on an individual basis? Additional guidance would be appreciated in this regard. It is uncertain whether it is possible to have some contracts that are classified as trading derivatives and some that are excluded from the scope of the standard because they are acquired for sale and usage requirements.

The text in paragraph 4B indicates that a contract to buy or sell a non-financial asset meets the definition of a derivative even if does not provide for net settlement, however, one of the parties has a ***practice*** of settling such contracts net with a third party, or a ***practice*** of taking delivery and selling it within a short period of time. Such settlements are not uncommon and we believe that guidance should be provided on what constitutes "the practice". Moreover, that guidance should be reinforced and referred to in other paragraphs of the Standard that discuss commitments to buy or sell non-financial assets (for example, paragraph 14).

Paragraph 4B refers to "… if an entity has a practice…". It is unclear as to how one establishes this practice, for instance in a new business scenario, or when the practice changes - how many instances of different treatment establish a new practice? In our experience, this exemption is widely abused and we suggest that more guidance be given on the crux of the exemption – and that is to make it clear what is meant by "expected purchase, sale or usage requirements". If a financial institution buys a grain future and expects to sell it at a future date (before delivery), we submit that this should not be considered "an expected sale" requirement and the instruments should therefore not be exempted.

6. *Paragraphs 22, A20 and A21 – preferred shares that may indirectly establish a contractual obligation to deliver cash*

Classification of such preferred shares is very difficult and requires a great deal of judgement in the evaluation of the significance and impact of various terms attached to those shares. We believe that more guidance is required in this area, preferably illustrated by examples. Based on our experience, preferred shares often represent, in substance, a liability rather than an equity instrument, even though there is no legal requirement to deliver cash. The proposed guidance seems rather weak and does not indicate what factors should be considered in the classification. The examples of issues that, in our opinion, should be addressed are:

- assessment of economic compulsion which may be demonstrated by the issuer's obligation to pay accelerating dividends, or by other terms; or
- assessment of the issuer's obligation to pay a cumulative fixed-rate dividend on a regular basis (e.g. annually) for a specified or unspecified period of time.

7. *Paragraph 22 – deletion of guidance on economic compulsion*

We have great concerns regarding the deletion of the text on economic compulsion. In fact, we support greater guidance being provided to determine when this concept should be applied as we suspect that inadequate attention has been given to this in the past.

In practice, this text has enabled us to advise our clients on the appropriate treatment of instruments that are designed by 'structurers' to be accounted for as equity, yet are priced as liabilities by investment banks and investors. Generally the substance of these instruments is very clear: almost all behave like debt instruments, except on liquidation of the entity. The economic compulsion argument is an important ingredient in ensuring that the true substance of the instrument is reflected in the financial statements.

8. *Paragraph 22A - contingent settlement provisions*

We support including the guidance from SIC 5, however, we believe that it now needs further refinement as it has led to certain inconsistencies in practice.

A practical issue, for example, arises in relation to a debt instrument that is convertible into equity shares. If the conversion right is contingent upon reaching a specific index amount (say the entity's own share price at issue date plus 5%), then this seems caught by SIC 5, yet there is no conceptual basis to distinguish this from a convertible without this feature where split accounting would be applied.

Guidance should also be included on how to account for an instrument that is mandatorily convertible into shares, but contains provisions that change the number of shares to be issued dependent upon an index.

9. *Paragraph 22C*

The requirement to classify the described instrument as a liability seems to disregard the embedded derivative that is present in the instrument. In some cases an entity may have an obligation of an amount that fluctuates in part or in full in response to changes in a variable other than the market price of its own equity instruments, for example, profit levels or turnover. We believe that in such cases the "embedded" will not be a derivative, but the full amount recognised as a liability (the amount of which is determinable based on the other factor). Any amendment to this paragraph should bring this factor into consideration.

10. *Paragraphs 22 - 22C/29A - 29G equity minority interests*

Under the proposals, equity minority interest should be reported within the equity section of group financial statements. The revised text does not explain whether the same treatment must be applied to derivatives on own shares and to derivatives on minority shares. We understand that IFRIC is to address this issue and urge that IFRIC to consult on this matter and that its conclusions be adopted within the revised standard.

11. *Paragraph 26 – measurement of the conversion option in a convertible instrument*

Under the existing Standard, the issuer of the instrument recognises the equity conversion when the instrument is issued and does not re-measure that option until conversion or maturity of the instrument. However, the issuer may be forced to convert early or, may encourage holders to convert the instrument early (using an incentive). Such early or induced conversion may result in a gain or, more often in a loss. The standard does not provide any guidance on how to account for such gains and losses. We would appreciate an indication whether such gains and losses should be reflected in the income statement or in equity.

12. *Paragraph 29F – obligation to redeem an entity's own shares*

As indicated in the discussion in paragraphs B23 and B24, such instruments meet the definition of a derivative and, in our opinion, should be accounted for as such.

