22 August 2008

Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

Via "Open to comment" page on www.iasb.org

Dear Sir David

Comments on IASB Discussion Paper *Reducing Complexity in Reporting Financial Instruments*

Thank you for the opportunity to comment on the IASB Discussion Paper *Reducing Complexity in Reporting Financial Instruments*. CPA Australia and the Institute of Chartered Accountants in Australia (the Institute) are professional membership bodies representing professional accountants in Australia. We represent over 160,000 members who work in diverse roles across public practice, commerce, industry, government, academia throughout Australia and internationally.

CPA Australia and the Institute have jointly considered the DP and our comments are set out below and in the attached Appendix.

General Comments on the Proposals

The DP outlines various approaches to reducing the complexity related to the reporting of financial instruments, which includes intermediate and long-term solutions with respect to measurement and hedge accounting. We do not support an intermediate solution to measurement, as we do not believe that any intermediate solution would reduce complexity. We do however support an intermediate solution to simplify hedge accounting, with respect to documentation and effectiveness testing.

In relation to the IASB's long-term measurement objective, we believe that further analysis is required, in conjunction with the Conceptual Framework project, before a definitive conclusion regarding measurement of financial instruments can be reached.

Our response to matters on which specific comment is requested is included in the attached Appendix.

If you have any questions regarding this submission, please do not hesitate to contact either Kerry Hicks (the Institute) at kerry.hicks@charteredaccountants.com.au or Mark Shying (CPA Australia) at mark.shying@cpaaustralia.com.au.

Yours sincerely

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Appendix - Matters on Which Specific Comment Requested

IASB questions

1. Do current requirements for reporting financial instruments, derivative instruments and similar items require significant change to meet the concerns of preparers and their auditors and the needs of users of financial statements? If not, how should the IASB respond to assertions that the current requirements are too complex?

The current requirements generally meet the concerns of all interested parties, however our members have told us they are also very complicated to apply. The IASB should respond to these assertions by undertaking a long-term project to consider and assess the accounting for financial instruments in order to develop a principles-based standard that is relatively less complicated but still satisfies the needs of preparers, auditors and users of financial statements. Most intermediate solutions would only delay the inevitable long-term replacement of IAS 39.

2. (a) Should the IASB consider intermediate approaches to address complexity arising from measurement and hedge accounting? Why or why not? If you believe that the IASB should not make any intermediate changes, please answer questions 5 and 6, and the questions set out in Section 3.

We believe that the IASB should only consider addressing hedge accounting as an intermediate solution (and not measurement), because:

- Complexity relating to measurement cannot be resolved with an intermediate solution which would satisfy the criteria outlined in paragraph 2.2 of the Discussion Paper.
- Some of the complexities relating to hedge accounting can be simplified as an intermediate approach, which would satisfy the criteria outlined in paragraph 2.2 of the Discussion Paper.

(b) Do you agree with the criteria set out in paragraph 2.2? If not, what criteria would you use and why?

We agree with the criteria set out in paragraph 2.2, except for 2.2(b) because we do not agree that fair value for all financial instruments should be the long-term objective without appropriate in-depth analysis. Refer to our response to Question 4(a) for further discussion on this matter.

3. Approach 1 is to amend the existing measurement requirements. How would you suggest existing measurement requirements should be amended? How are your suggestions consistent with the criteria for any proposed intermediate changes as set out in paragraph 2.2?

See our response to Question 2(a).

4. Approach 2 is to replace the existing measurement requirements with a fair value measurement principle with some optional exceptions.

(a) What restrictions would you suggest on the instruments eligible to be measured at something other than fair value? How are your suggestions consistent with the criteria set out in paragraph 2.2?

We believe that measurement of financial instruments should be considered and assessed as part of a long-term IASB financial instruments project. In relation to the IASB's long term objective that all financial instruments be measured at fair value, we encourage the IASB to ensure that appropriate analysis is undertaken in conjunction with the Conceptual Framework project to arrive at a solution that is less complex and results in useful information. This long-term project would also assess measurement related issues such as impairment and recognition of gains and losses. Focussing on the long-term solution is a better use of the IASB's resources, rather than tying up resources in an intermediate financial instrument measurement project which is unlikely to satisfy the criteria in paragraph 2.2.

