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EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO IAS 32, FINANCIAL INSTRUMENTS: PRESENTATION AND IAS 1, PRESENTATION OF FINANCIAL STATEMENTS: FINANCIAL INSTRUMENTS PUTTABLE AT FAIR VALUE AND OBLIGATIONS ARISING ON LIQUIDATION

Dear Sir,

ISDA appreciates the opportunity to comment on the Exposure Draft (“ED”) of Proposed Amendments to IAS 32, Financial Instruments: Presentation and IAS 1, Presentation of Financial Statements published on 23rd June.

Our members represent leading participants in the privately negotiated derivatives industry and include most of the world’s major financial institutions, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities. As such, we believe ISDA brings a unique and broad perspective to the work of the IASB on accounting for financial instruments.

We understand the objective of the ED is to develop a limited scope, short term solution to improve the financial reporting of financial instruments puttable at fair value and instruments with obligations arising on liquidation. ISDA is supportive of the Board’s objective and welcomes short term amendments to Standards that improve financial reporting. In previous comment letters, ISDA has expressed concerns with the presentational requirements outlined in IAS 32, in particular that certain instruments are accounted for as equity even though they have features more akin to a financial liability and vice versa, and we appreciate the IASB’s efforts to improve financial reporting for such instruments. Having said this, ISDA would not support the amendments in the ED, as currently drafted, for the following reasons:

- We are concerned that the proposed amendments are based on a series of rules and not on an underlying accounting principle. In our view, this is more likely to lead to inconsistencies in financial reporting rather than provide more relevant and understandable information. In particular, we would draw to the Board’s attention the possibility under the amended rules that two entities with the same financial instrument could be required to account for the instrument in different ways;

- Introducing amendments through a series of rules may create a precedent and lead to the IASB making similar rules based amendments to Standards rather than focusing on longer term, principles based solutions. We do not support such an approach and note that this is not consistent with the IASB's own Framework for the Preparation and Presentation of Financial Statements; and
- In the ED, the IASB has suggested that this is a matter that requires an immediate fix. Whilst ISDA would agree that many issues in IAS 32 need to be re-deliberated we note that this particular issue has been dealt with, in the short term, by preparers through the provision of additional disclosure and revisions to the profit or loss account and balance sheet formats. New accounting rules implemented without an appropriate basis may result in inconsistencies in financial reporting.

As a result of the above concerns, we would encourage the Board to withdraw the ED and consider these issues, along with other issues arising from the implementation of IAS 32, as part of the joint project on liability and equity.

The appendix to this letter sets out our detailed response to the questions posed by the Board in the ED. We would be pleased to discuss our comments further with the Board or staff. Please contact either Melissa Allen at Credit Suisse or Ed Duncan at ISDA.

Yours sincerely



Melissa Allen
Chair of ISDA's European Accounting Committee
Managing Director, Credit Suisse



Ed Duncan
Director of European Policy at ISDA

Cc:
Stig Enevoldsen,
EFRAG, Chairman

The Appendix

Question 1: Financial instruments puttable at fair value

The ED as drafted would allow entities such as mutual funds and companies with a finite life to classify certain financial instruments that have characteristics similar to ordinary shares as equity rather than as financial liabilities. ISDA is supportive of the Board's objective, as outlined in the ED, of proposing short term amendments where this will result in more relevant and understandable financial reporting. Having said this, we are concerned that the proposed amendments are not based on clearly established principles and may lead to inconsistencies in financial reporting. Take, for example, a situation where Company A has issued CU 10 million of shares that are puttable at fair value and are the most subordinated class of instruments with a claim to the net assets of the entity. At the same time, Company B may also have issued CU 10 million of shares puttable at fair value but have a non substantive subordinate instrument in issue for CU 0.1 million. In this situation, although the two entities have issued very similar instruments, Company A would account for the financial instrument as equity whereas Company B would account for the instrument as a liability.

We are also concerned that introducing a rules based amendment could establish a precedent for future short term fixes to other Standards. We do not support rules based amendments and note that they are not in line with the IASB's own Framework for the Preparation and Presentation of Financial Statements. Introducing a series of rules into an accounting Standard makes it more difficult to apply appropriate accounting judgement and ensure that the financial information faithfully represents the substance of the transaction, and may result in unintended consequences.

The Basis for Conclusions in the ED sets out the reasons why the amendments have been proposed and notes that additional disclosure and revised balance sheet and profit or loss account formats have not addressed the issues relating to a company's financial reporting where it has no equity. However, it is not clear from the Exposure Draft why this particular matter has been singled out as requiring a short term fix when there are many other significant issues in IAS 32 that need to be addressed. Preparers of financial statements with no equity have now amended their accounts to demonstrate the holder of the residual equity interest through the use of captions such as "net asset value attributable to unit holders" and "changes in net asset value attributable to unit holders" on the face of the primary statements. They have also provided additional disclosures to demonstrate that total members' interests may include items such as reserves that meet the definition of equity and instruments puttable at fair value that do not. With the additional disclosures, we do not see this as an area of the Standard that needs an immediate revision.

Finally, we believe that the amendment, as currently drafted, would still lead to certain instruments that are akin to equity being accounted for as a financial liability. Take, for example, a rights issue that is priced at 90% of the current market value and gives the holder the option to purchase further shares that are puttable at fair value. In this situation, as the instrument is not issued at fair value, the ED would not permit this to be accounted for as an equity instrument even if the shares already in issue meet the definition of equity. Again, this demonstrates the problems associated with issuing rules based amendments to accounting standards.

Due to the concerns expressed above, we would ask the Board to withdraw the ED and consider the issues it is seeking to address as part of the joint project on liability and equity. We would encourage the Board to consider the implications of new concepts such as "the most subordinated class" as part of the long term project on liability and equity. Fundamental changes of this nature should only be considered as part of a longer term project such as, in this case, the joint project on liability and equity, where they can be fully debated by constituents.

Question 2: Obligations to deliver to another entity a pro-rata share of the net assets of the entity upon its liquidation

Please refer to our response to question 1. ISDA does not support the proposed amendments in the ED and would encourage the Board to withdraw the ED and deal with the issues as part of the long term project on liability and equity.

Question 3: Disclosures

As noted above, ISDA does not support the proposed amendments to IAS 32 and IAS 1. Were the Board to continue with the proposals, we would agree that an entity should provide adequate disclosure in its financial statements to enable a user to evaluate the nature and extent of the entity's capital and the proposals in the ED to provide qualitative data and details of the entities objectives and policies, and processes for managing capital. However, we do not consider that disclosure of the fair value of an instrument puttable at fair value is appropriate as this will be based on the performance of the company and its residual value. To provide such disclosures would suggest that these instruments are more akin to a financial liability, a view shared by members of the Board in the dissenting views.

Question 4: Effective date and transition

ISDA does not support the proposed amendments outlined in the ED. However, if the Board were to continue with the proposals, we would agree that the proposed changes should be retrospective as it would be important that the rules be applied consistently to those financial instruments currently in issue and those to be issued in future reporting periods.