Institute of
CHARTERED ACCOUNTANTS
of New Zealand

CL 45

12 October 2004

Andrea Pryde
The International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Andrea

RE: IASB Exposure Draft of Proposed Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 4 *Insurance Contracts – Financial Guarantee Contracts and Credit Insurance*

The Financial Reporting Standards Board (FRSB) of the Institute of Chartered Accountants of New Zealand (ICANZ) is pleased to submit its comments on the IASB Exposure Draft of Proposed Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 4 *Insurance Contracts – Financial Guarantee Contracts and Credit Insurance* (IASB ED). The FRSB sought the views of New Zealand (NZ) constituents on the IASB ED.

The FRSB's responses to the questions to the IASB's Invitation to Comment are set out on the next page.

If you have any queries, or require clarification of any matters in this submission, please contact Joanna Yeoh (Joanna.yeoh@icanz.co.nz) in the first instance, or me.

Yours sincerely

Joanna Perry

Joanna Perry
Chair – Financial Reporting Standards Board

Question 1 – Form of contract

The Exposure Draft deals with contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs if a specified debtor fails to make payment when due under the original or modified terms of a debt instrument (financial guarantee contracts). These contracts can have various legal forms, such as that of a financial guarantee, letter of credit, credit default contract or insurance contract. Under the proposals in the Exposure Draft the legal form of such contracts would not affect their accounting treatment (see paragraphs BC2 and BC3).

Do you agree that the legal form of such contracts should not affect their accounting treatment?

If not, what differences in legal form justify differences in accounting treatments? Please be specific about the nature of the differences and explain clearly how they influence the selection of appropriate accounting requirements.

The FRSB agrees with the proposals in the IASB ED. The accounting treatment of any contract should reflect economic substance of the contract and not its legal form.

Question 2 – Scope

The Exposure Draft proposes that all financial guarantee contracts should be within the scope of IAS 39 (see paragraph 2 of IAS 39 and paragraph 4 of IFRS 4), and defines a financial guarantee contract as "a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument" (see paragraph 9 of IAS 39).

Is the proposed scope appropriate?

If not, what changes do you propose, and why?

The FRSB agrees with the proposed scope in the IASB ED. The FRSB notes that there was confusion over the correct treatment of financial guarantees as a result of IASB ED 5 *Insurance Contracts* and later IFRS 4.

Question 3 – Subsequent measurement

The Exposure Draft proposes that financial guarantee contracts, other than those that were entered into or retained on transferring financial assets or financial liabilities within the scope of IAS 39 to another party, should be measured subsequently at the higher of:

(a) the amount recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and

(b) the amount initially recognised (ie fair value) less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue* (see paragraph 47(c) of IAS 39).

Is this proposal appropriate? If not, what changes do you propose, and why?

The FRSB does not agree with this proposal as the proposed measurement requirements have a conservative bias. The FRSB considers that the measurement of financial guarantee contracts should be free from bias which is consistent with neutrality, a qualitative characteristic of financial statements. The FRSB recommends that, out of the two measurement options presented in the IASB ED, financial guarantee contracts be measured at best estimate consistent with IAS 37. The FRSB believes that the amount calculated using best estimate is more relevant than the historical cost of the financial guarantee minus cumulative amortisation, and therefore more useful. The FRSB recognises that this proposal tries to reconcile the requirements of IAS 37 and IAS 39, and more importantly converges with the requirements under US GAAP (FIN 45). The FRSB supports these two objectives but nevertheless does not agree with this proposal in the IASB ED. The FRSB accepts that this proposal may be pragmatic in the short-term until the completion of the IASB's joint project with the FASB on revenue.

Question 4 – Effective date and transition

The proposals would apply to periods beginning on or after 1 January 2006, with earlier application encouraged (see paragraph BC27). The proposals would be applied retrospectively.

Are the proposed effective date and transition appropriate? If not, what do you propose, and why?

The FRSB agrees with this proposal and notes that it would be helpful if the amendments were confirmed as soon as possible.

Question 5 – Other comments

Do you have any other comments on the proposals?

The FRSB has no further comments.