13. *Paragraph 31A and B - cost allocation*

We feel that the principle should be that only external incremental costs related to a share issue can be carried forward and that the total should always be allocated based upon the relative fair values of the shares in issue and the new shares created. We have also experienced some practical difficulties in distinguishing between costs that are external and those that are internal (for example in cases where a transaction could be outsourced, but has instead been supported from within the organisation, and in other cases some argue that *all* costs are by definition external) as well as determining what 'incremental costs' are. It is also unclear what is meant by a transaction that is "not completed" and we suggest that it be made clear that this refers to a transaction that is not completed *as at reporting date*.

14. *Paragraph 44 – disclosures*

Narrative disclosure is necessary to place the quantified data into context.

15. *Paragraph 45 - currency risk disclosures*

In our experience, for most entities the currency risk exposure has a far more significant impact on profits and net assets than either interest rate risk or credit risk. The current disclosures on the latter two components outweigh the requirements in relation to spot and forward currency positions. We suggest that the changes proposed to IAS 21 and IAS 32 should accordingly be expanded to address this shortcoming.

16. *Paragraph 77B(d) – disclosures about fair values*

Where an entity makes a assumptions in order to value a financial instrument and these assumption may be replaced by alternative assumptions, the assumptions chosen should be disclosed. This would be in line with the proposed amendments to IAS 1 paragraph 110.

17. *Paragraph 80 - going concern presumption in fair value measurement*

The deletion of this paragraph is consistent with the basic premise that IAS 32 deals with only disclosure and presentation rather than measurement. We would suggest that the Board clarify that where an entity fair values an instrument in situations where the going concern assumption is no longer applicable, then this should be disclosed.

18. *Paragraph 93A.(g)(ii) - disclosure of collateral*

We suggest that the wording in this paragraph should be changed as follows "the fair value of the collateral that it has sold and if the entity has an obligation to return it."

19. *Paragraph 94 - additional disclosures*

This paragraph relates to the additional disclosures in respect of the income and expense recognized during the period; and the averages for the balance sheet amounts. We feel that this is very useful information in assessing the activity and risk undertaken by the entity during the period, rather than only the information at the end of the period. Rather than the paragraph being deleted, we suggest that it be added to the *required* disclosures. In some cases entities close out positions just before reporting date and then immediately recreate the positions after year-end. This creates a situation at balance sheet date that does not provide sufficient information to users of the exposures that were assumed during the reporting period.

20. *Paragraph A7 – Equity instruments: warrants*

The paragraph gives warrants as an example of an equity instrument. In practice, warrants are commonly settled net in cash and therefore they would meet the definition of a derivative. We suggest that warrants are dropped from this paragraph. In particular, an entity may issue warrants and then "reacquire" them as part of its trading portfolio. Such instruments will meet the definition of a derivative.

IAS 32 - Matters not specifically addressed

1. *Classification and treatment of linked units*

Property companies in South Africa often issue linked units. In terms of the linked unit, a portion is issued to the unit holder as equity and a portion issued as a debenture. The two elements cannot be sold separately. The debenture portion is the larger portion of the entire instrument (for example 99% of the value). This is set up for tax purposes, as interest is tax deductible by the property company. The trust deed generally provides that a percentage of the profits must be paid out to the unit holders on an annual basis, for example, 85%. This represents the "interest" and "dividend" on the linked units. Such distribution always takes place at the same time. The debentures generally have a repayment date at least 25 years after issue, but are often not repaid. We would appreciate additional guidance on the accounting treatment and classification of such instruments, possibly in an appendix to the statement.

2. *Presentation of embedded derivatives (not addressed in IAS 39)*

IAS 39 does not address the presentation and disclosure of embedded derivatives in the balance sheet. We believe that IAS 32 should provide guidance on that issue.

IAS 39 : FINANCIAL INSTRUMENTS - RECOGNITION AND MEASUREMENT

Question 1 – Scope: Loan commitments (paragraph 1(i))

Do you agree that a loan commitment that cannot be settled net and the entity does not designate as held for trading should be excluded from the scope of IAS 39?

We support the view expressed in IGC Question 30-1 that a bank's commitment to make a loan at a <u>fixed rate</u> in the future, is a derivative instrument.

We are not certain of the reason for the proposed exclusion of loan commitments per se. Loan commitments are within the scope of IAS 32 and we believe that they should remain within the scope of IAS 39.

We are not clear on what is meant by "net settlement" of a loan commitment. If the exclusion is retained, we suggest that an explanation of the term be provided.

Question 2 – Derecognition: continuing involvement approach (paragraphs 35 – 57)

Do you agree that the proposed continuing involvement approach should be established as the principle for Derecognition of financial assets under IAS 39? If not, what approach would you propose?

We support the proposed continuing involvement approach for its ease of use and clarity it provides. We appreciate the fact that the existing principle combining the component approach with the "risks and rewards" model is very difficult to apply and we agree that a revision is required.

