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Sir David Tweedie
Chairman
International Accounting Standards Board
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Dear Sir David

Amendments to IAS 39: Fair Value Option – Effective date and transition provisions

Deloitte Touche Tohmatsu is pleased to comment on the International Accounting Standards Board's (the Board's or IASB's) staff paper of 23 March 2005 regarding the proposed *Amendment to IAS 39: The Fair Value Option – Effective date and transition provisions* (referred to as the proposal). The proposal is a very brief paper that only sets out an overview of certain alternatives on the basis of the Board's tentative decisions. Our comments are based on this brief paper without full consideration of a detailed analysis of the alternatives.

While we remain of the view that the unrestricted fair value option as set out in IAS 39 *Financial Instruments: Recognition and Measurement* (Revised in March 2004) is preferable to a restricted version, we support the Board's current proposal compared to the previous restricted fair value option detailed in the Exposure Draft (June 2004). We encourage the Board to issue the amendment as soon as practicable.

We support a proposed effective date of 1 January 2006 with earlier application encouraged. In reviewing the transition provisions, it appears from the brief description of the Alternatives, that first-time adopters of IFRS would be affected in broadly the same way under each Alternative. However, the Alternatives require significant analysis for those entities that have already adopted IFRS.

Of the alternatives suggested in the staff paper of 23 March 2005 on transition, we believe that Alternative B in the proposal would be acceptable in addressing the issues that arise as a result of restricting the fair value option. We do not support Alternative A, which appears overly restrictive for existing IFRS preparers as they would not be able to apply the amended fair value option to pre-existing financial instruments at the time of adopting the amended fair value option. In contrast, Alternative B has the advantage of consistent treatment for entities that adopt IAS 39 (Revised March 2004) for the first time, regardless of whether they are first-time adopters or existing IFRS preparers currently applying the previous version of IAS 39. In addition, we do not favour Alternative C because we cannot find a reasonable justification for differentiating early adopters from those who adopt on the standard's effective date.

Entities affected by the "carve-out" version of IAS 39 within the European Union are currently facing a precarious situation as regards the fair value option. Whilst the IASB must be commended for its efforts in seeking a solution to the fair value option debate, we encourage the IASB and the European Commission to address the issue of whether the "carve-out" version will remain, until the amended fair value option is endorsed (if at all) and what the transitional provisions will be. We acknowledge that this issue is not necessarily one for the IASB to address, but dialogue at this stage of the process would allow both parties to work together and consider the best course of action for the benefit of the many first-time adopters of IFRS in this constituency.

In seeking to address the concerns of its constituencies, which include first-time adopters and existing IFRS preparers, we believe the IASB's staff has unduly complicated the various Alternatives in the proposal. Consequently, we suggest an Alternative that is not detailed in the IASB's staff proposal that we consider to be a simpler method of achieving transition to the amended fair value option whilst drawing on the advantages of both Alternatives B and C.

Suggested alternative approach

We advocate an approach that would permit an entity, upon adoption of the amendment, to designate as at fair value through profit or loss, any existing financial instrument that complies with the requirements of the amended fair value option. When an entity adopted IFRS, IAS 39 specifically, or applied the unrestricted fair value option should not matter. Pursuant to this approach, the following transition provisions would apply:

- an entity would be prohibited from de-designating a financial instrument that had been designated under the unrestricted fair value option except, in the case where a financial instrument does not meet the requirement of the amended fair value option, in which case, de-designation is required (this is consistent with the IASB's staff proposal).

- comparative financial information should not be retrospectively restated (this is consistent with the IASB's staff proposal).

- any gains or losses for existing financial instruments designated as at fair value through profit or loss upon adoption of the amendment, would be accounted for and presented as a cumulative adjustment to the opening equity balance of the reporting period. Fair value gains or losses arising in the reporting period would be recognised in profit or loss. This approach would separate for accounting purposes (and therefore presentation), the gains or losses of previous reporting periods.

This approach would seem to deliberately provide entities that may have applied the unrestricted fair value option with the opportunity to designate existing financial instruments with the benefit of experience. However, of the jurisdictions in which IFRS and IAS 39 (Revised March 2004) specifically, have been applied, the number of entities in our view, that have actually applied the unrestricted fair value option and therefore could potentially "cherry pick" is comparatively small when compared with the benefit of offering simplicity for the larger population that are adopting IAS 39 (Revised) for the first time. Consequently, we believe that the concerns of the IASB's staff in seeking to restrict potential abuse on adoption of the amended fair value option are exaggerated.

- in order to ensure transparency on adoption of the amended fair value option we believe disclosure requirements should be introduced, specifically directed at existing IFRS preparers that have previously chosen not to make use of the unrestricted fair value option for a specific financial instrument but have elected to designate that financial instrument as at fair value through profit or loss upon adoption of the amendment (that is, the unrestricted fair value option was not applied previously to this pre-existing financial instrument). This provision would require disclosure of the effect of the designation for the current period and each prior period presented, similar to the requirements of paragraph 29(c) and (d) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

  The disclosure requirements can be easily deleted from the pronouncement at a later date when the specific transition issue related to the amended fair value option becomes redundant.

- as entities may choose to apply the amended fair value option to instruments with unrealised losses, it may be prudent for the transition guidance to stress that entities must apply the impairment provisions as appropriate at the reporting date prior to the date of adopting the amendment in order to ensure that any losses arising as a result of impairment are recognised appropriately in the correct reporting period, as opposed to subsuming them within the financial effect of transition.

In summary, our proposal makes transition simpler, results in fair value measurement of more financial instruments in cases where fair value provides more meaningful information, results in the recognition and presentation of prior period gains or losses within equity separate from fair value gains or losses of the reporting period, and introduces disclosure requirements that provides users of the financial statements with useful information about the adoption of the amended fair value option.

If you have any questions concerning our comments, please contact the undersigned in London at (020) 7007 0907.

Sincerely,

Ken Wild
Global IFRS Leader