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International Accounting Standards Board
Secretary for the Improvements Project
30 Cannon Street
London EC4M 6XH
GREAT BRITAIN

14 October 2002

Exposure draft of proposed amendments to IAS 32, "Financial Instruments: Disclosure and Presentation" and IAS 39, "Financial Instruments: Recognition and Measurement".

Dear Sir,

In response to your invitation to comment, and as a preparer of accounts under International Accounting Standards, I am pleased to attach our comments on the above mentioned exposure draft.

Yours faithfully,

James Halliwell
Group Reporting, Planning and Control Manager
Syngenta AG

1. General Comments

1. We fully support the objective of the proposed amendments to improve the existing requirements in IAS 32 and IAS 39. Recognition and measurement of financial instruments under IAS 39 have become extremely complex in practice. Therefore, complexity should be reduced wherever possible, especially in the following areas:
   a) Impractical limitation of 12 months for held-for-sale acquired subsidiaries (32.18 and 138) .
   b) Disclosure of book values of financial instruments exposed to interest-rate risks (6 maturity periods instead of 3 at present, ED 32.49).
   c) Hedge accounting (reduction of required documentation where possible).

2. Hedging plays a central role in risk management. Unfortunately, some amendments to the existing rules will not improve insight into preparers' risk management strategies as it further formalises the requirements for hedge accounting, especially regarding:
   a) Accounting treatment for firm commitments
   b) Cash flow hedges
   c) Basis adjustment.

3. As the Implementation Guidance is expected to be followed by preparers, it is necessary for the Board to develop a due process to formally consider the Q&A it will publish.

4. Due to the complexity of financial instrument recognition and measurement and based on the experience of implementing IAS 39 we cannot support the new standard becoming effective in 2003. Neither the Standard nor the Implementation Guidance can be published well in advance in order to allow preparers to properly adapt internal guidelines, procedures and systems to the envisaged amendments. Hence, this standard should become effective in 2004, under the assumption that the final standard and the Implementation Guidance are published well in advance.

5. The Board intends that the new standard will be in place for a considerable period. We welcome this objective as it will allow the Board to work first on the project “performance reporting” which has to set the fundamental principles for measurement and recognition of the performance of financial instruments before related concepts are to be introduced in other IFRS.

2. Answers to specific Questions

2.1 IAS 32, Financial Instruments: Disclosure and Presentation

Q. 1 - Probabilities of different manners of settlement

We disagree with the proposal to classify financial instruments without regard to probabilities of manner of settlement. Paragraph 18 of IAS 32 states clearly the fundamental principle that financial instruments should be classified in accordance with the substance of their contractual relationships. We do not understand how the substance of an instrument can be fully assessed without any regard to the settlement provisions in the contract. We believe that a contingent cash settlement provision where there is no realistic possibility of the contingency occurring does not by itself determine the substance of an instrument and should not be a decisive factor in its balance sheet classification. If such a provision is used as the determinant, we believe this would place legal form over substance. It could also give rise to abuse. We also believe that remote contingencies should not be reflected in financial statements. We therefore support the current conclusion in SIC 5 that contingent settlement provisions should not be considered if the probability that the issuer would be required to settle in cash or another financial asset is remote at the time of issuance. We also recommend that consideration be given to introducing a similar remoteness provision elsewhere in the standard. For example, in circumstances where derivatives on own equity contain multiple settlement options, any whose exercise is remote should be excluded from the determination of the appropriate classification.

We accept that in some cases it will be difficult to determine that there is no realistic possibility of the contingency occurring. However, the classification as liability or equity in such cases could be dealt with through considering whether the overall economic effects of the contract on the issuer and the holder are similar to those of equity or of a liability if the contingency in the contract were to be triggered by the future event.

Q. 2 – Separation of liability and equity elements

We agree that only one approach is necessary.

Q. 3 – Classification of derivatives that relate to an entity's own shares

Given the primary focus in paragraphs 18 and 19 of the exposure draft on classification following the substance of the contractual arrangements of the instrument, we believe it is essential that the requirements should not permit the development of instruments that, while sharing the same economic characteristics, are accounted for differently. This is particularly relevant when considering the proposals relating to derivatives on own equity.