A strong view was expressed that the continuing involvement approach is mechanical and assumes that fair value of any portion of a financial asset can be reliably estimated. Application will result in various elements of a financial asset (for example, interest-only strips) and "new" financial assets (for example, servicing assets) being reflected in the balance sheet in different lines, based on a number of assumptions. In the absence of experience with and understanding of this model, this may result in entities misrepresenting the substance of transactions. More importantly, readers of the financial statement may fail to link the retained elements with the original financial assets to understand the overall impact of the transfer.

A concern was raised that some of the elements of continuing involvement may not meet the definitions of asset and liabilities, resulting in a meaningless effect of grossing up of the balance sheet. This concern was addressed via the application of set-off in instances where the requirements for set-off appeared to have been achieved.

Question 3 – Derecognition: pass-through arrangements (paragraph 41)

Do you agree that assets transferred under pass-through arrangements where the cash flows are passed through from one entity to another (such as from a special purpose entity to an investor) should qualify for derecognition based on the conditions set out in paragraph 41 of the Exposure Draft?

The arrangements described in paragraphs 41 and 42 as pass-through arrangements may be somewhat simplistic. A commentator felt that the specific rule for pass-through arrangements might be used as an excuse to derecognise the transferred assets from the special purpose entities balance sheet before its consolidation is even considered.

If the proposed change is approved, the reference to a special purpose entity in the example in paragraph 42 may make the requirements of SIC-12 superfluous.

We note that paragraph 41a requires that an entity collects "equivalent amounts" but are unsure of the meaning. In practically all circumstances the transferor takes a margin off the amounts collected. Does this mean that it would not be a pass-through arrangement, as they are not paying over "equivalent amounts"? Surprisingly, paragraph 42 then refers to the transfer of "all *or a portion* of the contractual rights to cash flows" which implies that the transferor *can* keep a margin on the flows and that the amounts will not be equivalent.

Question 4 - Measurement: fair value designation (paragraph 10)

Do you agree that an entity should be permitted to designate any financial instrument irrevocably at initial recognition as an instrument that is measured at fair value with changes in fair value recognised in profit or loss?

We agree with the principle.

A view was expressed, however, that an option to measure financial liabilities at fair value may, in the absence of specific restrictions, disclosure requirements and guidance, permit "cherry picking" and recognition of gains resulting from unfavourable changes in the credit standing of the entity in the income statement. In a number of countries, due to the underdeveloped market in rated, traded corporate debt, the determination of reliable fair values will be very difficult, leaving substantial room for the use of discretion. We appreciate, however, that this amendment represents a major step toward a greater use of fair values for financial instruments.

In establishing the fair value of an instrument, the credit worthiness of the entity that has issued that instrument has to be considered. By designating its debt as a held for trading instrument, an entity who has been downgraded will realise a profit through the income statement. Therefore an entity that may have serious going concern issues, may become technically solvent through this provision. This raises the issue of whether the credit worthiness of an entity should be taken into consideration in the calculation of the fair value of its own debt. IAS 39.98 states that –

"Underlying the definition of fair value is a presumption that an entity is a going concern without any intention or need to liquidate, curtail materially the scale of its operations, or undertake a transaction on adverse terms. Fair value is not, therefore, the amount that an entity would receive or pay in a forced transaction, involuntary liquidation, or distress sale."

In our opinion, this paragraph could preclude the consideration of one's own credit-worthiness in an entity that may have a going concern problem in calculating the fair value of the entity's own debt. If this is true, we suggest that the revised standard should make this clear.

Another issue is the legal aspect of fair valuing a debt instrument. Even though the fair value of a liability may change and even though the liability may be capable of settlement at that adjusted value (e.g. by negotiation between the parties), legally an entity is liable for the face amount /amortised cost. It would therefore be useful to disclose the amortised cost of a liability, where it is carried at fair value. The disclosure requirement may be deduced from the IAS 32 requirement to show terms, conditions etc of all financial instruments (and IAS 32 paragraph 49 requires disclosure of the 'principal'), but we feel the amendments to IAS 39 could make this disclosure linkage clear.

We also suggest that the last sentence of the first definition in paragraph 10 will more clearly reflect the ambition of the standard (and paragraph 17A) if it were to state: "Any financial instrument may be ***irrevocably*** designated as held for trading when it is initially recognised".

The proposed amendment specifies that in presenting and disclosing information, an entity should label such instruments "other than trading". This effectively introduces a new category of financial assets and financial liabilities. We believe that this change, if approved, should be reflected in the paragraphs discussing definitions and classification, on a consistent basis. Otherwise it may lead to misunderstandings and confusion.

Question 5 – Fair value measurement considerations (paragraphs 95 – 100 D)

Do you agree with the requirements about how to determine fair values that have been included in paragraphs 95 – 100 D of the Exposure Draft? Additional guidance is included in paragraphs A32 – A42 of Appendix A. Do you have any suggestions for additional requirements or guidance?

