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July 21, 2004

CL 48

Ms Sandra Thompson
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Ms Thompson,

Re: Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: *Recognition and Measurement – The Fair Value Option*

Staff of the International Federation of Accountant's International Auditing and Assurance Standards Board (IAASB) appreciates this opportunity to comment on the International Accounting Standards Board's (IASB) Exposure Draft, Proposed Amendments to IAS 39 Financial Instruments: *Recognition and Measurement – The Fair Value Option* (Exposure Draft).

Due to its meeting schedule, the IAASB has not had an opportunity to give consideration to the changes to IAS 39 proposed in the Exposure Draft. Accordingly, the following represents the IAASB Staff's reaction to certain aspects of the Exposure Draft. In particular, comments are provided on the proposal that the fair value option be used only for items whose fair value is verifiable as described in paragraph 9, 48A-49B, and BC23-BC26 of the Exposure Draft. The comments are based on consideration of the ability for auditors to obtain sufficient appropriate audit evidence to conclude whether management has complied with the requirements of IAS 39. The comments contained herein do not necessarily represent the views of the IAASB.

Fair Value Measurement Considerations

We applaud the IASB's efforts to address the concerns of some constituents that entities might apply the fair value option of IAS 39 to certain financial assets or financial liabilities whose fair value is not verifiable, and thereby possibly determining their fair value in a way that inappropriately affects profit or loss.

We agree, in general, with the view of the IASB that the term 'reliably measurable' is a broad concept which includes notions of faithful representation, substance over form, prudence and completeness. We also agree that, because of the subjectivity in the valuation of financial assets and liabilities and the impact such measurements may have on profit or loss, a narrower meaning of the term should be conveyed to ensure that fair value estimates are capable of consistent evaluation and measurement. We therefore support the IASB's proposal to establish, in the context of the fair value option, a stricter and more specific test than that implied by 'reliably measurable.' We believe that the proposal strengthens management's responsibility to report credible and reliable financial information based on demonstrable evidence.

We note that the Exposure Draft draws into the body of IAS 39 some of the guidance on fair value measurement that was previously included in paragraphs AG75 and AG76 of the appendix to IAS 39. In particular, the Exposure Draft explains that, in the absence of an active market for the financial instrument, the chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It also provides for the need for an entity to periodically calibrate the valuation technique and test it for validity using prices from any observable current market transaction in the same instrument. We believe that IAS 39 will be strengthened by inclusion of all of this guidance.

Notwithstanding our general support for the proposal, we encourage the IASB to consider further whether a 'two-tier test' for fair value measurement is appropriate. The issue of reliability (and indeed verifiability) affects all items measured at fair value irrespective of whether the basis of measurement is mandatory or voluntary. If the use of fair value is acceptable, it is unclear why consistent criteria (such as the new 'verifiability' criteria) would not apply to all fair value estimates. We believe, however, that the IASB is moving in the right direction and would encourage the IASB to continue to seek ways to introduce more robust guidance over the use of fair value measurement.

We also have some specific concerns and suggestions that the IASB may wish to consider regarding the proposal for the fair value option to be used for items whose fair value is verifiable.

Use of the Term 'Verifiable'

We disagree in principle with the use of the term 'verifiable' to describe acceptable circumstances for when the fair value option may be applied. While the term is used with a similar meaning in the conceptual frameworks of other standard-setters, its specific use in the Exposure Draft implies that it should be understood only in terms of the definition proposed therein. It may also imply that the general characteristic of being 'capable of being verified' is not essential to other matters requiring recognition and measurement in financial statements.

We believe that the Exposure Draft can achieve the same effect by simply identifying in paragraph 9 of the Exposure Draft the criteria for use of the fair value option (as contained in paragraph 48B). By doing so, the clarity of the requirements of the standard would be enhanced, and the need to identify and define a specific term could be avoided. This treatment would not be inconsistent with IASB's practice of specifying criteria for measurement and recognition without the use of a defining term, such as the treatment afforded to the criteria for restructuring provisions in IAS 37.

If the IASB concludes that the term 'verifiable' should be retained in the final amended IAS 39, we recommend that it be designated explicitly as a defined term for purposes of that IAS only.

Elements of verifiability

Paragraph 48B of the Exposure Draft explains that the fair value of a financial asset or financial liability is verifiable "if and only if the variability in the range of reasonable fair value estimates is low." Paragraph BC25, however, explains this to mean that if several independent and knowledgeable observers were asked to estimate the fair value of a particular instrument in accordance with IAS 39, they would "all arrive at approximately the same amount." In addition, paragraph AG80 explains, for purposes of investments in equity instruments that do not have a quoted market price in an active market, that fair value measurement is reliable if (a) the variability in the ranges of fair value estimates is not significant for that instrument or (b) "the probabilities of the various estimates within the range can be reasonable assessed and used in estimating fair value."

The guidance provided by paragraphs BC25 and AG80 appears to go beyond the requirement established by paragraph 48B. That is, while paragraph 48B focuses on the variability in the range of reasonable fair value estimates, paragraphs BC25 and AG80 appear to create the expectation of an ability to reach consensus on the fair value estimate.

We believe that the ability to reasonably and consistently determine the fair value estimate itself, rather than the range of reasonable fair value estimates only, is particularly important to the objective of the Exposure Draft. In some circumstances, the variability in the range of reasonable fair value estimates may be low but the range itself may be quite wide, even in relation to materiality. Entities therefore are afforded the opportunity to introduce subjective judgments, and possibly bias, in the determination of fair value estimates. Accordingly, we suggest that the IASB consider expanding the definition of 'verifiable' to include the notion that the fair value estimate within the range is also capable of reasonably consistent determination. Implicit in such a requirement would be the need for entities to evaluate whether in fact the range of fair value estimates is reasonable for purposes of meeting the 'verifiability' test.

In relation to the proposed definition of 'verifiable', we are concerned that management and others may interpret the meaning of 'low' differently. From an auditing point of view, it is essential that a specific description be established within the standard of when that threshold is met. We therefore recommend that a definition, or at least further guidance, be provided in terms of what would constitute 'low variability,' possibly in terms of a statistical rule-of-thumb or in relation to materiality. If this is not considered practical, we recommend that the examples provided in paragraph 48B of when fair value is verifiable be supplemented and contrasted by examples of when fair value is not verifiable. We believe additional guidance or examples may help entities to interpret the term 'verifiable' consistently, and to understand further those situations that are, and are not, acceptable under the Exposure Draft.

Should the above matters require any clarification, I would be pleased to discuss them with IASB Staff before the Exposure Draft is finalized.

Very truly yours

James M. Sylph

James M. Sylph
Technical Director, IAASB

cc: John Kellas, IAASB Chairman
Kevin Stevenson, IASB Technical Director
Wayne Upton, IASB member of CAG