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Dear Sirs

Comments on Exposure Draft of Proposed Amendments to IAS 32 and IAS 39

We welcome the opportunity to provide comments on the Exposure Draft on behalf of the Danish Institute of State Authorised Public Accountants (FSR).

FSR's Accounting Standards Committee has reviewed the ED and we summarize our comments below. Our comments have been presented for the Danish Accounting Advisory Panel which represents users and preparers of financial statements.

We apologize for the late answer.

General comments
We find that the Exposure Draft generally improves and clarifies the accounting treatment of financial instruments.

However, we have to express some concern regarding the total scope and sometimes the level of details. The risk is that the standards will be very difficult to understand and use.

We also see a tendency of formal requirements dominating the substance of transactions – a tendency that gives rise to concern.

Comments to IAS 32:

Q1- 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).

Generally we agree. Although clearly artificial and unrealistic conditions should be disregarded when evaluating the substance of financial instrument.

Q2 – 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 the residual assigned to the equity element?

We agree.

Q3 – 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 agree.
Last part of 29E (c) could need some clarification.

Q4 – 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.).

We support a consolidation of the text in IAS 32 with IAS 39 into one comprehensive Standard with a view to give integrated description of recognition, measurement, presentation and disclosure requirements and thus give a better and more understandable description of a complex field.
Furthermore one comprehensive Standard minimises repetitions and the risks of inconsistencies. One Standard will be voluminous but shorter than the two Standards as they are today.

Comments to IAS 39:

Q1 – 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 agree.

Q2 – Derecognition: continuing involvement approach (paragraphs 35-37)
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 could you propose?

We do not support the proposed amendments, because the principle for derecognition when some contractual commitments still exist seems embossed by protective measures rather than evaluating the substance. Furthermore we are in doubt whether this principle is in line with the definitions in Framework.

We believe that the main focus should still be on risks and rewards related to the transferred asset or liability.

Although we agree that the current approach in IAS 39 is very complex in practice, we suggest not changing the approach, as, in our view, the proposed change is not an improvement.

Q3 – 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?

We agree.

Q4 – 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?

We welcome the change that in some circumstances will make hedge accounting unnecessary.

We have interpreted that credit risk, including own credit risk, is always included in the measurement. In our view this issue should be addressed in the revised standard and we recommend that own credit risk should be excluded.

Q5 – 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?

We support the guidance on how to determine fair values.

We could though recommend guidance regarding transaction costs.

(NB! Must regard A15-25).

Q6 – Collective evaluation of impairment (paragraphs 112 and 113A-113D)
Do you agree that a loan asset or 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 paragraph 113A-113D?

We agree.

Q7 – 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 disagree that impairment losses for investments in debt and equity instruments that are classified as available-for-sale should not be reversed.

For instance in

- IAS 2 paragraph 31 (reversal of any write-down of inventories is recognised as income),
- IAS 16 paragraph 37 (reversal of a revaluation decrease of the same asset (property, plant and equipment) previously recognised as an expense shall be recognised as income) and
- IAS 38 paragraph 76 (a revaluation decrease should be recognised as income to the extent it reverses a revaluation decrease of the same intangible asset which was previously recognised as an expense),

impairment losses are reversed and recognised as income.

We fail to see any substantial difference in the degree of certainty in determining when impairment losses in available-for-sale assets or other assets have been recovered.

Furthermore, the same complications apply for both the determination of the impairment and the determination of reversal.

Therefore we recommend a consistent treatment of reversals through income when the initial revaluation decrease was previously recognised as an expense.

Furthermore, we do not support the amendment in paragraph 116 which prescribes that impairment losses on financial assets carried at cost shall not be reversed as long the instrument is recognised.

Q8 – Hedges of firm commitments (paragraphs 137 and 140)

Do you agree that at 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 that as a concept hedging of firm commitments to sell or buy an asset should be considered a fair value hedge and thereby reduce the volatility effect on equity from hedges of firm commitments.

Though we have doubts whether the fair value adjustment from the hedged item qualifies as an asset or liability according to the Framework. Generally we feel that fair value adjustments of the hedges should follow the hedged items.

Q9 – "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 of gains or losses on the hedged asset or liability?

We disagree with the proposal. The former treatment was significantly simpler both to record and present.

We are concerned that the tracking of gains/losses recognised in equity might cause problems in practice, including difficulties when doing impairment testing of previously hedged items.

The suggestion puts form over substance in a degree that makes the accounts misleading compared to realities.

Bringing IAS in line with FASB should not in it self be an argument.

Q10 – 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 recognised 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 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?*

In general we support the transition method in paragraph 171 which prescribes that the opening balance of retained earnings for the earliest prior period presented and comparative amounts shall be adjusted as if the Standard had always been in use unless restating the information would require undue cost or effort.

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If you have questions to the above, please do not hesitate to contact us.

Yours sincerely

Eskild Nørregaard Jakobsen
Chairman of FSR's Accounting
Standards Committee

Ole Steen Jørgensen
Head of Department