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GROUP OF 100 Inc.
ABN 83 398 391 246

The Group of 100 is an association of senior accounting and finance executives representing the major public companies and government owned enterprises in Australia.

National Secretariat
Level 28, 385 Bourke Street
Melbourne, Victoria 3000
Telephone: (03) 9606 9661
Facsimile: (03) 9670 8901
Email: g100@group100.com.au

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Sir David Tweedie
Cha Irma n
International Accounting Standards Board
30 Cannon Street
LONDON EC 4A 6 XH
UK

Dear Sir David

IAS 32 and IAS 39

The Group of 100 (G100) is pleased to provide comments on proposed improvements to IAS 32 and IAS 39.

HEDGING

The G100 is concerned about the affect of the hedge accounting requirements on the risk management activities of companies. We believe that the basic principle of hedge accounting should be that the movements in the carrying amount (fair value) of the hedge instrument should be accounted for on a consistent basis with the hedged item. For example, if the purchase of an item of capital equipment is hedged we believe that movements in the carrying amount of the hedge instrument should be included in an equity reserve and included in the measurement of the cost of acquisition of the hedged item. The objective of undertaking hedging in these cases is to purchase certainty as to the cost of the asset.

While the proposals would eventually reflect the outcome of the hedging process in the statement of financial performance we believe that the requirements in IAS 39 to achieve this will impose unreasonable administrative and record-keeping burdens on companies. For example, to trace and recognise in the statement of financial performance the result on the hedge instrument to inventories as they are sold or to reporting periods in which plant and equipment is used imposes an additional layer of recording and tracking the outcome of which would be achieved if the outcome of the hedge were included in the measurement of the hedged item.

A further concern is that the approach to hedging is selective and unbalanced. Derivative instruments are measured at fair value but the hedged item may not be recognised or, if recognised, are carried at cost. For example, in the case of resource companies hedging may be undertaken in order to ensure the viability of a project by 'locking-in' anticipated proceeds and/or the cost of capital equipment. The proposals do not deal with the changes in value of the hedged item such as ore reserves.

We believe that robust criteria should be established for the application of hedge accounting during the hedge period. In this regard we believe that:

- the hedge instrument must be designated and documented as a hedge of an underlying;
- for hedge accounting to continue to apply the hedge instrument must continue to be effective as a hedge in delivering the objective of the hedging process;
- in respect of anticipated transactions there must be a continuing high probability that the transaction as designated will occur and
- gains and losses on the hedge instrument should be recognised in an equity reserve ntil the underlying transaction occurs.

Improvements TO IASB 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 para 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).

We believe that the analysis of the features and characteristics of a financial instrument should be undertaken from the point of view of the entity undertaking the accounting. In the financial reports of the issuer the substance of the instrument and its classification as debt or equity should be undertaken from its point of view because the instrument is to be reflected in its financial reports. To do otherwise changes the perspective of the financial report. While symmetry of view by the issuer and the holder is desirable it is essential that financial reports reflect this outcome.

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 then the residual assigned to the equity element?

The G100 supports the objective of separating the liability and equity elements of compound instruments. However, we believe that the approach adopted should be consistent with that adopted in the US as a means of achieving convergence.

Q3. Classification of derivatives that relate to an entity's own shares (paragraphs 29C and 29G). Do you agree with the guidance proposed about the classification of derivatives that relate to an entity's own shares?

Yes.

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 finailsing the revised Standards.)

The G100 considers that separate standards are appropriate. However, it would be preferable if all requirements relating to recognition and measurement, and the principles on which they are based, were dealt with separately from the disclosure requirements.

IMPROVEMENTS 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'

Yes.

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 would you propose?

While the simplicity of the continuing involvement approach is appreciated we believe that the continuing involvement approach is inconsistent with the IASC Framework. An asset is defined in terms of control over economic benefits which occurs where the entity has the capacity to benefit from the asset and to deny or regulate the access of others to that benefit.

For the derecognition of the asset to occur the company must relinquish its control over the economic benefits embodied in the financial asset. Under the continuing involvement approach a company may be required to continue to recognise an asset where no future economic benefits are expected to flow to the company, for example, where it has provided a guarantee in relation to the financial asset. The substance of the arrangement may be that the entity has relinquished control of the financial asset which the transferee can sell or pledge and has given a guarantee which has a low probability of crystallising.

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?***

Where the requirements of paragraph 41 are satisfied the asset should be derecognised.

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 recognised in profit or loss?***

Yes. A company would make this choice where it best represents the nature and function of the investment in respect of the company.

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-lOUD 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?***

The additional guidance in this vexed area is welcome and is likely to be extremely helpful for users.

Q6. ***Collective evaluation of impairment (paragraphs 112 and 113A-11D). 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?***

The G100 does not support this proposal. If a loan asset (or other asset) is individually assessed for impairment we do not believe that it should also be included in a portfolio assessment of similar assets. An extension of this approach would be the impairment testing of individual assets of an entity and then an assessment of the total assets of the entity as a form of portfolio or even the entity as a whole.

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?***

No. Available-for-sale securities are similar in nature to inventories in respect of their purpose and function for the company. If impairment losses are reinstated/ reversal of write-downs are incurred in respect of other types of assets, it is not clear why different rules would apply in respect of these types of securities.

Q8. 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?

No. We believe that on the basis of present application of definitions of assets and liabilities the gain or loss on a hedge instrument should be recognised in equity until the underlying transaction occurs. However, we note that recognition of these items in equity, rather than as deferrals, without the recognition of changes in fair value of the hedged item could mean that a mining company that hedges anticipated sales could report negative net assets (equity) because of the impact of adverse movements in the fair value of the hedging instrument. In these situations treatment in this way has the potential to significantly affect and distort the reported equity of a company. Where a hedged item is measured at fair value and changes in fair value are recognised in the profit and loss the changes in value on the hedge instrument should also be recognised in the profit and loss.

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 drectly 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.

The outcome of the hedge should be included in the measurement of the underlying transaction to reflect the purpose of the hedging process. The position on the hedge instrument should remain in equity until the hedged transaction occurs. We consider it inappropriate and administratively onerous for amounts included in equity to be released/amortised over the life of the hedged item.

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 period derecognition transactions should not be grandfathered)? Alternatively, should prior derecognition transactions be grand fathered and disclosure be required of the balances that would have been recognised had the new requirements been applied?

Where derecognition occurs before the application date of IAS 39, or other date specified, we believe that these transactions should be grandfathered and, if not, a significant implementation period should be provided to permit companies to seek necessary adjustments to say, debt covenants in trust deeds.

Yours sincerely

Tom Pockett

Tom Pockett
National President

c.c. Mr Keith Alfredson - Chairman AASB