

THE ROUNDTABLE DISCUSSIONS ON IAS 32 AND IAS 39

Introductory Note

- 1 We should like to welcome you to a series of roundtable discussions on the International Accounting Standards (IASs) 32 and 39 – Financial Instruments.
- 2 We have decided to hold these roundtable discussions because it has become obvious that, of all the 34 original pronouncements that we (the IASB) inherited from our predecessor body (IASC), these two have created the most concern for our constituents, in particular for banks.
- 3 We are concerned that part of the reason for the current intense debate may well be a lack of understanding on both sides. On the one hand, preparers believe we are not listening to their arguments. On the other hand, we believe that preparers are not accepting that there are issues of both principle and application. The simplest example of an issue of principle is derivatives, which are ignored in virtually every existing accounting standard in Europe, obviously an unsatisfactory situation. The application of the hedging rules also seems not to be well understood. We believe that an open and frank exchange of views at the roundtables will help to remedy the communication problems and may lead to identifying ways in which the requirements can be modified to ease the burdens on preparers while still satisfying the principles that we as standard-setters regard as essential.
- 4 Attached to this introductory note is a summary of the background to the development of the Standards, and a series of questions that we should like participants at the roundtables to discuss. Of course, participants may raise other subjects in the discussions. Also, you need address only those issues of interest to you—not every participant need be involved in the discussion of every subject. Indeed, the discussions may be more fruitful if you focus your contribution on subjects that are of direct interest to you, and where you have particular knowledge and experience.
- 5 We look forward to our meeting with you at the roundtables.

Background to the development of IAS 32 and IAS 39

- 1 Accounting for financial instruments is a difficult and controversial subject. The Board's predecessor body, the International Accounting Standards Committee (IASC) began its work on the issue some 15 years ago in 1988. During the next eight years it published two exposure drafts, culminating in the issue of IAS 32 on disclosure and presentation in 1995. IASC decided that its initial proposals on recognition and measurement should not be progressed to a standard, in view of
 - the critical response they had attracted,
 - evolving practices in financial instruments and
 - the developing thinking by certain national standard-setters.
- 2 Accordingly, in 1997 IASC published, jointly with the Canadian Accounting Standards Board, a discussion paper that proposed a very different approach, namely that all financial assets and financial liabilities should be measured at market value (referred to in IASC literature as 'fair value'). The responses to that paper indicated both widespread unease with some of its proposals and that more work needed to be done before a standard requiring a full fair value approach could be contemplated.
- 3 In the meantime, IASC concluded that a standard on the recognition and measurement of financial instruments was needed urgently. It noted that whilst financial instruments were widely held and used throughout the world, few countries apart from the United States had any recognition and measurement standards for them. In addition, IASC had agreed with the International Organization of Securities Commissions (IOSCO) that it would develop a set of 'core' International Accounting Standards that could be endorsed by IOSCO for the purposes of cross-border capital raising and listing in all global markets. Those core standards included one on the recognition and measurement of financial instruments.

4 Accordingly, in 1997 IASC decided:

- (a) to join with nine national standard-setters to form a Joint Working Group (JWG) to develop the proposals in the 1997 discussion paper. The ultimate aim was an integrated and harmonised standard on financial instruments that would reflect the best research and thinking on the subject worldwide. IASC recognised that this would take several years to develop. The JWG took the first step in the form of a draft standard published in 2000, before the IASB had been constituted.
- (b) at the same time, to develop an International Accounting Standard on the recognition and measurement of financial instruments that would serve until an integrated comprehensive standard was completed. This standard would be based on US GAAP—the only major GAAP with comprehensive requirements for financial instruments. The result was IAS 39, issued in 1999 after a period of exposure and comment.

5 The Board recognises that IAS 39 is a complex standard. This complexity arises, at least in part, from the following features.

