**Australian Government**

**Department of Finance and Deregulation**

Reference: RMS09/13191
Contact: Peter Gibson
Telephone: 02 6215 3551
e-mail: peter.gibson@finance.gov.au

Mr Kevin Stevenson
The Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS ST WEST VIC 8007

Dear Mr Stevenson

## AASB Exposure Draft 196 *Fair Value Option for Financial Liabilities*

The Department of Finance and Deregulation (Finance) welcomes the opportunity to provide comments on Exposure Draft 196 *Fair Value Option for Financial Liabilities* (ED 196). Finance has contributed to the Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) comments on ED 196. However, Finance believes it is appropriate to separately emphasise issues that are of a particular concern to the Commonwealth.

Finance agrees that changes in the credit risk of the financial liability designated under the fair value option should be reported in the Other Comprehensive Income (OCI), unless an accounting mismatch would occur. This addresses the long-standing concern that it is counter intuitive for an entity's operating result to improve when there has actually been a reduction in the credit quality of its liabilities (and vice versa). Such reporting would not provide useful information to users and may be misleading, particularly during situations such as the Global Financial Crisis.

In this regard, Finance notes that IASB needs to outline clearly the principles that guide which items should be reported in OCI.

Further, the presentation in OCI better aligns with the Australian Bureau of Statistics (ABS) Government Finance Statistics (GFS) treatment. This is consistent with ABS GFS as GFS recognises changes in the volume or value of assets, liabilities and equity that do not result from transactions as "other economic flows". However, Finance notes that under GFS the entire change in fair value of the financial liability will be presented in "other economic flows".

Finance supports the exemption to recognise the changes in the credit risk of the liability in the profit or loss where an accounting mismatch occurs. This option should be available when, as the IASB acknowledged, a mismatch arises because the entire change in the fair value of an asset would affect profit or loss but, if this exemption is not permitted, only a

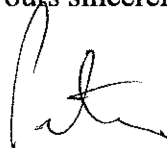
portion of the change in the fair value of the liability would affect profit or loss. It is of particular importance when financial assets and financial liabilities are managed as part of a portfolio.

It is Finance's view that:

- Fair value changes attributable to credit risk of the liability are essentially remeasurements and not transactions with equity holders, and therefore should not be presented directly in equity.
- The one-step approach with additional note disclosure is preferable to the two-step approach. The two-step approach introduces a new presentation method by recognising the change in profit or loss and subsequently reversing it into OCI.
- Generally, recycling from OCI to profit or loss is not appropriate.
- The ED proposal to use IFRS 7 guidance for determining the amount of the change in fair value that is attributable to changes in a liability's credit risk is a reasonable proxy.

If you have any queries regarding Finance's comments, please contact me on 02 6215 3551.

Yours sincerely



Mr Peter Gibson
Assistant Secretary
Accounting Policy Branch
1 July 2010