Appendix - Matters on Which Specific Comment Requested (cont'd)

(b) How should instruments that are not measured at fair value be measured?
See our response to Question 4(a).

(c) When should impairment losses be recognised and how should the amount of impairment losses be measured?

See our response to Question 4(a).

(d) Where should unrealised gains and losses be recognised on instruments measured at fair value? Why? How are your suggestions consistent with the criteria set out in paragraph 2.2?

See our response to Question 4(a).

(e) Should reclassifications be permitted? What types of reclassifications should be permitted and how should they be accounted for? How are your suggestions consistent with the criteria set out in paragraph 2.2?

See our response to Question 4(a).

5. Approach 3 sets out possible simplifications of hedge accounting.
(a) Should hedge accounting be eliminated? Why or why not?

Hedge accounting should not be eliminated given that hedges are used by entities as a way to manage risk, and so accounting requirements should exist which allow entities to report these activities.

(b) Should fair value hedge accounting be replaced? Approach 3 sets out three possible approaches to replacing fair value hedge accounting.
(i) Which method(s) should the IASB consider, and why?
(ii) Are there any other methods not discussed that should be considered by the IASB? If so, what are they and how are they consistent with the criteria set out in paragraph 2.2? If you suggest changing measurement requirements under approach 1 or approach 2, please ensure your comments are consistent with your suggested approach to changing measurement requirements.

As an intermediate solution, we do not believe any of the three approaches to replace fair value hedge accounting are appropriate, as none appear to satisfy the criteria outlined in paragraph 2.2, and thus do not appear to reduce complexity. Similar to our comments about measurement, any significant changes to the current hedge accounting requirements are unlikely to result in reduced complexity. A better use of IASB resources would be to assess hedge accounting requirements as part of a long-term IASB project, in order to develop appropriate principles-based requirements.

Appendix - Matters on Which Specific Comment Requested (cont'd)

6. Section 2 also discusses how the existing hedge accounting models might be simplified. At present, there are several restrictions in the existing hedge accounting models to maintain discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings. This section also explains why those restrictions are required.
(a) What suggestions would you make to the IASB regarding how the existing hedge accounting models could be simplified?

We believe that the only intermediate solution that will reduce complexity and would not require significant IASB resources would be to simplify the existing hedge accounting models. Suggestions include:

- Simplify hedge documentation requirements
- Simplifying hedge effectiveness testing, for example by replacing the quantitative effectiveness test with a qualitative test
- Only require prospective effectiveness testing at the inception of the hedge

We consider that while hedge accounting is an election, appropriate documentation is critical. However, the current requirements can be burdensome such that failure to comply with every detail can lead to failed hedge accounting even though the relationship is highly effective. Documentation could be simplified to exclude the information on ongoing assessment of the hedge instrument's effectiveness. This is consistent with our proposal to only require prospective effectiveness testing at the inception of the hedge.

Regarding effectiveness requirements, the current requirements are unnecessarily complex since they generally require a quantitative assessment of effectiveness both prospectively and retrospectively. Additionally, the imposition of a specified level of effectiveness makes it more difficult for entities to consistently apply hedge accounting and results in less comparable financial statement results. For example, an entity may apply hedge accounting in one period when the hedging relationship is 81% effective, although in the next period when the relationship may be only 79% effective it would be prevented from applying hedge accounting.

The only effectiveness test we propose is that entities should perform a qualitative prospective assessment at the inception of the hedging relationship which demonstrates the existence of an economic relationship between the hedged risk and the hedging instrument, and is consistent with the company's risk management strategy.