More than one measurement basis

6 IAS 39 contains four categories of financial asset, with three different accounting treatments. Before IAS 39 was introduced, IASC recognised that most countries had a mixed measurement model, showing some financial assets at cost while measuring others at market/fair value and taking changes in these values to the income statement. IASC decided to retain, but to regulate and structure, the different approaches. In particular it decided that:

- (a) assets that are held for trading would be measured at fair value, to reflect the purpose for which they are held.
- (b) all derivatives would be measured at fair value, because this is the only method that provides sufficient transparency in the financial statements. The cost of most derivatives is nil or immaterial. Hence if they were to be reported at cost, they would

not be included in the balance sheet at all and their success (or otherwise) in reducing risk would not be visible. In particular, gains and losses on such derivatives would go unreported and hence be hidden from the reader of the financial statements.

Secondly, the value of derivatives often changes disproportionately in response to market movements (put another way they are highly leveraged or carry a high level of risk). Fair value is the only measurement basis that can capture this leveraged nature of derivatives—information that is essential to communicate to investors the nature of the rights and obligations inherent in derivatives.

- (c) available for sale assets (ie those that are neither held for trading, nor originated loans, nor being held to maturity) would be measured at fair value with changes in value reported in equity until the asset is derecognised or becomes impaired. Measurement at fair value is appropriate given that available for sale assets are defined as those that may be sold, eg in response to changes in market prices or a liquidity shortage.
- (d) assets the entity is holding to maturity could be measured at amortised cost. Many argued that if an asset is held to maturity, all the entity cares about is the amount to be paid at maturity (in the absence of impairment). Any changes in market prices in the meantime are irrelevant to the entity, as it will not realise them and they will reverse by maturity.
- (e) Originated loans and receivables would be measured at amortised cost. IASC was persuaded that for such loans there are difficulties in estimating fair value, and that further progress was needed in valuation techniques before fair value could be required.

Hedge accounting

- 6 The need for hedge accounting arises, in part, from the mixed measurement model described above. IAS 39 allows hedge accounting to be used for a wide range of hedging relationships.

- 7 IAS 39 provides for two kinds of hedge accounting. This recognises that companies commonly hedge both the possibility of changes in cash flows (eg the possibility that interest rates may *fall*, causing interest income on a variable rate investment to fall) and the possibility of changes in fair value (eg the possibility that interest rates may *rise*, causing the value of a fixed rate investment to fall). Whilst these two kinds of hedging may involve companies entering into derivatives with exactly opposite risk positions, companies desire hedge accounting for both kinds of hedge.

Embedded derivatives

- 8 IAS 39 requires derivatives that are embedded in non-derivative contracts to be accounted for separately. This is necessary to ensure that contractual provisions that create similar risk exposures are accounted for in the same way whether or not they are ‘embedded’ in a non-derivative contract and to counter the possibility that companies might seek to avoid the requirement to measure derivatives at fair value by ‘embedding’ a derivative in a non-derivative contract.

Derecognition

- 9 IASB recognised that there were two main models used around the world for deciding when financial assets should be ‘derecognised’, ie treated as sold for accounting purposes. These are a control/components model and a risks and rewards model. The approach in IAS 39 is a mix of these two models.

The present Improvements project

- 10 The Board has on its agenda a longer-term project to reconsider the fundamental approach to accounting for financial instruments. This will include reviewing the basis of accounting established by IASs 32 and 39 and the proposals in the draft standard developed by the JWG. However, this project is unlikely to result in a standard for several years. In the meantime, the Board decided in 2001 to undertake a project to improve IASs 32 and 39. The objective of this limited improvements project is to reduce some of the complexity by clarifying the standards, eliminating internal inconsistencies and incorporating additional guidance. However, the objective was **not** to reconsider the

fundamental approach contained in IASs 32 and 39, which is the aim of the longer-term project above. It is therefore inevitable that some of the complexity will remain in the interim.

- 11 The Board will carefully consider all suggestions on how IASs 32 and 39 can be improved within this limited objective. In particular, the Board is interested in ways to simplify the application of IASs 32 and 39 without jeopardising the principles that underlie their requirements (these principles are set out in the questions that follow), unless it can be demonstrated how these principles can be improved in the short term.
- 12 Some have suggested that IAS 39 should be withdrawn pending the outcome of the Board's longer-term project. However, this would leave the IASB's standards with no requirements on financial instruments for several years. Financial instruments are a large part of the assets and liabilities of virtually every company, in particular financial institutions, as well as playing a central role in the efficient operation of financial markets. Accordingly, the Board believes that to have no financial reporting requirements for financial instruments is simply not a viable option.

