



International Accounting Standards Board®

Press Release

FOR IMMEDIATE RELEASE

8 July 2004

IASB PUBLISHES PROPOSALS FOR LIMITED AMENDMENTS TO STANDARD ON FINANCIAL INSTRUMENTS

The International Accounting Standards Board (IASB) today published three short Exposure Drafts proposing limited amendments to IAS 39 *Financial Instruments: Recognition and Measurement*. Two of the proposed amendments are aimed at easing the implementation of the standard by providing additional and immediate guidance on issues identified by the business community; the other is intended to ensure that a guarantor's balance sheet includes all guarantees issued. The limited amendments do not relate to the IASB's ongoing broad examination of the accounting for financial instruments and work on interest margin hedging.

The IASB is committed to maintaining a 'stable platform' of unchanged Standards during the period to 2005. Accordingly, only one of the proposed amendments—which is aimed at easing the implementation of IAS 39 on its first adoption—would apply for 2005; the other two amendments, though available for early adoption, would have effective dates of 1 January 2006.

Brief summary of the three proposed amendments

The Exposure Draft *Transition and Initial Recognition of Financial Assets and Financial Liabilities* proposes an amendment that would apply when entities first adopt IAS 39. It would allow, but not require, entities to adopt an approach to transition that is easier to implement than that in the current version of IAS 39 and would enable entities to eliminate a difference between the IASB's Standards and US requirements.

The Exposure Draft *Cash Flow Hedge Accounting of Forecast Intragroup Transactions* clarifies the treatment in consolidated financial statements of a foreign currency cash flow hedge of a highly probable forecast external transaction denominated in the functional currency of the group entity (eg a subsidiary) entering into the transaction. Thus, a group

could designate that external transaction as the hedged item, provided that the transaction gives rise to an exposure that will have an effect on consolidated profit or loss (ie it is denominated in a currency other than the group's presentation currency).

The Exposure Draft *Financial Guarantee Contracts and Credit Insurance* proposes that the issuer of a financial guarantee contract should measure the contract initially at fair value. If the financial guarantee contract was issued in a stand-alone arm's length transaction to an unrelated party, its fair value at inception is likely to equal the premium received. The Exposure Draft also addresses the subsequent measurement of those guarantees. The proposed requirements would apply even if the contract meets the definition of an insurance contract in IFRS 4 *Insurance Contracts*.

Introducing the proposed amendments, Sir David Tweedie, IASB Chairman, commented:

These proposed amendments are an attempt to address some limited, but important, implementation issues on IAS 39 and respond directly to certain concerns expressed by constituents. Our objective is to ease the implementation of IAS 39, and to ensure that liabilities for financial guarantees are not omitted from the financial statements. We shall welcome comments on whether the proposals meet their objective.

Comments are requested by 8 October 2004.

The primary means of publishing proposed International Financial Reporting Standards and amendments to Standards is by electronic format through the IASB's subscriber Website. Subscribers are able to access the proposed amendments published today through "online services". Those wishing to subscribe should contact:

IASCF Publications Department, 30 Cannon Street, London EC4M 6XH,
United Kingdom. Tel: +44 (0)20 7332 2730, Fax: +44 (0)20 7332 2749,
email: publications@iasb.org Web: www.iasb.org.

Printed copies of the set of three Exposure Drafts of proposed amendments to IAS 39 (ISBN 1-904230-64-4) will be available shortly, at £10 for the set including postage, from IASCF Publications Department.

From 19 July, the text of the Exposure Drafts will be available freely from the IASB's Website.

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NOTES TO EDITORS**Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement on Transition and Initial Recognition of Financial Assets and Financial Liabilities**

- 1 When improving IAS 39 the IASB decided to include guidance on when an entity can recognise gains or losses on initial recognition of financial instruments. The revised version of IAS 39 issued in 2003 states that the best evidence of the fair value of a financial instrument at initial recognition is the transaction price, unless the fair value can be evidenced by comparison with other observable current market transactions, or is based on a valuation technique whose variables include only data from observable markets. It follows that a 'day 1' gain or loss can be recognised only if evidenced in this way. When developing this requirement, the IASB noted that it converged with US generally accepted accounting principles (GAAP).
- 2 The transition provisions in the revised IAS 39 and in IFRS 1 *First-time Adoption of International Financial Reporting Standards* require retrospective application of this guidance.
- 3 After the revised IAS 39 was issued in December 2003, constituents raised the following concerns:
 - (a) retrospective application of the 'day 1' gain or loss recognition requirements will be difficult and expensive, and may require subjective assumptions about what was observable and what was not.
 - (b) retrospective application diverges from the requirements of US GAAP. Very similar requirements in US GAAP are applicable only to transactions entered into after 25 October 2002.
- 4 Given these concerns the IASB decided, as a special case, to propose an amendment to the transition requirements in the revised IAS 39. This amendment would apply only

when entities first adopt the revised version of IAS 39. It would allow, but not require, entities to adopt an approach to transition that is easier to implement than that in the revised IAS 39 and also enable entities to eliminate any reconciling differences with US GAAP. More specifically, the proposed amendment would give entities a choice of applying the 'day 1' gain or loss recognition requirements in IAS 39 either:

- (a) prospectively to transactions entered into after 25 October 2002, or
- (b) retrospectively as required by paragraph 104 of IAS 39.

