

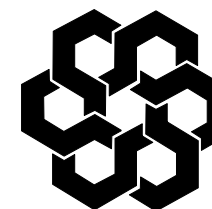
**PROPOSED LIMITED
REVISIONS TO
INTERNATIONAL
ACCOUNTING STANDARD**

**IAS 39
FINANCIAL INSTRUMENTS:
RECOGNITION AND
MEASUREMENT**

AND OTHER RELATED STANDARDS

Exposure Draft E66

Issued for comment by 10 September 2000



**International
Accounting Standards
Committee** ®

EXPOSURE DRAFT

Proposed Limited Revisions to
International Accounting Standard

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FINANCIAL INSTRUMENTS:
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This Exposure Draft is issued by the International Accounting Standards Committee for comment only. The recommendations in the draft may be modified in the light of the comments received before being issued in the form of an International Accounting Standard.

Comments should be submitted in writing so as to be received by **10 September 2000**. All replies will be put on public record unless confidentiality is requested by the commentator. If commentators respond by fax or E-mail, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by E-mail to: **CommentLetters@iasc.org.uk** or addressed to:

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Invitation to Comment

The Board of the International Accounting Standards Committee (IASC) has approved this Exposure Draft for distribution to professional accountancy bodies, members of the IASC Consultative Group, and other interested individuals and organisations for comment.

Comments should be submitted in writing so as to be received by **10 September 2000**.

Background

IAS 39, Financial Instruments: Recognition and Measurement, issued in December 1998, establishes principles for recognising, measuring, and disclosing information about financial assets and financial liabilities. IAS 39 is effective for financial statements for financial years beginning on or after 1 January 2001.

When the IASC Board voted to approve IAS 39, it recognised the need to monitor implementation issues and to consider how IASC can best respond to such issues on a timely basis. At its meeting in March 2000, the IASC Board approved an approach to publishing implementation guidance on IAS 39 in the form of Questions and Answers (Q&A). At that meeting, the Board appointed an IAS 39 Implementation Guidance Committee (IGC) to review and approve the draft Q&A and to seek public comment before final publication.

The Board also asked the IGC to identify any issues that it believed should be referred to the Standing Interpretations Committee for a formal Interpretation or referred to the Board for possible amendment of IAS 39 or other IAS. Based on a recommendation from the IGC, the IASC Board at its meeting in June 2000 decided to propose limited revisions relating to the five issues set out in this Exposure Draft. The proposed revisions address technical application issues that have been identified following the approval of IAS 39. The Board's assessment is that the proposed revisions will assist enterprises preparing to implement IAS 39 for the first time in 2001 and help ensure consistent application of the Standard. It is the Board's intent to have the final revisions in place before the 1 January 2001 effective date of IAS 39.

The proposed revisions set out in this Exposure Draft relate not only to IAS 39 but also to IAS 28, Accounting for Investments in Associates; IAS 31, Financial Reporting of Interests in Joint Ventures; and IAS 32, Financial Instruments: Disclosure and Presentation. Each of the proposed revisions is followed by an explanation of the Board's reasons for proposing the change. Respondents are encouraged to indicate whether they agree or disagree with each of the five proposed revisions and, if they disagree, to explain their reasoning.

No particular transitional provisions are proposed for any of the revisions. Consequently, the proposed revisions will apply when IAS 39 becomes operative, that is, for financial statements covering financial years beginning on or after 1 January 2001. Early adopters of IAS 39 use IAS 8 to account for any change in accounting policy that results from the proposed revisions. Respondents are asked whether they foresee any difficulty with the absence of specific transitional provisions.

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Trade date vs. settlement date: IAS 39.30 and IAS 39.167(c)

1. IAS 39.30 and IAS 39.167(c) are amended to read as follows:

30. A 'regular way' purchase or sale of financial assets should be recognised using either trade date accounting or settlement date accounting as described in paragraphs 32 and 33. The method used should be applied consistently for all purchases and sales of financial assets that belong to the same each category of the four categories of financial assets defined in paragraph 10. ~~A 'regular way' sale of financial assets should be recognised using settlement date accounting.~~

167. The following should be included in the disclosures of the enterprise's accounting policies as part of the disclosure required by IAS 32 paragraph 47(b):

[...]