Questions for the Roundtable Discussions

Introduction

- 1 In the roundtable discussions, the Board would like to focus on the main areas raised by respondents in their comment letters, in particular:
 - The distinction between debt and equity, including derivatives on own shares
 - Derecognition of financial assets
 - Derivatives and hedge accounting
 - Impairment of financial assets
 - Other issues
 - The fair value measurement option
 - Convergence with US GAAP
 - Other issues participants would like to raise
- 2 For each area, this paper first sets out the guiding principles that underlie the proposals in the ED. In the roundtables, participants will be asked (a) whether they agree with these principles and, if not, what changes they would propose and (b) for their views on specific issues raised in the comment letters.

The distinction between debt and equity, including derivatives on own shares (IAS 32, paragraphs 18-29G)

Principles underlying the ED's requirements

- 3 An instrument should be classified as equity if and only if it both:
 - (a) contains no obligation to transfer cash or other assets; and

- (b) will be settled either by the entity unilaterally delivering a fixed number of its own equity instruments, or by the entity exchanging a fixed number of its own equity instruments for a fixed monetary amount of cash or other financial assets.

4 It follows from these two principles that:

- (a) an instrument whose terms require it to be settled in cash is a liability¹ even if the amount of cash to be paid or received is fully indexed to the price of the entity's own equity shares
- (b) an instrument for which the counterparty can require settlement in cash is a liability¹ even if the amount of cash to be paid or received is fully indexed to the price of the entity's own equity shares. This applies to all puttable instruments (ie instruments that give the holder the right to put the instrument back to the entity for cash), including those issued by mutual funds, unit trusts and similar institutions.
- (c) a derivative under which the entity is obliged to pay out cash in exchange for receiving its own equity shares gives rise to a non-derivative liability—and hence a reclassification from equity to liabilities—for the present value of the cash it is obliged to pay out.
- (d) an instrument that will be settled by the entity delivering shares whose value is equal to a fixed monetary amount², or where the number of shares to be delivered is indexed to something other than the price of the entity's own shares (eg the change in the price of gold) is a liability¹.
- (e) A derivative under which the entity will receive a fixed amount of cash in return for delivering a fixed number of its own equity shares is equity.

5 Questions for participants: Do you agree with the principles set out in paragraph 3? If not what changes would you propose? Would those changes require an amendment to the

¹ Or, in the case of a derivative, possibly an asset

² Ie the entity will deliver how ever many shares are worth, say \$1,000

definitions of equity and a liability given in paragraph 49 of the *Framework*? Should any other principles be added?

Specific issues raised in the comment letters

Instruments with multiple settlement alternatives (IAS 32, paragraph 29E)

- 6 The ED proposes that where an instrument contains multiple settlement alternatives (ie it may be settled in cash or shares) and the entity can choose how it is settled, past practice and management's intent should be considered in classifying the instrument as asset/liability or equity. Some respondents criticise this proposal, believing that past practice and management's intent should not affect how an instrument is classified.

(a) Do you agree with these respondents and why?

(b) If you agree:

(i) What principles would you propose for classifying instruments with multiple settlement alternatives as either asset/liability or equity, and why?

(ii) Would you also amend the equivalent requirement in IAS 33 *Earnings Per Share*³ on how a contract that may be settled in shares or cash at the entity's option is to be reflected in diluted earnings per share?

Economic compulsion (IAS 32, paragraph 22)

- 7 The ED retains the notion in IAS 32 that a preferred share that does not establish a contractual obligation explicitly may establish it indirectly through its terms and conditions (sometimes referred to as 'economic compulsion'). It proposes, however, that the existing example in IAS 32 of such an instrument should be eliminated (the example is of a preferred share that has such a contractually provided accelerating yield that the issuer will be economically compelled to redeem the instrument).

