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Exposure Draft of Proposed Amendments to IAS 32, Financial Instruments: Disclosure and Presentation, and IAS 39, Financial Instruments: Recognition and Measurement

Ladies and Gentlemen,

we are responding to your invitation to comment on the above Exposure Draft on behalf of IBM Business Consulting Services Deutschland.

Proposed Amendments to IAS 32

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 the 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).

<u>Answer</u>

We agree with this amendment in principle, but have some concerns about the acceptance in practice. Especially the treatment of puttable instruments as proposed in the Exposure Draft results in significant changes in practice that may be not easy to understand and to accept by the users of IAS as well as by the analysts of IAS financial statements.

Question 2 - Separation of liability and equity elements (paragraphs 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?

<u>Answer</u>

We agree with this 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?

<u>Answer</u>

We agree in principle.

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.)

Answer

Yes.

IAS 39 Amendments

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?

Answer

We agree.

Question 2 - 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?

Answer

No. We will support every consistent set of rules for the accounting of derecognition of financial instruments that does not need a complex set of rules.

The continuing involvement approach has the intention to reduce complexity and give a more concrete guidance. But in fact the new proposals provide a very large number of individual rules that does not give the impression of decreased complexity or increased clarity. In the end we do not see the final advantage of the proposed derecognition model.

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As we learned from the introduction of the current derecognition rules of IAS 39 we think that every new set of rules related to derecognition needs to be field-tested for an appropriate time before it should be allowed to replace the current rules.

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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?

Answer

We strongly support every step towards a clear and consistent guidance, e.g. to the securitisation industry, but at the moment we are not sure if we can overlook all the consequences of the proposed treatment. We also have concerns that for a derecognition of this special type of transaction different rules are applicable compared with those for "normal" transactions.

In our opinion the link between derecognition of financial instruments and consolidation of SPEs needs to be consistently reconsidered.

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 recognized in profit or loss?

Answer

Yes.

From a point of view that especially stresses the implementation aspects and the fact that the current hedge accounting rules are not in line with the current risk management approaches (by forbidding net hedges and the accounting for internal derivatives) we generally would support an approach that brings accounting and risk management strategies closely together.

On the other hand a comprehensive fair value model like the one set out by the JWG might be an alternative to avoid all the problems and inconsistencies of the rules for hedge accounting of IAS 39. But we also agree with several critics against the proposed concept.

Given the fact that the fundamental principles for hedge accounting should not be reversed, the proposed possibility to designate any financial instrument as an instrument that is measured at fair value with changes in fair value recognised in profit or loss is an absolutely necessary improvement to have a possibility to reduce the complexity of the implementation of IAS especially with banks.

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Considering the complex and difficult tasks to install the hedge accounting requirements of IAS 39 and that fact that many companies need to show IAS financial statements from the year 2005 on we see difficulties for the implementations if the rules that need to be applied are not fixed in the near future.

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

Do you agree with the requirements about how to determine fair values that have been included in paragraphs 95–100D 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?

Answer

In principle we support the requirements, with smaller remarks to some of the rules.

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

Do you agree that a loan asset or other financial asset measured at amortised cost that has been individually assessed for impairment and found not to be individually impaired 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 113A-113D?

Answer

We agree.

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?

Answer

We cannot see a consistent theoretical basis for not reversing impairments of available-for-sale financial instruments.

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

Do you agree that a hedge of an unrecognized 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?

Answer

We support the proposed amendment.

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 recognized directly in equity should remain in equity and be released from equity consistently with the reporting of gains or losses on the hedged asset or liability?

Answer

We have concerns against this change because it seems to be less practicable.

Question 10 - Prior derecognition transactions (paragraph 171B)

Do you agree that a financial asset that was derecognised under the previous derecognition requirements in IAS 39 should be recognized as a financial asset on transition to the revised Standard if the asset would not have been derecognised under the revised derecognition requirements (ie that prior derecognition transactions should not be grand fathered)?

Alternatively, should prior derecognition transactions be grand fathered and disclosure be required of the balances that would have been recognized had the new requirements been applied?

Answer

The proposed approach will require a reconsideration of all previous transactions. Because of the complexity of the proposals grandfathering would be very helpful for an successful implementation of IAS in the EU.

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If you have any question in relation to this letter please do not hesitate to contact Dr. Oliver Fink (oliver.fink@de.ibm.com).

Yours faithfully

ppa. Thomas Balgheim   i.V. Christian Moser

IBM Business Consulting Services Deutschland