This concern is best expressed by presenting an example: an issuer writes two options on its own equity: one a deep in the money written call and the other a deep in the money written put, both relating to the same fixed number of shares and maturing on the same day but with significantly different strike prices – the call would be exercised unless the share price fell significantly and the put would be exercised unless the share price rose significantly. The premium received for each would be largely intrinsic value but would also include some element of time value.

Assuming both instruments are separately tradable and are not regarded as linked, the accounting treatment of the options would depend on the manner of settlement. If both could only be exercised gross by physical delivery of shares, the premium received on both options would be taken to equity and a liability would be established under paragraph 29F for the discounted amount of the liability on the put. The cash receivable on exercise of the call, however, would not be recognized as a financial asset. The discount would then be charged to the income statement over the period to maturity as an interest charge. On maturity, assuming that both instruments remain in the money, the cash received on the exercise of the call will be taken to equity whereas the cash paid on the exercise of the put would be offset against the liability. Since the same number of shares will be issued under the call and bought back under the put on the same day, there will be no equity instrument outstanding at the end of the day.

Assume, however, that both written options are cash settled. Both will be treated as derivatives with gains/losses going through income. The gains and losses relating to the movement in the intrinsic value of the options would offset each other through the income statement, but the time value of each option would be credited to income (on a fluctuating fair value basis) over the period to maturity. When the options mature, the net cash paid by the issuer to settle them will be the difference between the strike price of each of them and the market value of the shares – effectively the difference between the two strike prices. In net terms, this is the same outcome as in the previous example but the accounting treatment is different. The time value on the options is taken as a credit to income and there will be no interest charge.

2.2 IAS 39, Financial Instruments: Recognition and Measurement

Q. 1 – Scope: loan commitments

We agree.

Q. 3 – Derecognition: pass-through arrangements

We agree.

Q. 4 – Measurement: fair value designation

We agree.

Q. 5 – Fair value measurement considerations

We agree.

Q. 6 – Collective evaluation of impairment

While broadly satisfied with the proposal, we consider that it should be made clear that the preferred valuation approach is individual assessment. We consider that the present wording places too much emphasis on a collective approach and that there is a danger that this will be interpreted as allowing the creation of general doubtful debt provisions. There may be certain industries, eg. banking, retailing of consumer goods, where this is an acceptable approach. However, generally we would encourage the use of a specific approach.

Q. 7 – Impairment of investments in available-for-sale financial assets

No, we do not agree. The IASB does not appear to have a consistent criterion for deciding what impairments can be reversed: It is proposed to permit it for inventories and for intangibles under certain circumstances but not for goodwill and – now – AFS financial assets. Why not? Particularly if based on demonstrable market prices, the validity of the reversal may even be more clearly evidenced than with inventories. Permitting reversal where there is adequate supporting evidence would also be much more consistent with IAS 2, IAS 8 (changes in estimate), IAS 16, para. 37, and IAS 38 , para. 76.

Q. 8 – Hedges of firm commitments

No, we do not agree. While the proposed accounting treatment for firm commitments has the same effect as the basis adjustment, it results in recognising the fair value of hedged firm commitments while unhedged commitments are currently not recognised and would presumably continue to stay off balance sheet, which results in a conceptual inconsistency between economically similar situations. The dangling "commitment" to be recorded in the balance sheet does not readily represent anything: such a meaningless position does not fit with the IASB's reluctance to recognise timing accruals and deferrals in the balance sheet. The proposed treatment is also more complicated from a practical standpoint since it duplicates the entries whereas, with the current treatment as a cash flow hedge, the opposite entry of the derivative simply goes to the hedging reserve.

Furthermore, the IASB proposals do not address the issue of hedged transactions that are still cash flows hedges such as future export sales. Also the problem remains when a forecasted transaction is hedged before it is committed. For example, an enterprise may want to hedge its raw material needs for a given period but firm orders have not yet been placed with the suppliers. So the hedge effectiveness would not be guaranteed when the company places the firm commitment later on. It would make much more practical and conceptual sense to leave the definition of fair value hedges in consistent terms related to accepted recognised assets and liabilities and treat firm commitments and forecasted transactions in the same way, as cash flow hedges as now. They are economically identical. The proposal is an excellent example of where converging to US GAAP would result in a lower-quality solution than IAS currently offers, as is the proposal to eliminate the "basis adjustment" (see Q. 9 below).