³ see paragraph 51(c) of the Exposure Draft of proposed improvements to IAS 33 that was issued in May 2002

- 8 Some respondents are concerned that the removal of the example could be interpreted as a signal that economic compulsion should not be considered in determining the classification of an instrument as a liability or equity.

Do you believe that the Board should retain the example or give other guidance on when an instrument that does not establish an explicit contractual obligation creates an obligation indirectly through its terms and conditions? If so, what guidance would you propose?

Derivatives that result in a reclassification from equity to liabilities (IAS 32. paragraph 29F)

- 9 As set out in paragraph 4(c) above, the ED proposes that certain derivative transactions should result in a reclassification of other instruments from equity to liabilities. For example, if an entity enters into a forward contract to buy 100 of its own shares on a specified future date in return for paying cash of \$150, the ED proposes that entity should report a non-derivative liability—and hence make a reclassification of shares from equity to liabilities—for the present value of the \$150 of cash it is obliged to pay out. Some respondents object to this requirement since they believe that it amounts to ‘synthetic instrument accounting’.

Do you agree with these respondents? Why/why not?

Derecognition of financial assets (IAS 39. paragraphs 35-57)

Principles underlying the ED’s requirements

- 10 A transfer of a financial asset should result in derecognition only to the extent that it results in the transferor having no continuing involvement with the asset.
- 11 Accordingly, where a transfer of a financial asset results in the transferor having no continuing involvement with a *portion* of the asset, that portion should be derecognised.
- 12 There should be no exceptions to this principle for particular transactions or circumstances.

- 13 Recognition and derecognition relate to assets and liabilities and not to the definition of the entity. Consolidation is a separate issue.
- 14 Questions for participants:
- (a) Do you agree with these principles and if not what changes would you propose?
Should any other principles be added?
 - (b) If you do not support a continuing involvement approach, what alternative approach would you support, and why? In particular:
 - (i) If you support a risks and rewards approach, how would you make it operational?
In particular, how should different risks and rewards be aggregated or otherwise compared?
 - (ii) If you support a control approach, how would you make it operational? In particular, how should control be assessed when more than one party has rights and obligations relating to a financial asset and none of the parties has the ability to sell, pledge or otherwise control that asset?
 - (iii) Some respondents suggest using the approach set out in US GAAP. Do you support this suggestion and, if so, what particular aspects of US GAAP would you support incorporating into IAS 39?
 - (iv) Some respondents suggest that the Board should not change IAS 39 now, pending a fuller debate in its longer-term project on derecognition. Do you support this suggestion? Why/why not?
 - (v) If you support another approach, what is that approach and how would you make it operational?
 - (c) Under the approach you support, do you believe that a portion of a financial instrument can be transferred and derecognised or, alternatively, that a financial instrument can be transferred and hence derecognised only in its entirety?

Specific issues raised in the comment letters

Pass-through arrangements and the interaction with the consolidation of SPEs (IAS 39, paragraphs 41 and 42)

- 15 Many transactions in which derecognition issues arise involve one or more special purpose entities (SPEs). Some respondents raise the interaction of the proposals in the ED, in particular those on pass-through arrangements, with SIC 12 *Consolidation – Special Purpose Entities*. Alternative approaches suggested include:
- (a) creating an exception from consolidation principles for certain ‘qualifying’ SPEs, perhaps along the lines of that included in US GAAP. It should be noted that US GAAP includes many detailed rules for when an SPE is ‘qualifying’ and, in many cases, a legal opinion is necessary to demonstrate compliance with these rules.
 - (b) clarifying, and perhaps widening, the proposals in the ED on pass-through arrangements to make them more operational. In particular, some respondents suggest that the proposals should clearly permit most securitisation arrangements to qualify for derecognition. It should be noted that other respondents suggest that the proposals on pass-through arrangements should be narrowed (rather than widened), for example, to cases where a pro-rata proportion of all cash flows from the financial asset, or specified cash streams (eg all interest collections) are passed through.
 - (c) eliminating the proposals in the ED on pass-through arrangements. As a result, virtually all securitisations and many other transactions involving SPEs would not result in derecognition in consolidated financial statements, since the SPE would be consolidated under SIC-12.
- 16 Question for participants:
- (a) Do you believe that the proposals in the ED on pass-through arrangements should be amended? Why/why not?
 - (b) If so, which of the above three approaches (or another alternative) do you support and why?

