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Deloitte Touche Tohmatsu

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Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Transition and Initial Recognition of Financial Assets and Financial Liabilities

Dear Sir David,

Deloitte Touche Tohmatsu is pleased to comment on the International Accounting Standards Board's proposed amendments to IAS 39 *Financial Instruments: Recognition and Measurement - Transition and Initial Recognition of Financial Assets and Financial Liabilities* (the proposed amendment).

Deloitte Touche Tohmatsu strongly supports the notion of the Board maintaining a 'stable platform' of unchanged Standards during the period to 2005 in order to provide entities with a period of stability up to 2005 when many entities will be adopting IFRS for the first time. In order to maintain a 'stable platform' it would be desirable to minimise the number of changes to Standards that will be effective for 2005, such as IAS 39 *Financial Instruments: Recognition and Measurement* in the run up to that date. However, we believe that in certain very special cases, such as the one described in the proposed amendment, limited changes to the Standard with regard to transition provisions are acceptable.

We welcome the move to clarify the accounting for the gain or loss after initial recognition in paragraph AG76A. However, as explained in our response to Question 1, we believe that the proposed wording is not sufficiently clear: it seems to imply amortisation of the deferred gain or loss over time, but does not state this as an explicit method. We can see the merits of the amortisation method, but we can equally see the conceptual basis and merits of the approach that would allow recognition of the deferred gain or loss only to the extent that significant unobservable inputs that resulted in deferral of the gains or losses, become observable. We encourage the Board to address 'day 2' recognition explicitly and state clearly which method should be used. We also encourage the Board to work on this jointly with the FASB so as to prevent divergence between the two GAAPs.

We believe that the departure from full retrospective application is fully justified in respect of the requirements on 'day 1' gain or loss recognition. We believe that prospective application of the 'day 1' profit and loss recognition requirement should apply from the effective date of the revisions to IAS 39, i.e. 1 January 2005. We believe that such prospective application should be equally available to current IFRS reporters and first-time adopters adopting IFRS before 1 January 2006. Were such full prospective application to be allowed from 1 January 2005, retrospective application to the effective date of the EITF 02-03 guidance should be permitted so that those entities that report both under US GAAP and IFRS can avoid a reconciling difference in this respect.

However, if the Board is minded to limit full prospective application, we suggest that it should not create divergence between IFRS and US GAAP on this issue. We understand that, in practice, the US GAAP requirements in EITF 02-03 were applied prospectively to transactions entered into after 21 November 2002, being the date that the EITF was finalised, hence we believe that exemption from retrospective application, if not applied from the effective date of the revisions to IAS 39, should be applied from that date, 21 November 2002.

We appreciate the opportunity to provide our comments. If you have any questions concerning our comments, please contact Ken Wild in London at (020) 7007 0907.

Sincerely,

Deloitte Touche Tohmatsu

Deloitte Touche Tohmatsu

APPENDIX: Responses to Questions in Exposure Draft

Question 1

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

We support the general principle of IAS 39, IFRS 1 *First-Time Adoption of International Financial Reporting Standards*, and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors,* which in most cases require the full retrospective application of the requirements of IAS 39, thereby ensuring that the financial assets and financial liabilities are measured and recognised in the comparative financial statements on the same basis as in the current year financial statements. However, we acknowledge that in certain circumstances there may be good reasons to permit a limited departure from this general principle. In particular, full retrospective application of certain provisions of the Standard may be difficult in practice, and also generate reconciling differences with US GAAP that do not represent fundamental conceptual differences between IFRS and US GAAP. We therefore support the proposed exemption.

Date from which entities may prospectively apply 'day 1' income statement requirements

As stated above, we believe that the departure from full retrospective application is fully justified in respect of the requirements on 'day 1' gain or loss recognition. Hence, we believe that the Board should introduce full prospective application from the effective date of the revisions to IAS 39, being 1 January 2005, with early adoption allowed from the date when the equivalent US guidance in EITF 02-03 was introduced so that those entities that report both under US GAAP and IFRS can avoid a reconciling difference in this respect.

We note that the US GAAP requirements with regard to 'day 1' gain or loss recognition, contained within EITF 02-03 *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities,* allowed prospective application for transactions entered into or after 25 October 2002. However, in practice the US GAAP requirements were applied prospectively to transactions entered into after 21 November 2002, being the date on which EITF 02-03 was finalised. Therefore, if the Board is minded to limit the allowance for the prospective application and given the fact that one of the aims of the proposed amendment is to eliminate a reconciling item between US GAAP and IFRS, we believe that the date of 21 November 2002 should be used so as to avoid the reconciling items between IFRS and US GAAP, which are otherwise likely to remain for a number of years until the deferred gain or loss is wholly recognised in the income statement.

Clarification regarding subsequent measurement of financial liabilities and financial assets

We welcome the Board's proposal to introduce clarification on how the Standard should be applied to the subsequent measurement of financial assets and financial liabilities where 'day 1' gains or losses have not been recognised. We agree that such gains or losses should not be immediately recognised on 'day 2.'

However, we believe the exposure draft falls short of providing users with adequate guidance as to when deferred gains or losses should be subsequently recognised in profit or loss. The statement in AG76A, that gains and losses should be released when there is "a change in a factor (including time) that market participants would consider in setting a price" is not sufficiently clear, i.e. it can be read to imply straight-line amortisation of deferred gains or losses over time. We can see the merits of the amortisation method, but we can equally see the conceptual basis and merits of the approach that would allow recognition of the deferred gain or loss only to the extent that significant unobservable inputs that resulted in deferral of the gains or losses, become observable. We encourage the Board to address 'day 2' recognition explicitly and state clearly which method should be used. We also encourage the Board to work on this jointly with FASB so as to prevent divergence between the IFRS and US GAAP.

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 agree that the Exposure Draft appropriately addresses the concern raised in 5(a). However, as noted in our answer to Question 1 divergence from the requirements of US GAAP on retrospective application will remain if the date of 25 October 2002 was used as proposed in the Exposure Draft. We believe that the exemption should be drafted to as to allow prospective application from 21 November 2002.

Question 3

Do you have any other comments on the proposals?

We have no further comments.