We appreciate the additional guidance on how to determine fair values and, in general, we agree with the requirements. However, the discussion and the examples provided seem to focus on the measurement of financial assets rather than liabilities. Paragraph 100C states that creditworthiness of a debtor should be taken into consideration in applying discounted cash flow analysis to determine fair value of a financial asset. Paragraph 100D discusses in detail the valuation of a debt instrument. There is no guidance about elements that have to be included in a valuation model for a financial liability. We believe that, in the absence of experience and historical records, the measurement of financial liabilities at fair value will pose certain difficulties, primarily with estimating of own credit risk. It is therefore necessary to provide examples demonstrating how to estimate fair value of liabilities.

Moreover, guidance should be provided about whether and how to take liquidity into account. For example, for the sale of a large block of shares, the most recent transaction price may not constitute the best indicator of fair value.

More guidance is also required about determining fair value in the situation where an entity is a "market maker" for a particular instrument, for example, an individually negotiated a 20-year cross-currency swap. Another example would be warrants linked to a share, which are typically priced by a seller at a price above their fair value.

It is also worth clarifying that a change in a valuation technique should only be allowed in the event where it could be demonstrated that the newly adopted technique results in a more appropriate solution. It should be emphasised that the basis for calculating inputs must be consistent.

We do not support the proposed deletion of paragraph 98. This requires that one take into account the current circumstances of the entity in determining fair value. Where an asset's value is affected by a decision to dispose of the asset in the immediate future, it is appropriate to reflect the impact of that decision within the valuation methodology.

Finally, we would appreciate more guidance on measurement of unlisted equities. When can *inability to determine fair value* be demonstrated?

Question 6 – Collective evaluation of impairment (paragraphs 112 and 113 A – 113 D)

Do you agree that a loan asset or other financial asset measured at amortised cost that has been individually assessed for impairment should be included in a group of assets with similar credit risk characteristics that are collectively evaluated for impairment? Do you agree with the methodology for measuring such impairment in paragraphs 113 A – 113D?

We agree that a financial asset measured at amortised cost that has been individually assessed for impairment and with respect to which no impairment has been observed, should be included in a group of assets with similar credit risk characteristics that are collectively evaluated for impairment. This will ensure that such an asset is taken into consideration when impairment losses inherent in a portfolio, but not yet specifically identified, are being assessed (for example, in the determination of concentration risk). It will also provide a consistent measurement basis for all financial assets.

Moreover, we support the view that a financial asset that has been individually assessed for impairment and identified as impaired should be excluded from a group of assets that are evaluated on a collective basis. We believe that the assessment performed on an individual basis generally provides more accurate and reliable results. We view the collective assessment as an acceptable alternative in the situation where individual assessment would be unworkable.

We support the view that assets should be included in a collective evaluation of impairment subsequent to initial recognition. This principle illustrates the assumption expressed in the Framework about losses inherent in a portfolio of assets.

We also agree with the requirement that estimated expected future cash flows should be discounted using a rate that takes into account an adjustment for the initial expected loss rate. That would result in adjusting an interest rate on any portfolio at a contractual rate other than the interest-free one. Interestingly, if the credit risk of the portfolio remained constant over its life, there should be no further impairment recognised (no impairment would be specifically identified) and all assets within that portfolio amortised at the risk free rate. We understand that this is an intention of the standard, however, it is worth explaining and confirming.

Question 7 – Impairment of investments in available–for–sale financial assets (paragraphs 117 – 119)

Do you agree that impairment losses for investments in debt and equity instruments that are classified as available for sale should not be reversed?

We do not agree conceptually with the proposed change. In many cases the difference between impairment and a decline in fair value is very subtle and difficult to evaluate. In our opinion, the proposed amendment may deter entities from recognising impairment losses, specifically for equity instruments classified as available-for-sale. Moreover, in accordance with the change, the treatment of impairment losses for investments would no longer be consistent with the treatment of impairment losses for other assets and would not be consistent with the provision of IAS 2, IAS 8 and IAS 36.

Question 8 – Hedges of firm commitments (paragraphs 137 and 140)

Do you agree that a hedge of an unrecognised firm commitment (a fair value exposure) should be accounted for as a fair value hedge instead of a cash flow hedge as it is at present?

We agree with the proposed amendment. However, we believe that guidance should be provided to explain the difference between a firm commitment and highly probable forecast transaction. A commitment to purchase equipment in foreign currency will result in a different accounting treatment for that equipment compared to a forecast purchase, since in the first case the initial value of equipment will be adjusted and in the latter case there will be no basis adjustment. Another question worth clarifying is whether the hedge accounting model should be changed if a forecast transaction becomes a firm commitment (upon signing of a contract).

We would also appreciate guidance on the balance sheet classification of the recognised fair value changes of the hedged firm commitment. Should it be included in the initial carrying value of the assets and liabilities recognised as a result of committed transaction? How should it be presented prior to initial recognition of the firm commitment?

There seems to be an anomaly in respect of the requirements for cash flow hedge accounting. A cash flow hedge is described as "a hedge of the exposure to variability in cash flows that is (i) attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a forecasted transaction (such as an anticipated purchase or sale) and that (ii) could affect reported net profit or loss)".