(c) for each category of the four categories of financial assets defined in paragraph 10, whether 'regular way' purchases and sales of financial assets are accounted for at trade date or settlement date (see paragraph 30).

Reason

2. The IASC Board notes that the requirement in IAS 39 to use settlement date accounting for sales of financial assets, while permitting both trade date accounting and settlement date accounting for purchases of financial assets, lead to inconsistencies in the reporting of those assets. Not only could a buyer and seller both report the same asset in the period between trade date and settlement date, but the same reporting enterprise could report the same asset two or more times by buying back a sold asset before the settlement date of the preceding sale. The Board also notes that differences in legal systems across countries lead to additional complexity since ownership may be transferred and change in control occur at different points in time between trade date and settlement date in different jurisdictions.

3. Moreover, in making preparations to implement IAS 39, institutions with large volumes of transactions in financial instruments have identified practical problems associated with the requirement to apply settlement date accounting for sales of financial assets. For instance, financial institutions that presently apply trade date accounting for both purchases and sales have indicated that they would have to incur significant system costs on the switchover to settlement date accounting for sales.
4. To facilitate a smooth and timely implementation of IAS 39 and avoid the conceptual and practical problems identified in the preceding paragraphs, the Board has concluded that both trade date accounting and settlement date accounting should be permitted for sales of financial assets provided that the reporting enterprise applies the selected accounting policy in a consistent manner for both purchases and sales of financial assets that belong to the same category of financial assets (financial assets held for trading, available-for-sale financial assets, held-to-maturity investments, and loans and receivables originated by the enterprise).

Accounting for collateral: IAS 39.44 – 46 and IAS 39.170

5. IAS 39 is amended by deleting IAS 39.44-46 and by revising IAS 39.170 to read as follows:

Accounting for Collateral

~~44. If a debtor delivers collateral to the creditor and the creditor is permitted to sell or repledge the collateral without constraints, then:~~

- ~~(a) the debtor should disclose the collateral separately from other assets not used as collateral; and~~
- ~~(b) the creditor should recognise the collateral in its balance sheet as an asset, measured initially at its fair value, and should also recognise its obligation to return the collateral as a liability.~~

~~45. If the creditor is constrained from selling or repledging the collateral because the debtor has the right and ability to redeem the collateral on short notice, for example, by substituting other collateral or by terminating the contract, then the creditor does not recognise the collateral in its balance sheet.~~

~~46. To illustrate application of paragraph 44, if A transfers and delivers certain securities to B but the transaction does not qualify for derecognition on A's books, and B takes possession of the collateral and is free to sell or pledge it, the following journal entries would be made to reflect the collateral:~~

A's Books (the 'borrower'):		Debit	Credit
Securities given as collateral	xx		
Securities			xx
To separate the collateralised asset from unrestricted assets.			
Cash	xx		

Liability	xx		
To record the collateralised borrowing.			
B's Books (the 'lender'):		Debit	Credit
Securities held as collateral	xx		
Obligation to return securities			xx
To reflect B's control of the asset and its obligation to return them to A.			
Receivable	xx		
Cash			xx
To record the collateralised lending.			

170. Financial statements should include all of the following additional disclosures relating to financial instruments:

[...]

- (e) if the enterprise has reclassified a financial asset as one required to be reported at amortised cost rather than at fair value (see paragraph 92), disclose the reason for that reclassification; ~~and~~
- (f) disclose the nature and amount of any impairment loss or reversal of an impairment loss recognised for a financial asset, separately for each significant class of financial asset (paragraph 46 of IAS 32 provides guidance for determining classes of financial assets);-
- (g) a borrower should disclose the carrying amount of financial assets pledged as collateral for liabilities and (consistent with IAS 32.49(g)) any significant terms and conditions relating to pledged assets; and
- (h) a lender should disclose the fair value of collateral that it has accepted and that it is permitted to sell or repledge and the fair value of collateral that it has sold or repledged, and (consistent with IAS 32.49(g)) any significant terms and conditions associated with its use of collateral.