Q. 9 – "Basis adjustments"

No, we do not agree. The basis adjustment approach properly reflects the economic reality of the hedge, namely that the entity has protected the expected value of the cost or revenue. We would argue that the basis adjustment does not lead to inconsistent initial measurement or presentation of hedged and unhedged assets and liabilities; it is not inappropriate to consider a documented link to a designated hedging instrument when assessing the substance of the transactions resulting in recognition of an asset or liability. Furthermore, the recording of the value changes in equity and especially their transfer to income over a period of time are much more complicated from a practical book-keeping viewpoint.

Q. 10 – Prior derecognition transactions

No, we believe this will be very cumbersome and costly of effort without any major benefit in most cases. The amendments to the standard should be applied prospectively. In general, we suggest that in deciding whether new standards should be applied prospectively, the following factors should be taken into account:

a) the potential dilution of public confidence that might arise from repeated and frequent restatements of comparative figures in financial statements as the IASB works to improve the standards;

b) the burden that retrospective restatement imposes on the preparer community who applied the existing accounting standards as written in good faith;

c) the potential confusion which users of the financial statements may experience as a result of the differences between originally published and restated figures.

d) Convergence with US GAAP, under which prospective application has been required for the majority of recent standards.

Other points

Paragraph. 1(a) – scope of IAS 32 and IAS 39: We disagree with the concept of a fixed 12-month time limit for determining whether an interest in an entity held exclusively for disposal should be accounted for under IAS 27 and 28 or under IAS 39, for example where competition authorities require an associate or joint venture to be divested but allow more than 12 months to satisfy this requirement.

Paragraph 1 (d) – we understand that the Board wished to reword the scope exclusion for insurance contracts so that contracts which had the legal form of insurance, but the economic substance of financial instruments, would be accounted for according to their substance. However, we believe it would be unfortunate and lead to practical difficulties if this had the effect of requiring every commercial entity which is the policyholder of a credit insurance policy to account for its rights under that policy as financial assets in accordance with IAS 39, and we doubt that this was the Board's intention. We suggest that this paragraph be reworded in order to state that rights, such as loss recoveries, under credit insurance contracts should be recognised in accordance with IAS 37.

The proposed revised paragraph 43 of IAS 39 requires an entity to recognise a servicing liability where the servicing fee received does not compensate the entity for performing the servicing. Under some factoring agreements, there may be no separate servicing fee payable to the transferor; instead, the servicing may be built into the pricing of the agreement. We believe that in such cases, where the pricing of the agreement is in line with market conditions, there should be a presumption that the transferor is receiving fair value for performing the servicing, and no servicing liability should be recognised.

Under paragraph. 122, a non-derivative financial asset or liability cannot be used for hedge accounting purposes, except for hedges of foreign currency risks. This restriction appears to be quite arbitrary, without any conceptual foundation. To consider an example with the current issue of accounting for CO2 trading rights, we believe that the restriction could have negative consequences if CO2 trading rights do not meet the definition of derivatives.

Para. 129 (b) also restricts the ways in which a non-financial asset, such as inventories of commodities, can be designated as a hedged item, on the grounds that it is difficult to isolate and measure the cash flows or fair value changes attributable to specific risks other than foreign currency risks. This leads to burdensome requirements for entities which hedge their purchases and sales of commodities. Commodities markets provide clear evidence of fair value, but this often relates to commodities of a standard generic quality specification, and this may not be the exact product for which the entity wishes to transact due to its specific requirements. Paragraph 129 (b) currently prevents such an entity from dividing the hedged commodity item into two components: a generic component for which an effective hedge can be entered into, and a specific component which may not be hedged. We believe that the wording of paragraph 129 (b) should be revised to allow entities to make this distinction and rebut the presumption that the cash flows involved cannot be isolated and measured.

We strongly recommend the Board to seriously reconsider broadening the hedging base for non-derivative financial assets and liabilities before issuing an amended IAS 39.

Paragraph. 160: We assume that the last sentence added to this paragraph relates to hedging losses which might either:

a) cause or increase an impairment of the hedged item were it to be initially recognised at the contracted amount, or

b) cause the contract which is the basis of the hedged item to become onerous, or increase the extent to which it is expected to be onerous.

However, this is not at all clear from the wording. We suggest some explanation is given of the intention behind the rule.