The examples in paragraph 139 have been deleted leaving the only example that of an interest rate swap. The question arises as to why the swap should be defined as a cash flow hedge given that it is a "firm commitment", which should be recognized as a fair value hedge. Further, in order to qualify for hedge accounting, the transaction has to be "highly probable", therefore does this require that it has to be a "firm commitment" to be highly probable? The Board should issue guidance on the definition of these terms to create consistency and in this regard we note that US GAAP devotes a number of pages to addressing this issue.

The Interpretations Guidance Committee ("IGC") has issued guidance stating that:

- it is unlikely that an enterprise could predict future cash flows with sufficient certainty that 100% of forecasted aggregate cash flows could qualify as 'highly probable' for hedge accounting purposes. On the other hand it is possible, based on reliable forecasting processes, that a portion of predicted cash flows, normally those expected in the short-term, will qualify as 'highly probable';

- a forecasted transaction is 'highly probable' (and can therefore qualify for hedge accounting) if its timing can be forecast reliably within a three month time period. As long as the transaction actually takes place within a short period, say two months, after it was forecast, hedge accounting can be applied; and

- retrospective effectiveness testing can be carried out either on a period-by-period basis or on a cumulative basis since the inception of the hedging relationship.

The anomaly is further emphasised by paragraph 29 (e) – "planned future transactions, no matter how likely are not assets or liabilities of an entity because the entity has not become a party to a contract".

In terms of changing the accounting treatment of a hedge of a firm commitment from a cash flow hedge to a fair value hedge, and therefore reflecting the net profit or loss resulting from the hedge of a firm commitment in the income statement, it is of concern to long-term borrowers that the benefit of the hedge is not reflected in the balance sheet or in the long-term funding rate achieved by the borrower.

Since the performance of long-term borrowers is more visible when viewed through the balance sheet or the long-term funding rate we believe there is merit in the argument that the change in the fair value of the hedge is included in the initial measurement of the hedged item.

Question 9 – "Basis adjustments" (paragraph 160)

Do you agree that when a hedged forecast transaction results in an asset or liability, the cumulative gain or loss that had previously been recognised directly in equity should remain in equity and be released from equity consistently with the reporting gains or losses on the hedged asset or liability?

We agree, although the proposed treatment of cash flow hedges will complicate the related accounting. It will be cumbersome to keep track of hedging gains and losses relating to assets that do not affect the income statement in a systematic way, for example, inventories (where a purchase transaction has been hedged). However, we appreciate the argument about convergence with the cash flow hedge accounting model under US GAAP. Given that both approaches eventually have the same effect on the income statement, we support the proposed change.

It may be worth pointing out that the proposed accounting is not consistent with the principle in IAS 16 under which capitalisation of the hedging cost would be allowed.

A view was held by some commentators that basis adjustments should not be eliminated. The following explanation was put forward to substantiate this view:

> By retaining the cumulative fair value adjustment on the hedging instrument in equity, we believe that the balance sheet would not fairly reflect the extent of the reporting entity's hedging activities.
>
> The hedging criteria under AC 133 are onerous to satisfy, and only bona-fide hedging transactions are therefore likely to qualify for hedge accounting. On this basis, we believe that, provided the hedge criteria are met, the accounting treatment of hedging transactions should ensure that both the balance sheet and the income statement reflect the economic substance of the underlying hedging relationship. With the hedging gains or losses reported and retained in equity, the carrying value of a forecast acquisition of a financial asset or issuance of a financial liability would be recorded at the market rate prevailing on the date of the transaction. The benefit of the associated hedging activities would be ignored from a balance sheet perspective, and may therefore be misleading to users of the financial statements. Having met the stringent hedging criteria set out under IAS 39 we cannot see the benefit of now introducing a further constraint on reflecting the true economic substance of having carried out the hedge.

We do not believe that the substantive differences between the hedge of a forecast transaction and the hedge of a firm commitment are sufficient to warrant different accounting treatments.

By isolating the hedging gains or losses from the underlying hedged item, an additional burden will be placed on the entity's accounting and information systems. From a benefit versus cost basis it would appear that much time would need to be consumed in complying with this amendment with little or no benefit to users of the information.

Question 10 – Prior derecognition transactions (paragraph 171 B)

Do you agree that a financial asset that was derecognised under the previous Derecognition requirements in IAS 39 should be recognised as a financial asset on transition to the revised Standard if the asset would not have been derecognised under the revised Derecognition requirements (i.e. that prior Derecognition transactions should not be grandfathered)? Alternatively, should prior Derecognition transactions be grandfathered and disclosure be required of the balances that would have been recognised had the new requirements been applied?

We do not agree with the proposed change. Since the proposed approach "loosens" the requirements, it is likely that re-assessment would result in derecognition of assets that may have been precluded from derecognition in the past. This is also inconsistent with the transition rules as laid out in other standards such as IAS 17.

