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NEW ZEALAND INSTITUTE OF CHARTERED ACCOUNTANTS

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CANADA

Email: edcomments@ifac.org

Dear Stephenie

ED 37 Financial Instruments: Presentation
ED 38 Financial Instruments: Recognition and Measurement
ED 39 Financial Instruments: Disclosure

The Financial Reporting Standards Board (FRSB) of the New Zealand Institute of Chartered Accountants is pleased to submit its comments on the three Financial Instrument Exposure Drafts (the EDs) recently issued by the International Public Sector Accounting Standards Board (IPSASB). The FRSB commends the IPSASB on issuing these EDs and considers that they are a critical component of the IPSASB's convergence programme, particularly as governments consider the impact of recent credit crisis interventions on their financial statements.

We note that IPSASB has justified proposed departures from the underlying IASB standard by reference to the 'Rules of the Road'. We support this approach and welcome the fact that marked-up copies of the proposed EDs have been made available.

Although the FRSB understands that IPSASB is aiming to converge with IFRSs as at 31 December 2008 and that there are good reasons for selecting a single cut-off date, we suggest that the IPSASB consider whether it would be necessary or beneficial to incorporate any amendments to IFRSs issued after this date into the IPSASB's converged standards because these amendments are either fundamental to the application of the standards or significantly improve the standards. We also urge the IPSASB to continue to monitor the IASB's project to revise IAS 39 *Financial Instruments: Recognition and Measurement* with a view to adopting the revised standard as soon as possible.

Our detailed comments on each ED are set out in Appendices to this letter. If you have any queries or require clarification of any matters in this submission, please contact Clive Brodie (clive.brodie@nzica.com) in the first instance, or me.

Yours sincerely

Joanna Perry
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Appendix 1 – FRSB comments on ED 37 Financial Instruments: Presentation

Specific Matters for Comment

1.	ED 37 allows entities to treat financial guarantee contracts issued through an exchange transaction as insurance contracts if the issuer elects to recognize and measure them in accordance with the international or national accounting standard dealing with insurance contracts. However, all financial guarantee contracts issued at no or nominal consideration are required to be treated as financial instruments. Do you agree with this approach? Please state your reasons for either agreeing or disagreeing with this approach.

1. The FRSB does not consider that it is necessary to mandate the treatment of financial guarantee contracts issued at no or nominal consideration as financial instruments (paragraph 3(c)(i)) and disagrees with the proposal to allow a choice of treatments for exchange transactions (paragraph 3(c)(iii)).

2. The FRSB acknowledges that in proposing that financial guarantee contracts issued at no or nominal consideration be accounted for as financial instruments, the IPSASB had regard to the potential significance of financial guarantee contracts in the public sector and was seeking to enhance the comparability of financial statements (as discussed in paragraph BC6 of the ED). However, as discussed below, the FRSB considers that comparability could be enhanced by other means.

3. In respect of paragraph 3(c)(iii),the FRSB does not support the open option that is proposed. As currently drafted, paragraph 3(c)(iii) would allow an entity adopting the proposed financial instrument standards to choose whether to account for financial guarantee contracts issued by way of an exchange transaction as an insurance contract from that point onwards. By contrast, entities applying IAS 32 can apply IFRS 4 *Insurance Contracts* only to financial guarantee contracts that the issuer has *previously elected* in accordance with IFRS 4 paragraph 4(d) to account for as insurance contracts. IFRS 4 paragraph 4(d) requires that the entity must have *previously asserted* explicitly that it regards such contracts as insurance contracts and used accounting applicable to insurance contracts. It also specifies that the election made by an entity in respect of each contract is irrevocable. Under IAS 32, and IFRS 4, this accounting policy choice has therefore been limited to a once-off election under very constrained circumstances.

4. We suggest that the IPSASB limit the ability of entities to apply an international or domestic insurance standard to both exchange and non-exchange financial guarantee contracts by including, in ED 37, requirements similar to IFRS 4 paragraph 4(d). This would more accurately reflect the very limited accounting policy choice that is available under IAS 32. We also consider that these restrictions would allay any concerns that IPSASB has about lack of comparability of financial guarantees issued at no or nominal consideration.

2.	The transitional provisions to ED 37 do not provide any relief for entities initially adopting accrual accounting from preparing and presenting comparative information. Do you support this proposal? If additional transitional provisions are necessary, please indicate what these should be and state your reasons.

5. The FRSB supports the proposal not to provide any relief from retrospective application of the proposed requirements on first time application.

Appendix 2 – ED 38 Financial Instruments: Recognition and Measurement

Specific Matters for Comment

1.	Do you agree with the Application Guidance relating to the issuer of concessionary loans (paragraphs AG83 to AG89), in particular: (a) The requirement that any difference between the transaction price of the loan and fair value of the loan at initial recognition should be expensed; (b) The distinction between concessionary loans and the waiver of debt? If you do not agree with the Application Guidance please give your preferred alternative approach and state your reasons.

1. The FRSB does not wish to raise any issues regarding the guidance provided in relation to the issuer of concessionary loans.

2. However, the FRSB is concerned that the proposals in ED 38, taken together with the proposed amendments to IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* would lead to inconsistent treatment of some items.. We illustrate our concerns by considering the treatment, by the recipient, of a concessionary loan and a non-exchange grant receivable.