We recommend the removal of the ongoing prospective and retrospective effectiveness tests and the requirement to be between 80% and 125% effective. The hedge effectiveness tests are unnecessary since all ineffectiveness is reflected in the income statement either during the life of the hedging relationship or when the hedged cash flows are recycled. The existence of the effectiveness band can result in failure to achieve hedge accounting as a result of minor deviations in expected cash flows and places undue emphasis on the method used to assess effectiveness. Entities frequently use different methodologies to assess effectiveness than they use to measure ineffectiveness (for example regression analysis for the former and dollar offset for the later) which adds to the administrative burden of applying hedge accounting. Entities would only need to reassess their hedging relationship if circumstances suggest that there is no longer an economic relationship, for example if a currency becomes unpegged to the USD.

As stated in Question 5, the IASB should focus on developing a principles-based approach to hedge accounting for the long-term.

Appendix - Matters on Which Specific Comment Requested (cont'd)

(b) Would your suggestions include restrictions that exist today? If not, why are those restrictions unnecessary?

All other restrictions that currently apply would still exist, as eliminating these restrictions as part of an intermediate solution will not necessarily reduce complexity. Also, given that the current hedge accounting requirements are rules-based, these restrictions are required to provide some structure as to how the current hedge accounting requirements are applied.

(c) Existing hedge accounting requirements could be simplified if partial hedges were not permitted. Should partial hedges be permitted and, if so, why? Please also explain why you believe the benefits of allowing partial hedges justify the complexity.

We believe that partial hedges should continue to be permitted because although they are complex, they allow entities to use hedge accounting to manage their risk, and thus the impact on earnings.

(d) What other comments or suggestions do you have with regard to how hedge accounting might be simplified while maintaining discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings?

None.

7. Do you have any other intermediate approaches for the IASB to consider other than those set out in Section 2? If so, what are they and why should the IASB consider them?

No.

8. To reduce today's measurement-related problems, Section 3 suggests that the long-term solution is to use a single method to measure all types of financial instruments within the scope of a standard for financial instruments. Do you believe that using a single method to measure all types of financial instruments within the scope of a standard for financial instruments is appropriate? Why or why not? If you do not believe that all types of financial instruments should be measured using only one method in the long term, is there another approach to address measurement-related problems in the long term? If so, what is it?

As mentioned previously, we believe that the measurement of financial instruments should be assessed as part of a long-term IASB project, and considered in conjunction with the Conceptual Framework project. Concluding that fair value is the only solution long-term does initially appear to be simple and appropriate, but given the many different types of instruments held by entities, further work is required before coming to any conclusion. As such, we cannot comment on whether using a single method to measure financial instruments is appropriate without further analysis and consideration.

9. Part A of Section 3 suggests that fair value seems to be the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments.
(a) Do you believe that fair value is the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments?

See our response to Question 8.

Appendix - Matters on Which Specific Comment Requested (cont'd)

(b) If not, what measurement attribute other than fair value is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Why do you think that measurement attribute is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Does that measurement attribute reduce today's measurement-related complexity and provide users with information that is necessary to assess the cash flow prospects for all types of financial instruments?

See our response to Question 8.

10. Part B of Section 3 sets out concerns about fair value measurement of financial instruments. Are there any significant concerns about fair value measurement of financial instruments other than those identified in Section 3? If so, what are they and why are they matters for concern?

We agree with the concerns identified in Part B of Section 3.

11. Part C of Section 3 identifies four issues that the IASB needs to resolve before proposing fair value measurement as a general requirement for all types of financial instruments within the scope of a standard for financial instruments.

(a) Are there other issues that you believe the IASB should address before proposing a general fair value measurement requirement for financial instruments? If so, what are they? How should the IASB address them?

We agree that the issues identified in Part C of Section 3 need to be resolved by the IASB.

(b) Are there any issues identified in part C of Section 3 that do not have to be resolved before proposing a general fair value measurement requirement? If so, what are they and why do they not need to be resolved before proposing fair value as a general measurement requirement?

See response to question 11a.

12. Do you have any other comments for the IASB on how it could improve and simplify the accounting for financial instruments?

No.