IAS 39 - Other comments

1. *Paragraph 1(f) – financial guarantee contracts*

   The paragraph states that certain financial guarantees are subject to the Standard at initial recognition, however, they are subsequently measured in accordance with the principles in IAS 37. Further, the paragraph clarifies that IAS 39 applies to the recognition of financial guarantees incurred or retained as a result of the derecognition requirements. Under the proposed improvements, such guarantees represent continuing involvement in the transferred financial assets and are recognised to the extent of the amount that the transferor may be required to pay under the guarantee. Does IAS 39 (and the same principle) apply to subsequent measurement of such a guarantee? We believe it would be inappropriate to apply the measurement rules prescribed by IAS 37 and to re-consider whether such a liability might be only contingent. Consequently, the paragraph should refer to both recognition and subsequent measurement.

2. *Paragraph 2 – non financial risks*

   This paragraph discusses insurance contracts that are based on non-financial risks, including climatic, geological, or other physical variable is excluded from the scope. There are however, active participants in these markets and we suggest that participants who speculate in these types of instruments should be included in the scope of the standard.

3. *Paragraph 7*

This paragraph excludes contracts to buy or sell a non-financial instrument for the entity's expected purchase, sale or usage requirements. IAS 8 requires that in determining an accounting policy one should refer to other standards. This would apparently require that these instruments be accounted for using IAS 39 principles. Paragraph 7 therefore would need to clarify the definitions of purchase, sale or usage requirements. An example of this would be a situation whereby an OTC purchase agreement is entered into simultaneously with an OTC sale agreement, thereby locking in a profit. The goods are delivered directly from the supplier to the ultimate customer. There are two possible accounting treatments, depending on the interpretation of "purchase, sale or usage requirements" –

- The locked in profit is recognised on the date that the goods are delivered to the customer as sales and cost of sales, therefore the instruments are not recognised. This is because IAS 18 allows a sale to be recognised rather than a gain.
- The locked in profit is recognised prior to delivery date, as fair value adjustments, as these instruments are then seen to be net settled.

4. *Paragraph 7* - established practice

It is unclear as to how one establishes this practice, for instance in a new business, or when the practice changes (how many instances establish a new practice?)

5. *Paragraph 10 – categories of financial instruments*

The reference in the Standard to the number of categories of financial assets (originally four categories) and financial liabilities (originally two categories) is no longer inconsistent. In our view, assets and liabilities "designated as held for trading" represent a separate category of both financial assets and financial liabilities. We suggest that references to numbers be changed or deleted.

We agree that reclassification be prohibited as this should forestall any attempt to window dress financial statements. Practically, given the audit technique of test sampling, this would be highly difficult to detect, given the sheer volume of transactions in say a bank or an insurer.

There is however an inconsistency within the draft changes – it *requires* items to be classified as held for trading subsequent to initial recognition (for example where it is part of a portfolio for which there is evidence of a recent actual pattern of short-term profit-taking). The words "into or" in paragraph 89B should therefore be deleted.

Similarly, the last sentence of paragraph 89B (proposed to be deleted) should be reinstated with minor consequential amendments for example "An entity shall reclassify a financial asset into the trading category if there is evidence of a recent actual pattern of short-term profit-taking that justifies such reclassification".

Moreover, we have noted that there is no reference to "other" (non-trading) liabilities. We suggest that the definition of such liabilities is added in paragraph 10.

6. *Paragraph 10 - loans and receivables originated*

We suggest that the words "…. or available for sale…" within the loans and receivables originated definition should be deleted. This would allow an entity to designate 'originated' items as 'available-for-sale' and then take fair value changes to equity. We believe that this is not the intention of the amendment.

The definition also requires fixed or determinable payments, and therefore inter-company loans with undefined repayment periods cannot be classified as Originated. Given that these will then have to be fair valued, difficulties arise (with no guidance provided) on how to determine fair value where a repayment date is not specified (see our comment elsewhere on Q&A 66-3).

7. *Paragraph 10 - available-for-sale category*

We consider that the proposed amended standard will be unclear as regards the Available-for-Sale category. Previously this was viewed as a residual category whereas it now appears to be an optional one. The definitions in paragraph 10 under both HTM and originated indicate that an entity can 'elect' to categorise something as 'available-for-sale'. Is this correct?

8. *Paragraph 10 - effective interest method*

We notice that the entity is required to discount the *contractual* stream of future cash flows. In some cases this could place undue emphasise on the legal form of contracts, rather than the substance.

9. *Paragraph 10 – "near term"*

More guidance as to the meaning of "near term" is required.

10. *Paragraph 18A – disclosure of instruments designated as held for trading*

This paragraph is confusing. To avoid misclassifications and misunderstandings, we suggest that a new category of financial assets and financial liabilities is introduced.

Paragraph 18A states that that "… it uses a label such as …..". We feel that the term "label" would better be replaced by "description" and also suggest that the sentence requires the inclusion of a "shall" (for example "… it ~~uses a label~~ ***shall use a description*** such as …..".

11. *Paragraph 20*

This paragraph states "However, a financial asset that is quoted in an active market (such as a quoted debt security, see paragraph 99), does not qualify as a loan or receivable originated by the entity." We agree with this where the bond has been purchased in the secondary market, but where the bond has been acquired in the primary market, this would be inconsistent with the definition of an originated loan per paragraph 19.