Derivatives and hedge accounting (IAS 39, paragraphs 69, 89A and 121-165)

Principles underlying the ED's requirements – derivatives

17 The following principles underlie the ED's requirements for derivatives:

- (a) Derivative contracts create rights and obligations that meet the definition of assets and liabilities and, as a result, should be recognised.
- (b) Fair value is the only relevant measurement basis for derivatives, because it is the only method that provides sufficient transparency in the financial statements. The cost of most derivatives is nil or immaterial. Hence if they were to be reported at cost, they would not be included in the balance sheet at all and their success (or otherwise) in reducing risk would not be visible. In addition, the value of derivatives often changes disproportionately in response to market movements (put another way, they are highly leveraged or carry a high level of risk). Fair value is the only measurement basis that can capture this leveraged nature of derivatives—information that is essential to communicate to investors the nature of the rights and obligations inherent in derivatives.

Principles underlying the ED's requirements – hedge accounting

18 Hedge accounting allows entities to depart selectively from the normal accounting treatment that would otherwise be applied to the items included in the hedging relationship. In particular, cash flow hedge accounting provides an exception by deferring the recognition in the income statement of derivative gains and losses, whereas fair value hedge accounting provides an exception by accelerating the recognition of gains and losses on the hedged item. Hence hedge accounting principles are needed to provide discipline over the use of hedge accounting. Without such principles, the exceptions noted above would permit a free choice over when to recognise gains and losses. These hedge accounting principles fall into two groups:

- (a) those that underlie the ED's conditions for when a hedging relationship qualifies for hedge accounting (paragraph 19)

- (b) those that underlie the ED's requirements for the accounting treatment of a qualifying hedging relationship (paragraph 20).
- 19 A hedging relationship should qualify for hedge accounting only when the hedging relationship is:
- (a) clearly defined by designation and documentation;
 - (b) reliably measurable; and
 - (c) actually effective.
- 20 As regards the accounting treatment of a qualifying hedging relationship:
- (a) to the extent that a hedging relationship is not effective, the ineffectiveness is recognised immediately in the income statement.
 - (b) to the extent that a hedging relationship is effective, the offsetting gains and losses on the hedging instrument and the hedged item are recognised in the income statement at the same time.
 - (c) only items that meet the definitions of assets and liabilities are recognised as such in the balance sheet.
- 21 Question for participants: Do you agree with these principles and if not what changes would you propose? Should any other principles be added? Are there any requirements in the ED that you believe are not necessary to meet the above principles and, if so, what are they?

Specific issues raised in the comment letters

Hedges of net positions, including 'macro hedges' (IAS 39, paragraphs 132 and 133)

- 22 Some respondents state that hedge accounting should be permitted for transactions that do not qualify under the ED. In particular, some suggest that hedge accounting should be permitted for 'macro hedges'. What respondents mean by a macro hedge is often unclear, though in some cases respondents appear to refer to a hedge of the net position

arising from a portfolio of dissimilar assets and liabilities. (It should be noted that IAS 39 paragraph 132 allows hedge accounting for portfolios of similar items— ie where all of the items in the portfolio share the risk that is being hedged—provided that the general conditions for hedge accounting are met.)

23 Questions for participants:

(a) Do you believe that hedge accounting should be permitted for ‘macro hedges’ that do not qualify under the ED? If so, precisely what do you mean by a ‘macro hedge’?

(b) If your answer to (a) is yes,

(i) How would such transactions meet the principles set out in paragraph 19 above for when a relationship should qualify for hedge accounting? In particular, how would you assess whether the hedge is actually effective and what limits (if any) would you put around the variety of risks that may be included in a macro hedge (eg would you specify that all items in the portfolio must be subject to, say, “interest rate risk”; or that all items in the portfolio must be subject to the risk of a change in, say, LIBOR)?