Reason

6. IAS 39 currently requires a creditor (lender) to recognise in its balance sheet collateral it has received from a debtor (borrower) if the creditor is permitted to sell or repledge the collateral without constraints. This requirement has been the subject of intense debate since IAS 39 was issued. Several constituencies have called on the IASC to reconsider the requirement.
7. Some argue that, under the IASC Framework, the collateral and the related obligation to return the collateral do not meet the definition of an asset or a liability from the perspective of the creditor. They argue that the requirement to recognise collateral received results in the inclusion of the same asset in the balance sheets of two enterprises.
8. Moreover, the accounting treatment required by IAS 39.44-46 is not common in current practice around the world. FASB Statement 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, requires a similar treatment. The experience gained in the United States indicates that the condition that the secured party is permitted to sell or repledge the collateral without constraints is not operational in practice. The FASB has concluded that differing interpretations of the notion of constraint have resulted in a lack of comparability between entities and have decided to withdraw the requirement for a secured party to recognise collateral received in its balance sheet.
9. For these reasons, this Exposure Draft proposes to delete IAS 39.44-46, which required the creditor to recognise collateral. This Exposure Draft also proposes to expand disclosure requirements related to what had been in those paragraphs with a more general requirement that both borrowers and lenders provide additional disclosure regarding collateral. This more general requirement would be added to IAS 39.170, which is part of the disclosure section of the Standard.

10. Thus the proposed revisions to IAS 39 include a general requirement for borrowers to disclose financial assets that are pledged as collateral. Such a requirement presently exists for inventories (IAS 2.34(f)), property, plant and equipment (IAS 16.61(a)), and intangible assets (IAS 38.111(d)) as well as for banks (IAS 30.53). Such a requirement has also been proposed for biological assets (E65.64(d)). IAS 32 does not include a requirement to disclose financial assets pledged as collateral. It requires disclosure of information about the extent and nature of financial instruments, including significant terms and conditions that may affect the amount, timing, and certainty of future cash flows (IAS 32.47), and notes that terms and conditions relating to collateral held or pledged may warrant disclosure (IAS 32.49(g)). Also, the proposed revision to IAS 39 requires lenders to disclose the fair value of any collateral that they have received and are permitted to sell or repledge. If a lender sells or repledges collateral it has received, it discloses the fair value of that collateral separately.

Impairment and uncollectibility: IAS 39.112

11. IAS 39.112 is amended to read as follows:

112. Impairment and uncollectibility ~~are may be~~ measured and recognised individually for financial assets that are individually significant. Impairment and uncollectibility may be measured and recognised on a portfolio basis for a group of similar financial assets.

Reason

12. Constituents have suggested that the current wording of IAS 39.112, by using the term “may”, could be interpreted as permitting an enterprise not to measure and recognise impairment individually for individually significant financial assets. If “may” is interpreted as permissive, it could result in failure to recognise an impairment loss that has taken place. To clarify that the Board’s intention was not to allow an enterprise to disregard individual impairment for individually significant financial assets, the Board proposes to substitute “are” for “may be” in the first sentence of IAS 39.112.

Treatment of temporary investments in subsidiaries, associates, and joint ventures: IAS 28.8, IAS 28.10, and IAS 31.35

13. IAS 28 is amended by revising IAS 28.8 to read as follows and by deleting IAS 28.10:

8. *An investment in an associate should be accounted for in consolidated financial statements under the equity method except when:*

(a) *the investment is acquired and held exclusively with a view to its subsequent disposal in the near future; or*

(b) *it operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.*

Such investments in which case it should be accounted for as if they are investments in accordance with IAS 39, Financial Instruments, Recognition and Measurement under the cost method.

~~10. An investment in an associate is accounted for using the cost method when it operates under severe long term restrictions that significantly impair its ability to transfer funds to the investor. Investments in associates are also accounted for using the cost method when the investment is acquired and held exclusively with a view to its disposal in the near future.~~

14. IAS 31.35 is amended to read as follows:

35. *A venturer should account for the following interests as if they are investments either at cost or in accordance with IAS 39, Financial Instruments: Recognition and Measurement:*

(a) *an interest in a jointly controlled entity which is acquired and held exclusively with a view to its subsequent disposal in the near future; and*

- (b) *an interest in a jointly controlled entity which operates under severe long-term restrictions that significantly impair its ability to transfer funds to the venturer.*