Proposed effective date

- 5 If confirmed in a Standard, the proposals in this Exposure Draft would apply for annual periods beginning on or after 1 January 2005.

Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement on Cash Flow Hedge Accounting of Forecast Intragroup Transactions

- 6 A principle in IAS 39 is that entities can obtain hedge accounting only for transactions that involve a party external to the entity. Among the 2003 revisions to IAS 39 was the inclusion of an exception to this principle. This exception, previously contained in Guidance on Implementation (IGC) 137–13 *Intra-group monetary item that will affect consolidated net income*, allows the foreign currency risk in an intragroup monetary item to be designated as the hedged item in consolidated financial statements as long as the intragroup item results in an exposure to foreign exchange rate gains or losses that are not fully eliminated on consolidation under IAS 21 *The Effects of Changes in Foreign Exchange Rates*. However, the revised IAS 39 does not allow a forecast intragroup transaction to be designated as the hedged item in a foreign currency cash flow hedge in consolidated financial statements. This was allowed by the previous version of IAS 39 as interpreted by IGC 137–14 *Forecasted intra-group foreign currency transactions that will affect consolidated net income*.
- 7 After the revised IAS 39 was issued, constituents raised the following concerns:
- (a) it is common practice for entities to designate a forecast intragroup transaction as the hedged item.
 - (b) some entities using International Financial Reporting Standards (IFRSs) and entities that are planning to adopt IFRSs in 2005 have established a practice of designating

forecast intragroup transactions as hedged items and have entered into derivative instruments to hedge the resulting exposures.

(c) the revised IAS 39 creates a difference from US GAAP because the US standard SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* permits hedge accounting for foreign currency risk on forecast intragroup transactions.

- 8 The IASB noted that the revised IAS 39 permits entities that had designated a forecast intragroup transaction as the hedged item to obtain hedge accounting by designating a highly probable forecast external transaction as the hedged item. The IASB noted that if the hedge is designated in this way, entities can use the forecast intragroup transaction as part of the tracking mechanism (or ‘audit trail’) for associating the hedging instrument with an external transaction. Also, if—as is often the case—the external transaction is for a higher amount than the intragroup transaction, the entity could designate a part of the highly probable forecast external transaction as the hedged item.
- 9 However, the IASB also noted that there was confusion among constituents about whether the revised IAS 39 permits the designation outlined in the previous paragraph. Accordingly, the IASB proposes to clarify that in consolidated financial statements a group can designate as the hedged item, in a foreign currency cash flow hedge, a highly probable forecast external transaction denominated in the functional currency of the entity (eg a subsidiary) entering into the transaction, provided that the transaction gives rise to an exposure that will have an effect on consolidated profit or loss (ie it is denominated in a currency other than the group’s presentation currency).

Proposed effective date

- 10 If confirmed in a Standard, the proposals in this Exposure Draft would apply for annual periods beginning on or after 1 January 2006. Earlier application would be permitted.

Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts on *Financial Guarantee Contracts and Credit Insurance*

Financial guarantee contracts

- 11 The Exposure Draft 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.’ The proposals would require the issuer of a

financial guarantee contract (other than those that were entered into or retained on transferring financial assets or financial liabilities to another party) to measure the contract:

- (a) initially at fair value. If the financial guarantee contract was issued in a stand-alone arm's length transaction to an unrelated party, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary.
- (b) subsequently at the higher of (i) the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

These requirements would apply even if the contract meets the definition of an insurance contract in IFRS 4.

- 12 For a stand-alone financial guarantee contract issued in an arm's length transaction to an unrelated party, the main practical effect of the proposals is the requirement to use IAS 37 to determine whether an additional liability should be recognised. Without the requirements proposed in the Exposure Draft, if the issuer carries out a liability adequacy test meeting minimum requirements described in paragraph 16 of IFRS 4, the issuer need not use IAS 37 to determine whether an additional liability should be recognised.
- 13 Pending completion of amendments resulting from this Exposure Draft, these financial guarantee contracts are within the scope of IFRS 4.

Proposed effective date

- 14 If confirmed in a Standard, the proposals in this Exposure Draft would apply for annual periods beginning on or after 1 January 2006. Earlier application would be encouraged.

About the IASB

The International Accounting Standards Board (IASB), based in London, began operations in 2001. Contributions collected by its Trustees, the IASC Foundation, from the major accounting firms, private financial institutions and industrial companies throughout the world, central and development banks, and other international and professional organisations fund the operations of the IASB.

The 14 Board members (12 of whom are full-time) are drawn from nine countries and have wide international experience and a variety of functional backgrounds. The IASB is committed to developing, in the public interest, a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements. In pursuit of this objective, the IASB cooperates with national accounting standard-setters to achieve convergence in accounting standards around the world.

Upon its inception the IASB adopted the body of International Accounting Standards (IASs) issued by its predecessor, the International Accounting Standards Committee (IASC). IAS 39 is one of the standards inherited from IASC.

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