12. *Paragraph 29 (b) - recognition*

The paragraph discusses examples of a firm commitment and uses the description "a previously unrecognised firm commitment". The word "previously" should be removed as it creates confusion as it may be construed as either a transitional provision or a disqualification of hedge accounting.

13. *Paragraph 35 – Derecognition of a financial asset*

The component approach proposed for derecognition of financial assets assumes that for assets fair values can be determined for numerous components of financial assets. It is our concern that entities have little experience with fair value measurement, in particular, applied to various components of assets, which may result in misrepresentations and inaccuracies. Transfers of financial assets commonly have individually negotiated features or terms and may not give accurate indication of an arm's length prices. If the proposed component approach is retained, we expect more guidance that could be consistently applied to various transfers.

14. *Paragraph 37*

This paragraph, which has been deleted, stated that de-recognition would depend on the situation of both the transferee and the transferor. We feel that this paragraph should not be deleted, as it requires the consideration of both parties. We agree that this consideration should not be the only indicator that de-recognition has or has not occurred, but it would be an item to consider.

15. *Paragraph 38 (b)*

We are of the opinion that this paragraph should not be removed but should rather restated to include the following – "the transferor is both entitled and obligated to repurchase or redeem the transferred asset or **has transferred the asset** on terms that effectively provide the transferee with a lender's return on the assets received in exchange for the transferred asset. A lender's return is one that is not materially different from that which could be obtained on a loan to the transferor that is fully secured by the transferred asset". This would then cover the area where an asset has been transferred below fair value in order for the transferee to obtain a lender's return. There would usually be a kickback clause, which would guarantee the returns to be that of a lender's return.

16. *Paragraph 43 – servicing assets and servicing liabilities*

We do not agree with the statement that a servicing contract gives rise to "a financial assets or a financial liability" that should be recognised upfront. Firstly, it is inconsistent with the general revenue recognition principle and the distinction between an agent and a principal. If the amendment is implemented, an entity that has transferred its assets and retained servicing will apply different treatment to its servicing contract to any other entity involved in collection of assets owned by another party. That difference would be, in our view, difficult to justify. Secondly, what is meant by "adequate compensation"? Should it be evaluated by reference to an industry, or to a particular market or to something else? Thirdly, if the estimation results in a servicing liability, does it mean that the contract results in a loss and represents an onerous contract? Further, should such contract be evaluated in conjunction with other elements retained by the entity as a result of a transfer?

17. *Paragraph 54*

Accordingly, when the transferred asset is measured at fair value and has only a one–sided exposure to changes in the fair value because of a retained call or written put option, the recognition of the changes in the fair value of the asset is limited by the option exercise price." The reason that no de-recognition can take place is because the entity still has the risk of ownership of that asset or the obligation of that liability. By limiting the fair value of those items to the exercise price would not reflect the substance of that relationship. This could lead to "window dressing" as the option price could be set at zero, and this could cause the asset not to be de-recognised but to be recognised at zero.

18. *Paragraphs 66 and 67 – initial measurement of financial assets*

Paragraph 67 requires that the initial fair value of an interest-free loan or receivable is determined as the sum of all future cash receipts discounted using the market rate for a similar instrument prevailing at origination. The additional element lent is accounted for in accordance with its substance, as an expense or some other type of an asset. We believe that it is necessary to clarify that the requirement applies to low-interest loans and receivables. It is also not clear whether that requirement applies to inter-company transactions, where group entities have to prepare individual financial statements. If yes, further measurement issues arise. For example, how to account for an interest-free loan that is repayable on demand (and still outstanding at the reporting date)? Or, how to estimate fair value of an interest-free loan that does not have specified repayment terms? Should accounting for such loans between group entities differ from accounting for similar loans between unrelated parties? If the additional amount does not meet the definition of an asset, should the expense be treated as impairment on initial recognition? How should the debtor account for an interest-free loan? We believe the difference would represent a discount. It would be useful to provide additional examples (the example provided in the IGC Question 66-3 has been deleted).

19. *Paragraph 89B - reclassification*

Reclassification <u>into</u> the trading category should be permitted (allowed under the existing Standard) – which would result in greater use of fair value through income. Such a possibility should only be allowed for assets reclassified as held for trading due to the change in intention to short-term profit taking (and not the optional trading designation).

20. *Appendix A*

20.1 *Paragraph A1 – embedded derivatives*

The paragraph indicates that if a host contract has no stated or predetermined maturity and represents a residual interest in the net assets of an entity, then its economic characteristics and risks are those of an equity instrument. Does an inter-company loan with unspecified maturity meet the definition of equity instrument from the perspective of the borrower? If yes, how should interest payable on such loan be treated?

