CL 135

November 6, 2002

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom
VIA FAX

Dear Sir David:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (Standing Committee No. 1) thanks you for the opportunity to provide our thoughts regarding the proposed amendments to the Proposed Amendments to IAS 32, *Financial Instruments: Disclosure and Presentation*, and IAS 39, *Financial Instruments: Recognition and Measurement* (collectively referred to herein as "the amendment").

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement[1]. Members of Standing Committee No. 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of Standing Committee No. 1 and are not intended to include all the comments that might be provided by individual members on behalf of their respective jurisdictions.

It is our understanding that the International Accounting Standards Board (the Board) undertook this project in connection with its improvement and convergence efforts in preparation for the adoption of International Accounting Standards (IAS) by companies in several countries throughout the world, including most European Union-listed companies by 2005. In that context, it also is our understanding that the proposal is intended to serve as limited "repair and maintenance" of the existing IAS financial instrument accounting standards. Specifically, we understand that the changes are aimed at eliminating apparent internal conflicts within the existing financial instrument accounting standards, making the standards more operational and resulting in greater international convergence with standards issued by national standard setters.

[1] See IOSCO website, www.iosco.org

Furthermore, we also understand that the proposal is not intended to be a fundamental reconsideration of accounting for financial instruments. We understand that the Board may consider such an undertaking at some future date as resources allow. Our comments are being provided with that context in mind. In a different context, our comments may have been different.

General Comments

- If the body of IAS is to be widely adopted, Standing Committee No. 1 believes that all IAS must be adopted in their entirety. Some have raised concerns about the existing financial instrument accounting standards. Standing Committee No. 1 applauds the Board's efforts to take advantage of the opportunity provided by this proposal to address as many of the concerns as possible and achieve greater international convergence while balancing the existing time constraints. We believe this is extremely important.

- In order for IAS to be effectively adopted by listed companies in the European Union as currently contemplated, and any other areas making similar decisions, the standards must be applied throughout the world in a consistent and comparable manner. In that regard, everyone (including standard setters, preparers, auditors, and regulators) has a lot of work to do. We believe that the Board's role is to provide principles-based accounting standards, accompanied by a sufficient amount of application guidance to provide the foundation for implementation. Along those lines, Standing Committee No. 1 asks that the Board specify that the existing Guidance Notes to IAS 39 are required application guidance or make a determination that particular items are no longer needed or applicable. It is undesirable to have guidance issued by the IASB that has an uncertain status.

Hedging

The existing hedging guidance in IAS 39 is one of the controversial issues related to a widespread adoption of IAS. Many believe that the proposed amendment should further modify that guidance. While Standing Committee No. 1 recognizes that change often is controversial, Standing Committee No. 1 recommends that the Board carefully consider constituent concerns that have been expressed. For example, Standing Committee No. 1 is very concerned that a company may own two instruments that are exactly the same and account for them differently as a matter of simple free choice, not as a matter of different usage characteristics. If short-term changes can be made to the existing guidance to reduce preparatory burden without compromising the transparency of hedging activities, such changes should be made as part of this amendments project. In making such an evaluation, the Board should be especially sensitive to the need for a company to be able to assess ongoing effectiveness of a hedging relationship.

In light of the unusual intense controversy regarding hedge accounting, Standing Committee No. 1 urges the Board to pay particular attention to ensuring that all constituent concerns are thoroughly understood and openly discussed. In this regard, we have two process suggestions for the Board. Standing Committee No. 1 suggests that the Board consider holding a public roundtable that would permit representatives of various participants in financial reporting to exchange of views, questions and concerns in a public discussion about this issue. Such a discussion can be useful in giving interested parties a chance to share and debate views, and might serve as an enhancement of the evaluation of the comment letters the Board has received. Further, regardless of the outcome, Standing Committee No. 1 suggests that the Board outline its considerations and basis for its conclusions in a public communication that would be in addition to the discussion provided in the standard.

Expanded fair value designation

We understand that the Board has proposed to provide companies with an almost unconditional option to measure selected financial assets and financial liabilities at fair value, albeit once that designation is made for an individual instrument it cannot be changed. We understand that this decision was made for a number of reasons including:

- To ease the burden of reporting of hedging activities
- To allow for so-called "matched books" to be measured on a symmetrical basis.
- To reduce the burden of reporting of embedded derivatives.
- To achieve more international convergence, albeit it does create some additional international divergence in certain situations.

Standing Committee No. 1 believes these are laudable goals. With that said, Standing Committee No. 1 has concerns regarding consistency of reporting, and possible earnings manipulation, and encourages the Board to consider establishing clear parameters for application of such an option. Within a company, the ability to designate any financial instrument to be measured at fair value should not lead to different accounting for financial instruments which have the same characteristics.

Derecognition

We understand that the Board's proposed changes to the derecognition guidance in the amendment are designed to address internal conflicts that exist in existing IAS 39. While Standing Committee No. 1 is cautiously optimistic about the continuing involvement approach, we are concerned as well because of possible unintended consequences and apparent conflicts with other existing literature. We recommend that the Board undertake some field testing, using existing transactions and structures, prior to moving forward with the proposed approach.

Other Matters

We have the following comments on other matters:

- In the area of impairments – please clarify whether future events and conditions should be anticipated when performing the analysis.
- We believe the economic compulsion guidance in existing IAS 32 should be retained.
- Clarification would be desirable as to the treatment of transaction costs on equity transactions for both issuance and acquisition of an entity's own equity

instruments, along with robust disclosure for any such costs taken directly to equity

- Clarification of liability versus equity classification in instances where nominal terms exist, i.e., an obligation that fluctuates by an insignificant amount by reference to changes in the market price of the entity's own equity instruments

If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at (202) 942-4400.

Sincerely,

Jackson M. Day
Chairman
IOSCO Standing Committee No. 1