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enj/osj/kf (regu/efrag/(fair value option)

Dear Ms Sandra Thomson

Exposure Draft of proposed Amendments to IAS 39, Financial Instruments: Recognition and Measurement - "The Fair Value Option"

The Danish Accounting Standards Committee (DASC) is pleased to comment on the International Accounting Standards Board's (the Board's) proposed amendment to IAS 39, *Financial Instruments: Recognition and Measurement (IAS 39), The Fair Value Option* (the ED), dated April 2004.

The specific proposal has been developed to accommodate concerns of certain Regulators and Prudential supervisors in the financial industry. While the concerns raised may have merits in certain industries it is worth mentioning that an even larger group of enterprises in other industries must now accept a proposed amendment, the conceptual basis of which is questionable. Therefore, we would have hoped that other routes of addressing Regulators and Prudential supervisor concerns had been explored.

Overall, we do not believe the ED is the ideal solution and we have a number of concerns, which are:

- It is not appropriate to introduce yet another change to IAS 39 within such a short timeframe after its publication in December 2003 thereby impairing the intention of a 'stable platform' which is of utmost importance to all the companies who are currently spending significant ressources on their IFRS conversion process
- In our opinion, the fact that under current IAS 39, designation as fair value through profit or loss must be made irrevocably at inception, is sufficiently restrictive in order of avoiding abuse

- The DASC strongly supports the development of principle-based international accounting standards. Unfortunately, we find that the proposal is yet another move towards more rule-based standards, thereby adding even more complexity to a standard which is already complex in itself
- We see a risk that the proposed restrictions in the use of the fair value option will in fact eliminate the IAS 28 and IAS 31 scope exclusion for venture capitalist organizations introduced in December 2003 allowing such entities the possibility to measure their investments at fair value through profit or loss.

We understand that the ED has been issued with a view of gaining a broad acceptance of IAS 39 in Europe. We realise that the proposed revisions are only a small subset of IAS 39 and if such modifications will promote broad acceptance of IAS 39 in Europe in order to continue the movement towards a single set of accounting standards we find, on balance, that this is far more desirable than objecting to the proposed revisions. However, this should by no means be read as the DASC being in favour of ‘political’ revisions to the international accounting standards.

We have a number of technical comments and observations regarding the Proposed Amendment, which we have included in the attached Appendix.

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If you have questions to the above, please do not hesitate to contact us.

Yours sincerely

Eskild Nørregaard Jakobsen	Ole Steen Jørgensen
Chariman of the Danish	Head of Department, FSR
Accounting Standards Committee	

Appendix

Question 1
Do you agree with the proposals in this Exposure Draft? If not, why not? What changes do you propose and why?

We notice that if the proposed changes are effected, they will be the third round of change of the standard within a short time period. As the IASB is setting out in the Basis for Conclusions, the proposal to include the fair value option in IAS 39 has been issued for comment in June 2002 as part of the amendments proposed to IAS 39. A substantial majority of the commentators has agreed with the proposals, and the board has considered all comments when making a decision on the amendments. We do not find it appropriate, so shortly after the comments on the fair value option were first considered and an amended IAS 39 standard was issued, to propose a revision as no new views have been expressed. Moreover the timing of the exposure draft is also significantly affecting the stable platform that was agreed and which is necessary for many enterprises preparing for implementing IFRS in 2005 in Europe and elsewhere in the world.

For these reasons, we strongly encourage IASB to reconsider the proposal, alternatively to defer the effective date.

In our comment letter dated 1 November 2002 on the *Exposure Draft of Proposed Amendments to IAS 32 and IAS 39* we did welcome the change permitting an entity to designate any financial instrument irrevocably at initial recognition as an instrument that is measured at fair value with changes in fair value recognized in profit or loss in so far as it simplified the application of IAS 39 and facilitated the use of "natural hedges". We noted the concerns raised, which led to the issue of the proposal restricting the option set out in the standard from December 2003. However, we find that the fact that under the current IAS 39, the designation must be made irrevocably at inception is sufficiently restrictive with respect of avoiding the risk of abuse.

As we have indicated in previous comment letters, we support that accounting standards are principle-based in order for information to be presented in the manner most useful for users around the world. We believe the ED is yet another move from a principle-based approach towards a set of rules. The consequence is that even more complexity is added to the standard by introducing new terms or by using existing termsin another context.

The criteria proposed when to allow the use of the fair value option, such as 'contractually linked' and 'substantially offset' are not clear and will require further interpretation. If the 'substantially offset' criteria should be interpreted as being similar to hedge accounting criteria, it would not be a simplification. It would rather be a complication because there would then be two ways of applying hedge accounting.

We do not agree with the proposal to introduce 'verifiability' as a criterion for the use of the fair value option. In general, if a fair value is reliable, it should also be verifiable. These concepts are in our view not fundamentally different. The use of a new notion lacks conceptual arguments and basis. Also, the introduction of this term leads to a need for further interpretation. Applying different requirements where fair value measurement is permitted as compared to where such measurement is required creates inconsistency.

