The Association of Corporate Treasurers

Comments in response to
ED/2009/7 Financial instruments: Classification and measurement
Published by the IASB
July 2009

September 2009

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the end of these comments and on our website www.treasurers.org.

Contact details are also at the end of these comments.

We canvas the opinion of our members through seminars and conferences, our monthly e-newsletter to members and others, *The Treasurer* magazine, topic-specific working groups and our Policy and Technical Committee.

General

This document is on the record and may be freely quoted or reproduced with acknowledgement.

We welcome the IASB's project to improve IAS 39 and undertake a fundamental review of the standard. IAS 39 has widely been regarded as unduly complex and often leading to unrepresentative accounting outcomes. We realise there are practical issues in producing a full rewrite, but note that producing the revisions in three stages does make it somewhat difficult to give a reaction to the first phase when the all important stage three on hedging is not yet published.

Detailed responses

Classification approach

Question 1
Does amortised cost provide decision-useful information for a financial asset or financial liability that has basic loan features and is managed on a contractual yield basis? If not, why?

Question 2
Do you believe that the exposure draft proposes sufficient, operational guidance on the application of whether an instrument has 'basic loan features' and 'is managed on a contractual yield basis'? If not, why? What additional guidance would you propose and why?

Question 3
Do you believe that other conditions would be more appropriate to identify which financial assets or financial liabilities should be measured at amortised cost? If so,
(a) what alternative conditions would you propose? Why are those conditions more appropriate?

Within this initial exposure draft you are proposing to simplify the number of classification categories down to two and this is welcomed. The conditions to be met to account at amortised cost (basic loan features and managed on a contractual yield basis) seem a reasonable approach, with the exception that this approach, when applied to embedded derivatives, creates an anomaly.

Embedded derivatives

Question 4
(a) Do you agree that the embedded derivative requirements for a hybrid contract with a financial host should be eliminated? If not, please describe any alternative proposal and explain how it simplifies the accounting requirements and how it would improve the decision-usefulness of information about hybrid contracts.

Embedded derivatives that are not closely related to the host contract are, under current rules, separated out and revalued as if a stand alone derivative. Under your new proposal embedded derivatives would cause the host contract to be fair valued in its entirety. For convertible or index linked debt this would mean the underlying debt was itself revalued creating the anomaly that such a borrower would have this sort of borrowing at fair value when other borrowings were held at cost – a confusing and very mixed model. A further complication is apparent if you take the example an oil company issuing oil-linked debt. The company would in the past have been able to bifurcate an embedded derivative and then use this as a cash flow hedge of its revenues from sales of oil-based products. This treatment, which faithfully represents the substance of the structure, would probably no longer be available under the proposed standard.

Further more in the case of debt which is indexed to inflation we would argue that this sort of instrument could be regarded as having basic loan features and it would be helpful if this could be specifically affirmed in the eventual standard.

Fair value option

Question 5
Do you agree that entities should continue to be permitted to designate any financial asset or financial liability at fair value through profit or loss if such designation eliminates or significantly reduces an accounting mismatch? If not, why?

Question 6
Should the fair value option be allowed under any other circumstances? If so, under what other circumstances should it be allowed and why?

The retention of the fair value option is welcomed. This option has been valuable to companies who are unable to satisfy the rigours of the requirements for hedge accounting and instead have been able to apply it "where it eliminates or substantially reduces an accounting mismatch".

At present and in the proposals the fair value option would only be available at initial recognition. We have always thought that if it is sensible to allow the option to avoid a mismatch then this option should be capable of being invoked whenever the mismatch arises and equally revoked if the mismatch ceases, and would welcome the inclusion of such a concept now.

Reclassification

Question 7

Do you agree that reclassification should be prohibited? If not, in what circumstances do you believe reclassification is appropriate and why do such reclassifications provide understandable and useful information to users of financial statements? How would you account for such reclassifications, and why?

We do not support the proposed prohibition on reclassification of instruments from one category to another. The accounting is more meaningful and transparent if an instrument can be reclassified when it no longer meets the criteria for a particular classification. Any reclassification should only be allowed subject to suitable criteria such as a specific event and a real and demonstrable change of circumstances.

Investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured

Question 8

Do you believe that more decision-useful information about investments in equity instruments (and derivatives on those equity instruments) results if all such investments are measured at fair value? If not, why?

Question 9

Are there circumstances in which the benefits of improved decision-usefulness do not outweigh the costs of providing this information? What are those circumstances and why? In such circumstances, what impairment test would you require and why?

We do not support the proposal to remove the existing reliability exemption from the requirement to measure all equity instruments held (and all derivatives on such instruments) at fair value. If a market value does not exist and the fair value cannot be reliably measured then to insist on a fair value nonetheless seems perverse and will generate unreliable numbers. We accept that determining any impairment on such an equity investment is somewhat unreliable too but at least that will tend to be estimating in the direction of prudence.

Investments in equity instruments that are measured at fair value through other comprehensive income

Question 10

Do you believe that presenting fair value changes (and dividends) for particular investments in equity instruments in other comprehensive income would improve financial reporting? If not, why?

Under your proposals investments in equity are measured at fair value through P&L unless an irrevocable election at initial recognition is made to take gains and losses through OCI but you prohibit the recycling from OCI to profit or loss of such gains and losses. We welcome the option to use OCI which is far more appropriate for strategic investments not held for trading.

Alternative approach

Question 14

Do you believe that this alternative approach provides more decision-useful information than measuring those financial assets at amortised cost, specifically:

(a) in the statement of financial position?

(b) in the statement of comprehensive income?

If so, why?

Question 15

Do you believe that either of the possible variants of the alternative approach provides more decision-useful information than the alternative approach and the approach proposed in the exposure draft? If so, which variant and why?

The alternative approach you put forward creates a narrower class of assets that can be held at cost, and although it is not clear, leaves liabilities treated as in the main proposals. We see no particular merit in limiting the assets that are carried at amortised cost, and therefore do not think your alternatives as preferable to the main proposals.

TREASURY, RISK
AND FINANCE
PROFESSIONALS

ACT

The Association of Corporate Treasurers

The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for treasury, providing benchmark qualifications and continuing development through training, conferences, publications, including *The Treasurer* magazine and the annual *Treasurer's Handbook*, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce, financial institutions and professional service firms.

Our guidelines on policy and technical matters are available at http://www.treasurers.org/technical/resources/manifestosept2006.pdf.

Contacts: John Grout, Policy and Technical Director (020 7847 2575; jgrout@treasurers.org) Martin O'Donovan, Assistant Director, Policy and Technical (020 7847 2577; modonovan@treasurers.org)	The Association of Corporate Treasurers 51 Moorgate London EC2R 6BH, UK Telephone: 020 7847 2540 Fax: 020 7374 8744 Website: http://www.treasurers.org

The Association of Corporate Treasurers is a company limited by guarantee in England under No. 1445322 at the above address