20.2 *Paragraph A2 – valuation of an embedded option-based derivative*

The example in the paragraph specifies that the terms of an embedded option-based derivative that is required to be separated from a host contract are determined on the basis of the stated terms of the option feature. The initial amount of the host instrument is the residual amount after separating the embedded derivative. This rule applied by a holder of a bond convertible into its issuer's shares would result in different measurement than the one allowed in the proposed IAS 32 (for the issuer). Is this the intention?

20.3 *Paragraph A7(a) – embedded derivative in which the underlying is an interest rate*

According to this paragraph, an interest bearing instrument with an embedded derivative that may either double the holder's initial rate of return and could result in a rate of return that is at least twice the market return, would have to be separated, since such a derivative is not considered as closely related to the host contract. We do not understand why the example uses an arbitrary threshold of two, whereas other paragraphs (and standards) do not provide any thresholds or indicators. Further, do both conditions have to be met (double initial return <u>and</u> twice the market return) to determine that the derivative is not closely related? What if an instrument did not originally provide a market-related return?

20.4 Paragraph A9(n)

If a transferor provides an unlimited guarantee with respect to the transferred assets, it is our understanding that the transferred assets should be retained in full in the transferor's balance sheet. Could this be confirmed in the example (n)?

20.5 Paragraphs A9(p) and (q)

We are concerned that these examples indicate that it is easy to remove assets from the balance sheet and still receive some kind of return, achieving better performance ratios. Such transfers of assets may be engineered in such a way that the actual link between the payment on swap and interest payments made on the transferred assets will not be apparent. The fair value of the swap in this case will always depend on the return of the transferred asset.

IAS 39 - Matters not specifically addressed

1. *Treatment of tax benefits transferred through derivative instruments (e.g. tax benefit remitted through an interest rate swap)*

   Swaps may incorporate tax benefits and the Standard should refer to such situations and clarify that tax benefits do not represent a fair value component and should be accounted for separately, similar to the principle in IAS 17 that does not allow for using net cash investment method with respect to finance leases.

2. *Assessment of impairment for financial assets subject to transfers (transferor and transferee perspective)*

   We believe that additional guidance is required about impairment of elements of financial assets that may arise on transfers, for example a retained portion of receivables that represent the historical credit risk.

3. *Examples provided in the IGC Questions and Answers*

   We have noted that a number of examples have been deleted. We have found them useful and suggest that they be included in Appendices.

4. *Interest free loans repayable by mutual arrangement*

   Interest free loans repayable by mutual arrangement are a common occurrence and include:

   - intragroup loans
   - directors loans
   - shareholders loans

The standard should specifically address measurement of these loans.

IAS 39 - General comment on ordering of paragraphs

Proposed paragraph 89B deals with reclassifications, which we feel is more appropriately placed elsewhere (consider to be placed as paragraph 107 or 108). The headings are then more or less as follows:

M*easurement*

Initial measurement of financial assets and financial liabilities (paragraph 66)
Subsequent measurement of financial assets (paragraph 68)
Subsequent measurement of financial liabilities (paragraph 89A)
Fair value measurement considerations (paragraph 95)
Gains and losses on remeasurement to fair value (paragraph 103)
Reclassifications (paragraph 107 or paragraph 108)
Impairment (paragraph 109)

IAS 39 –Appendix

1. Paragraph A.8

This paragraph describes an example of de-recognition of an asset with a call option. It then states that the measurement of the asset at fair value is limited to the higher of the fair value of the asset or the option exercise price. It states that the transferor would not suffer any losses as a result of the decreases in the fair value of the transferred asset as a result of the decreases in the fair value below the exercise price. As per above, de-recognition requires the risks and rewards of ownership to be passed. A risk of ownership is that the fair value may fall below the exercise price, by not showing this, the risks of ownership are not being fairly reflected.

Furthermore, the example states that the borrowings should be recognised at the option exercise price less the time value of the option. This will become complicated where the option price is the market price at the exercise date, the revision to the standard does not clarify as to whether or not the consideration paid should be used.

2. Paragraph A.9(d)

This paragraph describes a situation where a repurchase right or right of first refusal is at fair value. Our experience has been that it is far more common that these rights are not at fair value and we accordingly suggest that the far more common and complex situations be addressed in the standards.

3. Paragraph A.9(k)

This paragraph describes a situation where there is a put or call option in place that is used to put the assets back to the extent that they default, similar to a guarantee, and requires that the asset does not qualify for de-recognition to the extent of the amount of the asset that is subject to the put or the call. It is unclear whether de-recognition should be allowed where the risk that the option would be exercised is less than the portion of the asset that the option covers. A similar lack of clarity arises in respect of paragraph A.9 (m) and paragraph A.9 (n).

5. Paragraphs B 18 to B22

This paragraph discuss an example of the sale of a financial asset with a retained call option. In paragraph B21, the changes in the fair value of the loan asset, as held by the transferee, are taken to equity, as well as the deemed interest on this loan. Is this an assumption that the option is in fact a cash flow hedge, and that is why there is no corresponding item for the transferor, (in this case, it is a written option and therefore cannot be used as a hedging instrument)? Why is there then an adjustment to equity when the option expires in paragraph B22 in the books of the transferor?

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