Concessionary loan

3. ED 38, paragraph AG88, proposes that a concessionary loan received by an entity be split into an exchange component (being the fair value of the loan) and an off market (non-exchange component) with the exchange component being accounted for in accordance with ED 38 and the off-market portion being accounted for in accordance with IPSAS 23. The following table sets out our understanding of what this would mean for the initial recognition, initial measurement and subsequent measurement of these two components, and some issues that we would like the IPSASB to consider.

	Fair value (exchange) component	Off market (non-exchange) component	Comment
Initial recognition	ED 38 para 16 When, and only when, the entity becomes a party to the contractual provisions of the instrument.	IPSAS 23 para 50 When, and only when, (a) it is probable that an outflow … will be required to settle the obligation and (b) a reliable estimate can be made of the amount of the obligation.	We are not sure that application of these different requirements would always lead to the two components of the transaction being recognised at the same point in time. We believe it is important that both components of the transaction should be recognised at the same point in time.
Initial measurement	ED 38 para 45 At its fair value plus transaction costs (apart from financial liabilities at fair value through surplus or deficit).	ED 38 AG88 states that any difference between the fair value of the loan and the transaction price (the loan proceeds) is accounted for in accordance with IPSAS 23. IPSAS 23 para 57 The best estimate of the amount required to settle the present obligation *at the reporting date*.	There is no discussion of transaction costs in ED 38. Should any transaction costs be allocated to the two components of the transaction? Transaction costs would affect subsequent measurement. Given that IPSAS 23 para 57 is dealing with measurement at initial recognition, why does it refer to measurement at “the reporting date”?

	Fair value (exchange) component	Off market (non-exchange) component	Comment
Subsequent measurement and derecognition	ED 38 para 49 At amortised cost using the effective interest method (apart from the exceptions listed in 49(a) to (d)).	ED 38 para AG90 Assets and liabilities arising out of contractual arrangements and which otherwise meet the definition of a financial instrument are subsequently measured and recognized in accordance with this Standard (ie ED 38).	Consistent treatment.

Contractual grant receivable

4. Using the guidance in ED 37, paragraph AG18, and ED 38 paragraph AG 90 we have set out our understanding of the initial recognition, initial measurement and subsequent measurement of a contractual grant receivable.

	Contractual grant receivable	Comment
Initial recognition	IPSAS 23 para 31 When, and only when, (a) it is probable that the future economic benefits or service potential associated with the asset will flow to the entity and (b) the fair value of the asset can be measured reliably.	This requirement differs from ED 38 para 16 which would apply to contractual exchange receivables.
Initial measurement	IPSAS 23 para 42 At fair value as at *the date of acquisition*.	IPSAS 23 does not address the treatment of transaction costs.
Subsequent measurement and derecognition	ED 38 para AG90 Assets and liabilities arising out of contractual arrangements and which otherwise meet the definition of a financial instrument are subsequently measured and recognized in accordance with this Standard (ie ED 38). ED 38 para 48(a) Loans and receivables are measured at amortized cost using the effective interest method.	Transaction costs will affect the subsequent measurement of loans and receivables under ED 38.

5. We appreciate that it is difficult to align the requirements of these standards. In order to ensure that all financial assets and financial liabilities are recognised and measured consistently, we recommend that the IPSASB specify that initial recognition and measurement of all financial assets and financial liabilities arising from transactions giving rise to both exchange and non-exchange revenue be in accordance with IPSAS XX (ED 38).

2.	Do you agree with the Application Guidance relating to financial guarantees provided for nil or nominal consideration (paragraphs AG91 to AG96), in particular that entities should apply a mathematical valuation technique to obtain a fair value where this produces a reliable measure of fair value? Alternatively, where a fair value cannot be obtained through observation of an active market, do you think that initial recognition should be in accordance with IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets." Please state your reasons.

6. The FRSB supports the proposals in the Application Guidance paragraphs AG91 to AG96. In New Zealand, we have found that a fair value cannot always be obtained through observation of an active market and that it is both useful and appropriate that initial recognition of financial guarantees issued at no or nominal consideration is in accordance with our provisions standard NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The methodology used by the New Zealand Government for recognising such financial guarantees includes an analysis of the estimate of the obligation if the guaranteed entity defaulted (loss given default) and the probability of default.

3.	Do you agree with the transitional provisions in paragraphs 114 to 123? If you do not agree with these transitional provisions please indicate further transitional provisions that are necessary, or those transitional provisions that are unnecessary. Please state your reasons.

7. The FRSB supports the proposed transitional provisions in ED 38.

Appendix 3 – ED 39 Financial Instruments: Disclosure

The IPSASB considered all of the required disclosures in IFRS 7 to assess whether any disclosures should be deleted for public sector specific reasons. Examples of disclosures specifically considered include sensitivity analyses and collateral. The IPSAS concluded that there is no public sector specific reason to depart from the requirements of IFRS 7 by deleting any disclosures. Do you agree?

1. The FRSB agrees that there is no public sector specific reason to delete any disclosures from IFRS 7. The FRSB supports the disclosures proposed in paragraph 36.