(ii) How would such transactions meet the general principles set out in paragraph 20 above for the accounting treatment of a qualifying hedging relationship? In particular:

- how would you measure the extent of any ineffectiveness?
- how would you ensure that paragraph 20(b) is met and what accounting entries would you make if an item in the hedged portfolio is sold or otherwise derecognised (eg if a loan in the hedged portfolio becomes irrecoverable)?

Internal contracts (IAS 39, paragraph 126B)

24 Some respondents suggest that the Board should permit hedge accounting in consolidated accounts for ‘internal contracts’, ie contracts between one part of a consolidated entity and another, regardless of whether the contract is offset with a third party. This can result

in gains or losses being recognised in the consolidated financial statements on a transaction that occurs within the consolidated group. As with 'macro hedges' it is often unclear what respondents mean by an 'internal contract' and, indeed, whether there is an actual contract.

25 Questions for participants:

(a) Do you agree with these respondents and, if so, why?

(b) If you do agree,

(i) Precisely what do you mean by an 'internal contract'?

(ii) How would you answer those who point out that it is a basic principle of consolidation that intragroup transactions are eliminated, ie that the members of a group are treated as a single entity when preparing consolidated accounts?

(iii) Would you put any limits around the use of internal contracts and, if so, what would these be?

Two kinds of hedge accounting (IAS 39, paragraphs 153 and 158)

26 Some respondents are concerned that IAS 39 contains two kinds of hedge accounting (cash flow hedge accounting and fair value hedge accounting), with each kind having different effects on reported assets, liabilities and equity. They believe that this unnecessarily complicates IAS 39's hedge accounting requirements and makes it difficult for users to see the effect on the entity of using hedge accounting.

27 In addition, some respondents are concerned that that in some cases an entity is able to choose which kind of hedge accounting it applies. An example is an entity, with fixed rate assets and floating rate liabilities, that hedges the mismatch in interest bases with an interest rate swap. The entity could designate the swap either as a fair value hedge of the fixed rate assets or as a cash flow hedge of the floating rate liabilities, with different effects on its reported assets and equity.

28 Questions for participants:

- (a) Would you support eliminating one of the two kinds of hedge accounting? If so, which one? Please note that if cash flow hedge accounting were to be eliminated, some transactions that at present qualify for hedge accounting would no longer do so, for example, hedges of variable rate instruments and hedges of forecast transactions. On the other hand, if fair value hedge accounting were to be eliminated, other transactions that at present qualify for hedge accounting would no longer do so, for example, hedges of fixed rate instruments. In addition, more gains and losses would be reported initially in equity, thus increasing the potential volatility of equity.
- (b) Alternatively, would you support a requirement that removed the choice of classification that at present exists for some hedging transactions (see paragraph 27)? If so, would you prefer that hedging transactions for which there is at present a choice were always classified as cash flow hedges, or always classified as fair value hedges? Why?

Hedges of firm commitments (IAS 39, paragraph 140)

- 29 Some respondents disagree with the ED's proposal that a hedge of a firm commitment should be accounted for as a fair value hedge.

Do you believe that a hedge of a firm commitment should be accounted for as a fair value hedge or a cash flow hedge? Why? Should entities be given the choice? Why?

Basis adjustment (IAS 39, paragraph 160)

- 30 Some respondents disagree with the ED's proposal that when a hedged forecast transaction results in an asset or liability, the cumulative gain or loss that had previously been reported in equity should remain in equity and be released to profit or loss when the hedged forecast transaction affects profit or loss. They prefer that when the asset or liability is recognised, the cumulative gain or loss that had previously been reported in equity is removed from equity and becomes part of the initial measurement of the asset or liability (sometimes referred to as 'basis adjustment')

Do you believe that 'basis adjustment' should be prohibited? Why/why not?

Impairment of financial assets (IAS 39, paragraphs 109-119)

NB: Paragraphs 31-38 relate to financial assets that are measured at amortised cost. Paragraph 39 relates to available for sale financial assets, ie to assets measured at fair value with some changes in value reported in equity.

