EFRAG

European Financial Reporting Advisory Group

Dr. Alexander Schaub
Director General
European Commission
Directorate General for the Internal Market

1049 Brussels

8 July 2004

Dear Dr. Schaub,

Re: Adoption of the amended IAS 32 *Financial Instruments: Disclosure and Presentation*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on the adoption of the amended IAS 32 *Financial Instruments: Disclosure and Presentation* as published by the IASB on 17 December 2003.

The IASB undertook an initiative to improve the IAS 32/39 financial instruments standards that it inherited from its predecessor body (the International Accounting Standards Committee – IASC), in time for them to be used by companies adopting International Financial Reporting Standards for the first time in 2005. The then current versions of IAS 32/39 were covered by EFRAG's positive "en-bloc" endorsement advice that was submitted to the Commission in June 2002. At that time, we indicated that the IASB was reviewing a number of its existing standards and that we would consider all changes to the existing IFRS when promulgated.

In contributing to the IASB's due process, EFRAG issued on 18 October 2002 a comment letter to the IASB on its exposure draft of proposed amendments to IAS 32 and 39. The intention of the IASB's improvements project was not to reconsider the fundamental approaches contained in IAS 32/39 because to do so would have resulted in a substantial delay in the production of a new standard on financial instruments. Rather, it was the IASB's objective (i) to improve the existing requirements based on issues raised by preparers, professional accountants, standard setters, regulators and others and (ii) to reduce some of the complexity by clarifying and adding guidance, eliminating internal inconsistencies and incorporating into the standards key elements of existing interpretations and implementation guidance.

More specifically, the IASB's main objectives with regard to improving IAS 32 were:

i. To provide additional guidance on selected matters – such as the measurement of the components of a compound financial instrument on initial recognition, and the classification of derivatives based on an entity's own shares – and to locate all disclosures relating to financial instruments in one standard.

ii. To replace the following Interpretations and draft Interpretation:

    a. SIC-5 *Classification of Financial Instruments – Contingent settlement Provisions*;
    b. SIC-16 *Share Capital – Reacquired Own Equity Instruments (Treasury Shares)*;
    c. SIC-17 *Equity – Costs of an Equity Transaction*; and
    d. draft SIC–D34 *Financial Instruments – Instruments or Rights Redeemable by the Holder*.

The introduction to the revised standard (IN paragraphs 4-19) summarises the main changes from the previous version of IAS 32, on which we provided a positive endorsement advice as part of our 19 June 2002 "en bloc" endorsement letter.

The revised standard retains the main thrust of the proposed amendments and incorporates further improvements at a number of points, some of which were proposed by EFRAG.

The amended IAS 32 becomes effective for annual periods beginning on or after 1 January 2005, with earlier application permitted. An entity applying IFRSs for the first time in 2005 is not required to prepare the comparative information in accordance with IAS 32. This facilitates transition to IFRS in 2005 while allowing for further improvement of IAS 32.

EFRAG has evaluated the amended IAS 32, including the Basis for Conclusions. Our evaluation is based on input from standard setters and market participants in accordance with EFRAG's due process.

With regard to our evaluation of the revised standard, we wish to highlight the following observations:

Puttable instruments

The new paragraph 18 of IAS 32 states that an entity may issue a financial instrument (puttable instrument) that gives the holder the right to put the instrument back to the issuer for cash or another financial asset, the amount of which is determined on the basis of an index or other item that has the potential to increase or decrease. For example, open-ended mutual funds, unit trusts, partnerships, and some co-operative entities may provide their unit holders or members with a right to redeem their interests in the entity at any time for cash equal to their proportionate share of the net asset value of the entity. Even when the legal form of a puttable instrument gives the holder a right to the residual interest in the assets of an entity, the inclusion of an option for the holder to put that right back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability and is presented as such.

EFRAG was informed that this new paragraph causes interpretation problems as to when a share in a co-operative organisation should be presented as a liability instead of equity under the amended IAS 32. As a result, IASB's interpretive body IFRIC published on 30 June 2004 a draft interpretation. Within its pro-active role, EFRAG will consider the draft IFRIC interpretation during its July 2004 meeting. Our endorsement advice on the final interpretation will, in accordance with our due process, be submitted to you shortly after its publication.

Considering the above, we have concluded that the revised IAS 32 *Financial Instruments: Disclosure and Presentation* meets the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards that:

i. it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
ii. it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, we believe that it is in the European interest to adopt the revised IAS 32. Accordingly, we recommend adoption of the revised IAS 32 *Financial Instruments: Disclosure and Presentation.*

We should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,

Stig Enevoldsen
EFRAG, Chairman