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THE INSTITUTE OF Chartered Accountants IN IRELAND

CL 36

Andrea Pryde
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30 Cannon Street
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8th October 2004

Dear Ms Pryde,

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 Accounting Committee (AC) of the Institute of Chartered Accountants considered this ED at its meeting on 16 September 2004.

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.

Answer
AC agrees that the legal form of contracts covered by this exposure draft should not effect their accounting treatment.

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?

Answer
AC agrees with the scope of the ED. Contracts which have the same effect in substance should be accounted for in the same manner.

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 (i.e. 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?

Answer
The ED does not distinguish between financial guarantee contracts from the issuer's perspective and that of holder. Paragraph 46, IAS 39 requires financial guarantees to be accounted for at fair value from the holder's perspective. The ED requires the financial guarantee contracts in the issuer's accounts to be carried at the higher of initial fair value and the amount determined in accordance with IAS 37.

Certain entities hold financial guarantee contracts as an economic offset for guarantees issued. Under the ED, these entities will have an accounting mismatch as the asset side would be at fair value and the liability side would be accounted as above. While AC supports the subsequent measurement proposals, it believes that the ED should be extended to provide the fair value option to guarantee liabilities. Such an approach is consistent with the treatment of other items under IAS 39 and would allow entities to avoid the accounting mismatch by fair valuing both assets and liabilities.

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?

Answer
AC believes the effective dates are appropriate.

Question 5– Other comments

Do you have any other comments on the proposals?

Answer
AC has no additional comments.

Yours faithfully,

Simon Magennis
Secretary
Accounting Committee
Institute of Chartered Accountants in Ireland