Principles underlying the ED's requirements

- 31 A loan or other financial asset that is measured at amortised cost is impaired when its carrying amount exceeds its recoverable amount. The recoverable amount is the present value of the expected cash flows. Consistently with the loan being measured at amortised cost (and not at fair value), the discount rate should be an original rate (as opposed to a current rate).
- 32 It may be probable that a group of financial assets is impaired, even though that impairment cannot yet be identified with any individual asset within the group. Hence, a loan or other financial asset that, when assessed individually is found not to be impaired, should be included in a group of similar financial assets that are collectively assessed for impairment.
- 33 No impairment loss should be recognised on the initial recognition of a loan or other financial asset. Entities do not generally originate or purchase loans at a loss. Accordingly, the discount rate used to measure impairment is the original effective rate,

adjusted to exclude that part of the original effective rate that compensates for the credit losses that, at initial recognition, were expected to arise on the asset.

- 34 The expected future cash flows used to assess the amount of an impairment loss are based on historical loss data, updated to reflect current conditions. The updating to reflect current conditions is based on objective evidence and observable data.
- 35 Question for participants: Do you agree with these principles and, if not, what changes would you propose? Should any other principles be added?

Specific issues raised in the comment letters.

Availability of data

- 36 Some respondents are concerned that entities lack the data necessary to apply the proposed model.
- (a) Do you agree with this concern?
- (b) If so:
- (i) precisely what data are lacking?
- (ii) how is the amount of any impairment in a portfolio of financial assets assessed at present, and what data are used in making this assessment?

Convergence with the Basle approach

- 37 Some respondents suggest that the Board should develop an approach that is consistent with Basle capital adequacy proposals. These proposals involve estimating expected defaults based on a long-run average of one-year default rates.

Do you believe that such one-year default rates can be used to measure the recoverable amount of a loan whose remaining maturity is more than one year? If so, how?

Future losses

- 38 Some respondents are concerned about the extent to which “future losses” would be recognised as impairment losses under the ED. It is often unclear what is meant by “future losses”, not least as the dividing line between a future loss and an incurred loss can be hard to draw.

What guidance would you propose for determining what evidence or data should (and should not) be taken into account when determining whether an asset is impaired and in measuring the resulting impairment loss?

Reversals of impairment losses (IAS 39, paragraphs 117-119)

- 39 Some respondents disagree with the ED’s proposal that impairment losses recognised on investments in debt or equity instruments that are classified as available for sale should not be reversed.

- (a) Do you agree with these respondents or the approach in the ED? Why?
- (b) If so, what criteria would you propose for distinguishing a reversal of an impairment loss (that would be reported in profit or loss) from other increases in fair value (that would be reported in equity)?

Other issues

The fair value measurement option (IAS 39, paragraph 10)

- 40 The ED proposes that an entity be permitted to measure any financial asset or financial liability at fair value with changes in fair value reported in profit or loss, by designating it as held for trading at initial recognition (the ‘fair value measurement option’). The objective of this option is to simplify the application of IAS 39, for example by
- removing the burden of separating an embedded derivative contained in a hybrid instrument,

- eliminating the need for hedge accounting for hedges of fair value exposures that are natural offsets, and
- enabling consistent measurement of matched asset and liability positions.

41 Some respondents agree with this proposal whereas others do not. Another suggestion is that the option should be retained, but be limited to certain financial instruments.

(a) Do you agree with the proposed fair value measurement option and why?

(b) Should the option be limited to certain financial instruments? If so, which ones and why?

(c) If the fair value measurement option were to be retained in the final standard, what items would you expect it to be used for?

Convergence with US GAAP

42 Some respondents, when commenting on a specific issue, suggest that IAS 39 should be made consistent with US GAAP. Other respondents commenting on the same issue, or the same respondents when commenting on other issues, support an approach that is not consistent with US GAAP.

What principles should the Board use to decide when to converge with US GAAP?

Other issues

43 Are there any other major issues you would like to raise with the Board?