The South African Institute of Chartered Accountants

CL 24

8 October 2004

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International Accounting Standards Board
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Dear Madam,

EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO IAS 39 FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT
TRANSITION AND INITIAL RECOGNITION OF FINANCIAL ASSETS AND LIABILITIES

In response to your request for comments on the International Accounting Standards Board's proposed amendments to IAS 39, *Financial Instruments: Recognition and Measurement (IAS 39), Transition and initial recognition of financial assets and liabilities*, attached please find the comment letter prepared by the South African Institute of Chartered Accountants (SAICA). Please note that SAICA in addition to being a professional organisation also acts as the secretariat for the Accounting Practices Board (APB), who is the official accounting standard-setting body in South Africa.

We would like to thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact me should you wish to discuss any of our comments.

Yours sincerely

Yusuf Hassan
Project Director – Standards

cc: Doug Brooking (Chairman of the Accounting Practices Board)
Geoff Everingham (Chairman of the Accounting Practices Committee)

SAICA COMMENT LETTER ON AMENDMENTS TO IAS 39

Question 1

Do you agree with the proposals in this Exposure Draft? If not, why not? What changes do you propose and why?

In general, we support the proposed amendments of the exposure draft.

The transition provisions of IAS 39 would in most instances require retrospective application, which on initial recognition of some financial instruments, may not always be practicable and may sometimes lead to an incorrect initial measurement. We therefore fully support the amendments to relax the requirement to retrospectively apply the provisions of IAS 39 to the initial recognition of financial instruments, and thereby allow where applicable, prospective application on initial recognition.

The prospective application alternative in the exposure draft resolves the concerns raised by constituents surrounding the issues of 'day 1' gain or loss recognition. The proposed amendments also results in convergence with US GAAP in so far as the dates for the prospective application of the amendments correspond (refer to our response on Question 2).

We concur with the exposure draft in that the prospective application should follow the measurement prescription as set out in AG76. We do however feel that there is a need to expand on the concept of "*observable market data*".

We would like to raise the following concerns with regard to the applicability of an observable market:

- What sources would constitute "*observable market data*"?
- How would the "*observable market data*" be interpreted for illiquid markets?

We further welcome the Board's clarification on the subsequent measurement of financial instruments in which 'day 1' losses were not recognised, and do agree that a 'day 2' recognition of gains and losses would be inappropriate. However, we do feel that AG 76A provides little guidance on the recognition of subsequent gains and losses. It was suggested that in addition to making an adjustment for a "*change in a factor (including time)*", adjustments should also be made once an input that was previously unobservable, becomes observable.

As an alternative, the Board should explain what it means by "*including time*". It should be clarified whether time is considered to be an observable input that should be taken into account, in which case, recognising the gain or loss on an amortisation basis seems to be in compliance with IAS 39 principles. Alternatively, the phrase could be interpreted as allowing recognition on a straight line basis.

Question 2

Do the proposals contained in this Exposure Draft appropriately address the concerns set out in paragraph 5 of the Background on this Exposure Draft? If not, why not, and how would you address these concerns?

We believe that the exposure draft adequately addresses the concerns regarding the impracticability of retrospective application of 'day 1' losses.

In order to converge with US GAAP, we suggest that the effective date of 25 October 2002 be changed. As we understand, the date of 25 October 2002 is derived from EITF 02-03 *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities* that allowed prospective application for transactions entered into after 25 October 2002. However, in practice, these requirements were applied prospectively as of 21 November 2002, the date that EITF 02-03 was finalised. Therefore we suggest that the date of prospective application in paragraph 107A should rather be 21 November 2002 as opposed to 25 October 2002.

We also note that the US GAAP guidance relates only to energy trading contracts and derivative contracts only, whereas the proposed amendment to IAS 39 will apply to all financial instruments. Nevertheless, we support the Board's proposals as a practical solution.

Question 3

Do you have any other comments on the proposals?

General

Paragraph 104 states: "*This standard shall be applied retrospectively except as specified in paragraphs 105-108*". In the event that the amendments in the exposure draft are accepted, we suggest that paragraph 104 be consequentially amended to make reference to paragraph 108A within its exceptions.

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