Reason

15. IAS 39 amended IAS 27, Consolidated Financial Statements and Accounting for Investments in Subsidiaries, by introducing a requirement to account for subsidiaries that are held temporarily or operate under severe long-term restrictions in accordance with IAS 39 in consolidated financial statements¹ (IAS 27.13). IAS 28 includes rules about a similar category of investments in associates. Such investments are exempted from the equity method in consolidated financial statements (IAS 28.8 and 28.10). However, IAS 39 did not amend the accounting rules for such investments. Moreover, IAS 31 excludes a similar category of interests in joint ventures from proportionate consolidation or the equity method (IAS 31.35). In this case, IAS 39 amended IAS 31 by requiring that such interests should be accounted for either at cost or in accordance with IAS 39 at the venturer's option.
16. As a result, without the proposed revision the measurement in consolidated financial statements of the types of investments noted above would differ:
- Temporary investments in subsidiaries are accounted for at fair value.
 - Temporary investments in joint ventures may be carried either at cost or at fair value.
 - Temporary investments in associates are carried at cost.
 - Other temporary investments in equity securities are accounted for at fair value.
17. To eliminate the inconsistencies noted above, the Board proposes to introduce wording similar to that in IAS 27.13 into IAS 28.8 and IAS 31.35. Harmonisation of the wording in IAS 28.8 with IAS 27.13 makes IAS 28.10 redundant.

¹ A subsidiary that is "acquired and held exclusively with a view to its subsequent disposal in the near future or operate under severe long-term restrictions that significantly impair its ability to transfer funds to the parent".

Disclosure of hedges: IAS 32.91-94

18. IAS 32 is amended by deleting IAS 32.91-93:

Hedges of Anticipated Future Transactions

~~91. When an enterprise has accounted for a financial instrument as a hedge of risks associated with anticipated future transactions, it should disclose:~~

- ~~(a) a description of the anticipated transactions, including the period of time until they are expected to occur;~~
- ~~(b) a description of the hedging instruments; and~~
- ~~(c) the amount of any deferred or unrecognised gain or loss and the expected timing of recognition as income or expense.~~

~~92. An enterprise's accounting policies indicate the circumstances in which a financial instrument is accounted for as a hedge and the nature of the special recognition and measurement treatment applied to the instrument. The information required by paragraph 91 permits the users of an enterprise's financial statements to understand the nature and effect of a hedge of an anticipated future transaction. The information may be provided on an aggregate basis when a hedged position comprises several anticipated transactions or has been hedged by several financial instruments.~~

~~93. The amount disclosed in accordance with paragraph 91(c) includes all accrued gains and losses on financial instruments designated as hedges of anticipated future transactions, without regard to whether those gains and losses have been recognised in the financial statements. The accrued gain or loss may be unrealised but recorded in the enterprise's balance sheet as a result of carrying the hedging instrument at fair value, it may be unrecognised if the hedging instrument is carried on the cost basis, or it may have been realised if the hedging instrument has been sold or settled. In each case, however, the accrued gain or loss on the hedging instrument has not been recognised in the~~

~~enterprise's income statement pending completion of the hedged transaction.~~

19. IAS 32.94 is amended to read as follows:

Other Disclosures

94. Additional disclosures are encouraged when they are likely to enhance financial statement users' understanding of financial instruments. It may be desirable to disclose such information as:

(a) the total amount of the change in the fair value of financial assets and financial liabilities that has been recognised as income or expense for the period; and

~~(b) the total amount of deferred or unrecognised gain or loss on hedging instruments other than those relating to hedges of anticipated future transactions; and~~

~~(e)~~

(b) the average aggregate carrying amount during the year of recognised financial assets and financial liabilities, the average aggregate principal, stated, notional or other similar amount during the year of unrecognised financial assets and financial liabilities and the average aggregate fair value during the year of all financial assets and financial liabilities, particularly when the amounts on hand at the balance sheet date are unrepresentative of amounts on hand during the year.

Reason

20. The disclosure requirements for hedges in IAS 39 effectively superseded those in IAS 32. Therefore, the Board has concluded that the disclosure requirements in IAS 32.91-93 and 94(b) are redundant and potentially confusing.