Should the outcome be for the IASB to proceed with the ED we would mention the following examples to illustrate our concerns:

Which non-listed equity instruments can be included under the fair value option with changes in profit or loss?
We would like the IASB to clarify the intended meaning of the quoted part of paragraph 9 of the ED relating to 'verifiable' for equity instruments (e.g. unlisted shares):

"Because designation as at fair value through profit or loss is at the entity's election, such designation shall be used only if the fair value of the financial asset or financial liability to be so designated is verifiable (see paragraph 48B). Equity instruments that do not have a quoted price in an active market and whose fair value cannot be reliably measured shall not be designated as at fair value through profit or loss (see paragraph 46(c) and Appendix A paragraphs AG80 and AG81)."

We believe that the ED is not clear on whether non-listed equity instruments can be included as at fair value through profit or loss or whether these would need to be recognised with fair value changes in equity (as available for sale financial assets).

Do the parent's investments in subs need to be 'verifiable' to be measured under the fair value option?
We would like the IASB to clarify whether the new criteria 'verifiable' also apply to investments in subsidiaries under IAS 27 in the parent's separate financial statements. We would believe that it should evenly and consistently apply to those investments, if they do not have a quoted price in an active market.

Question 2
Are you aware of any financial instruments to which entities are applying, or are intending to apply, the fair value option that would not be eligible for the option if it were revised as set out in the Exposure Draft?

Yes. The verifiability criterion could create difficulties for those venture capital organizations that elect to use the fair value option; regardless of the fact that the intention of the IAS 28 and IAS 31 scope exclusion introduced in December 2003 was to make it possible for such entities actually to measure their investments at fair value. In our view there should only be one reliability-criterion in IAS 39 for use of fair value.

Another instance where it is currently unclear to us as to whether or not companies will be affected is the area of investment properties. We believe that it is currently unclear whether and how investment property companies will be effected by the ED in relation to related financing of their investments. Some jurisdictions allow for enterprises to measure both assets *and related financial liabilities* at fair value subsequent to initial recognition. We kindly ask that the Board clarify its intentions related to this issue in the final standard.

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?

We agree with the alternative view in AV7, that it is inappropriate to refer to the powers of prudential supervisors or other regulators in the standard. The objectives of prudential supervisors are different from the objectives of IFRS. Reference will leave constituents and others with the impression that these prudential supervisors have the authority to both interpret IFRS and – even worse – has got the power to overrule or amend standards.

The result may be a violation of the level playing field that is aimed at in Europe through the adoption of IFRS. In addition, it would seem to be perceived as the IASB bowing into pressure groups rather than being an independent standard setter.

We question whether the proposal is effective in meeting the stated objectives, including a) avoid the recognition of gains or losses in profit or loss arising from changes in an entity's own creditworthiness and b) reduce volatility in profit or loss. Where a debt instrument contains an embedded derivative, it would still be possible to apply the fair value option. In addition, the use of 'natual hedges' – which the ED propose to limit – would seem to be a vehicle in itself to reduce volatility in profit or loss.

Question 4
Paragraph 9(b)(i) proposes that the fair value option could be used for a financial asset or financial liability that contains one or more embedded derivatives, whether or not paragraph 11 of IAS 39 requires the embedded derivatives to be separated. The Board proposes this category for the reasons set out in paragraphs BC6(a) and BC16-BC18 of the Basis of Conclusions on this Exposure Draft. However, the Board recognises that a substantial number of financial assets and financial liabilities contain embedded derivatives and, accordingly, a substantial number of financial assets and financial liabilities would qualify for the fair value option under this proposal.
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 derivatives that paragraph 11 of IAS 39 requires to be separated?

As stated above, we generally do not support restrictions in the use of the fair value option.

Question 5
Paragraph 103A proposes that an entity that adopts early the December 2003 version of IAS 39 may change the financial assets and financial liabilities designated as at fair value through profit or loss from the beginning of the first period for which it adopts the amendments in this Exposure Draft. It also proposes that in the case of a financial asset or financial liability that was previously designated as at fair value through profit or loss but is no longer so designated:

(a) if the financial asset or financial liability is subsequently measured at cost or amortised cost, its fair value at the beginning of the period for which it ceases to be designated as at fair value through profit or loss is deemed to be its cost or amortised cost.

(b) if the financial asset is subsequently classified as available for sale, any amounts previously recognised in profit or loss shall not be reclassified into the separate component of equity in which gains and losses on available for sale assets are recognised.

However, in the case of a financial asset or financial liability that was not previously designated as at fair value through profit or loss, the entity shall restate the financial asset or financial liability using the new designation in the comparative financial statements.

Finally this paragraph proposes that the entity shall disclose:

(a) for financial assets and financial liabilities newly designated as at fair value through profit or loss, their fair value and the classification and carrying amount in the previous financial statements.

(b) for financial assets and financial liabilities no longer designated as at fair value through profit or loss, their fair value and the classification and carrying amount in the current financial statements.

Are these proposed transitional requirements 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?

As noted above we recommend that the proposal is reconsidered, postponed or alternatively that the effective date be postponed . We find, however, the proposed transition requirements being adequately flexible and pragmatic, given the fact that the current IAS 39 allows the unconditional application of a fair value option.

Question 6

Do you have any other comments on the proposals?

No.