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EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO IAS 39 FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT – THE FAIR VALUE OPTION - DETAILED COMMENTS BY HoTARAC

Question 1

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

HoTARAC does not agree with the proposal to limit use of the fair value option as proposed in the Exposure Draft.

HoTARAC considers that fair value generally provides more meaningful information for users of financial statements than historical cost data, while acknowledging that, in some cases, historical cost data may be more useful. While there are many practical difficulties with mandating fair value in all cases, HoTARAC believes it is incorrect to limit the use of fair value to a number of specified instances. This allows “hybrid” Balance Sheets that contain a mixture of fair value and cost amounts, but prevents entities from preparing financial statements wholly or substantially on the fair value basis.

Instead, it would be better to allow the fair value option generally, but with prohibitions where it might be abused. For example, where the value of a liability is contractually linked to that of an asset, it may be sensible to prohibit entities from applying fair value to one but cost to the other.

If local regulators have concerns about the possible abuse of the fair value option, HoTARAC presumes that those regulators would be able to prevent the entities they oversee from adopting the fair value option. National standard-setters would also have this power. HoTARAC does not understand why the concerns of regulators should reduce IFRSs to a “lowest common denominator” approach.

In any case, the Exposure Draft’s proposals do not appear to remove the scope for inconsistency or “abuse”, since the “substantial offset” provisions would still need to be interpreted and applied.

HoTARAC notes the linkage between the fair value option and the IASB’s Reporting Comprehensive Income Project. Some of the concerns about volatility in the Statement of Financial Performance would be addressed if the Statement of Financial Performance were to be split into separate sections for remeasurements and transactions.

Question 2

Are you aware of any financial instruments to which entities are applying, or intending to apply, the fair value option that would not be eligible for the option if it were revised as set out in this Exposure Draft? If so:

- **(a) please give details of the instrument(s) and why it (they) would not be eligible;**
- **(b) is the fair value of the instrument(s) verifiable (see paragraph 48B) and if not, why not?; and**
- **(c) How would applying the fair value option to the instrument(s) simplify the practical application of IAS 39.**

The Australian Accounting Standards Board has commenced a project to align Australian Accounting Standards with the International Monetary Fund's Government Finance Statistics (GFS) Framework. A key feature of the GFS framework is the measurement of assets and liabilities at market values.

Therefore, HoTARAC anticipates that Australian governments and their controlled entities would seek to apply the fair value option to most or all of their financial instruments for which a fair value can be reliably measured. This would include, for example, the issued debt of the Australian Government. The Australian Government Issued Debt would not be eligible to be carried at fair value under the Exposure Draft, as it is represented by liabilities that do not fall within the specified instances where fair value measurement is allowed.

HoTARAC expects that Australian governments would not seek to measure at fair value, financial instruments that did not have a fair value that was reliably measurable. HoTARAC is not convinced that the concept of "verifiability" as set out in the Exposure Draft is appropriate. However, HoTARAC believes that Australian governments would not seek to measure financial instruments at fair value where they were not "verifiable" as defined in the Exposure Draft.

The application of the fair value option by Australian governments to marketable financial instruments would simplify the practical application of IAS 39 by promoting a consistent measurement basis for financial instruments. That is, all marketable financial instruments would be measured at their market values. Non-marketable financial instruments would be measured at cost or amortised cost.

Question 3

Do the proposals contained in this Exposure Draft appropriately limit the use of the fair value option so as to address adequately the concerns set out in paragraph BC9? If not, how would you further limit the use of the option and why?

HoTARAC does not support the concerns expressed in paragraph BC9:

(a) It is argued that entities might apply the fair value option to financial assets or liabilities whose fair value is not verifiable. HoTARAC is not convinced that the definition of "verifiable" in the Exposure Draft adds anything to the concept of reliable measurement. The Exposure Draft would appear to further complicate the application of fair value, which is already inconsistent across IFRSs. For example, fair value can only be applied in IAS 38 where there is an active market, but this constraint is not present in IAS 16. The Exposure Draft would introduce a third interpretation, with consequent confusion and inconsistency; and

(b) It is suggested that use of the fair value option might "increase, rather than decrease volatility in profit and loss". HoTARAC does not consider that reducing volatility is an objective of financial reporting. On the contrary, where there are significant movements in the value of an entity's assets and liabilities, this is important information for users of financial statements. However, if the IASB is concerned that, for example, an entity might apply the fair value option to only one part of a matched position, the IASB could require that, where the fair value option is applied to one part of a matched position, it must be applied to all parts.

Therefore, HoTARAC does not believe that the fair value option needs to be limited as proposed in the Exposure Draft. At the most, HoTARAC believes that the IASB could require entities to apply the fair value option to all parts of a matched position or none.

Question 4

Is the proposal in paragraph 9(b)(i) appropriate? If not, should this category be limited to a financial asset or financial liability containing one or more embedded derivates that paragraph 11 of IAS 39 requires to be separated?

HoTARAC believes that the proposal in paragraph 9(b)(i) is appropriate. The ability to use the fair value option should not be limited to a financial asset or financial liability containing one or more derivatives that paragraph 11 of IAS 39 requires to be separated.

Question 5

Are the proposed transition arrangements appropriate? If not what changes do you propose and why? Specifically, should all changes to the measurement basis of a financial asset or financial liability that result from adopting the amendments proposed in this Exposure Draft be applied retrospectively by restating the comparative financial statements?

HoTARAC does not support the proposed transitional arrangements. HoTARAC notes that the transitional arrangements appear to contradict the IASB's commitment to deliver a "stable platform" by 31 March 2004. HoTARAC believes that, in line with that commitment, entities should not be required to apply the revised Standard until the first reporting period beginning on or after 1 January 2006. Entities should, however, have the option to early adopt the revised Standard.

Question 6

Do you have any other comments on the proposals?

HoTARAC has no further comments on the proposals.