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Organización Internacional de Comisiones de Valores
International Organisation of Securities Commissions
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Organização Internacional das Comissões de Valore

October 1, 2008

Discussion Paper: Reducing Complexity in Reporting Financial Instruments
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

RE: Discussion Paper: Reducing Complexity in Reporting Financial Instruments

Dear IASB Members:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (Standing Committee No. 1) thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board (IASB or the Board) Discussion Paper: Reducing Complexity in Reporting Financial Instruments (the Discussion Paper).

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Standing Committee No. 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of Standing Committee No. 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

General Observations and Response to Questions 1-3:

Standing Committee No. 1 is supportive of accounting and disclosure guidance that is both principles-based and conducive to consistent application thereby satisfying users' general desire for relevant and comparable financial information. We agree that in some circumstances application of the recognition, measurement, presentation and disclosure guidance and requirements in International Accounting Standard No. 39 *Financial Instruments: Recognition and Measurement* (IAS 39) and International Financial Reporting Standards No. 7 *Financial Instruments: Disclosures* (IFRS 7) results in unnecessary financial statement user and preparer confusion. The confusion is often the result of IAS 39's existing measurement options and insufficient level of clarity surrounding the application of particular accounting methodologies. We believe these deficiencies contribute to confusion in, and opaqueness of, financial reporting.

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We agree the current financial reporting standards require improvement to meet the concerns of financial statement users. Therefore, we are supportive of improving the current accounting and disclosure guidance to provide clearer principles with an appropriate level of application guidance such that the accounting and disclosures result in more relevant and understandable information for users of financial statements. We also agree that any such improvements should consider the cost associated with such potential changes and be mindful of avoidable complexity. However, reducing complexity and improving accounting and reporting standards could be considered two different concepts. Therefore, we recommend caution to avoid over-emphasizing simplification at the expense of robust financial reporting and disclosure.

We are generally supportive of exploring the potential value of a single measurement attribute for all financial instruments, such as fair value, in the long term. However, our support for exploring a single measurement attribute is predicated on first resolving existing actual or perceived deficiencies within IAS 39 and IFRS 7. These current deficiencies include the multiple or overly complex recognition, measurement, presentation and disclosure attributes that exist for certain financial instruments (e.g., 'held to maturity' and 'available for sale' securities and the complexity of hedge accounting). Additionally, improvements to the existing fair value measurement guidance should be made in order to address issues experienced in the current economic environment (e.g., reliability and transparency of critical estimates, consideration of mark to model concerns in inactive markets and the incorporation of an issuer's own credit quality into the measurement of liabilities). All of these deficiencies may have profound impacts on the Board's current conceptual framework and financial statement presentation projects, which should be considered before moving forward. Before we can fully support the long-term measurement objective of fair value, we believe there are short-term issues that require immediate attention.

Replacing existing measurement requirements with a fair value measurement principle with certain exceptions:
We agree that as a priority, the Boards should focus on improvements to IAS 39's complex financial instrument recognition and measurement guidance. Specifically, we would support and encourage the IASB to focus its attention on eliminating the multiple existing IAS 39 accounting policy alternatives. To accomplish such a goal, we strongly urge the IASB to re-evaluate the 'held to maturity' and 'available for sale' recognition and measurement applications to determine which of the two measurement and recognition policies is most compatible with the Board's objective of presenting relevant information that is a faithful representation of such transactions.

As an organization of regulatory bodies, we appreciate the relative merits and deficiencies of each measurement and presentation policy and we have our own biases towards one policy or the other, even among the individual members. However, all members appreciate that the existence of multiple competing recognition and measurement policies for similar instruments might hinder the transparent flow of comparable decision useful information to investors. We also appreciate that the IASB must consider the views of preparers, investors and other users of the financial statements in making any decision. Therefore, IOSCO would support any IASB decision to eliminate either the held to maturity or the available for sale recognition and measurement alternative after a thoughtful and open consideration of the objectives of financial reporting which contemplated concerns that may be raised by users and preparers.

Simplification of Hedge Accounting: Standing Committee No. 1 agrees that the current hedge accounting requirements represent a major source of complexity in financial reporting. Therefore, we would support a project that would evaluate the current rules-based system and replace it with a principles-based model. Therefore, we encourage the Boards' to closely monitor the Financial Accounting Standards Board current hedge accounting exposure draft: *Accounting for Hedging Activities* (FASB ED). The feedback received from investors, preparers and other financial statement users will be a valuable source of information to guide the Board's continued evaluation.

Consistent with the FASB's current project, we do not support full elimination of hedge accounting at this time. Rather, we believe there are specific areas that could be improved certain of which are currently contemplated both within the DP and the FASB ED. We encourage the Boards to specifically consider eliminating the rules based approach to quantifying hedge effectiveness. Currently, the rules-based notion of highly effective, results in unnecessary complexity as arrangements with similar economic characteristics may be recorded differently simply due to slight differences in mathematical calculations. Consistent with the FASB's ED, we would support amending hedge relationship guidance to require that the hedging instrument and the hedging item are economically linked and reasonably effective (rather than highly effective). Any existing ineffectiveness would be recorded in profit and loss, and therefore achieve a similar result as permitting fair value options without increasing diversity which often follows options in accounting. As part of the Boards' reconsideration of the rules based hedge accounting approach, the Boards' should also explore whether elimination of the held to maturity and/or the available for sale measurement categories might also result in simplification of fair value hedge accounting.

Other intermediate approaches and concerns regarding the use of fair value: As noted above, we believe that investors, auditors and preparers would benefit from improved accounting and disclosure guidance on fair value measurements. In that respect, we believe the IASB should continue to accelerate its project on fair value measurement, taking into consideration the recommendations of the Financial Stability Forum, the IASB's Expert Advisory Panel and the guidance in Statement of Financial Accounting Standard No. 157, *Fair Value Measurement* (SFAS 157). In particular, we understand that disclosures that group fair value measurements into relative levels are often useful to investors. Therefore and considering the importance of fair value measurement groupings, the Boards should focus on improving the disclosure of the nature of fair value measurements. This focus should emphasize the importance of the issues currently discussed by the IASB's Expert Advisory Panel which has noted:

- Preparers continue to encounter difficulties with developing and implementing valuation techniques that achieve the financial reporting objectives of relevance and faithful representation. Aside from the perceived lack of verifiability, the variety of techniques applied also reduces comparability. As a result, the understandability of the related disclosures are become compromised. Therefore, the Boards should focus its efforts on determining what, if any, valuation guidance or guidance on applying and disclosing such judgments can be provided to help preparers achieve the objectives of financial reporting.

- Certain users and preparers have expressed concern regarding whether and how a company's own credit quality should impact the fair value measurement of an entity's liabilities, and the associated disclosures. To this point, the Boards' should determine whether the Financial Statement Presentation project objectives suitably resolve the concerns about understandability of incorporating own-credit risk into the changes in fair value. Standing Committee No. 1 agrees that conceptually credit risk is a necessary component of fair value; however, if its application results in presentations that are not representationally faithful, adjustment to fair value measurement and presentation are likely to be warranted.

- Certain preparers have expressed concern regarding the determinations of whether an active market does or does not exist. IAS 39 could be improved to provide greater principled guidance regarding how relative trading volumes may impact the consideration of whether an active market exists and the disclosures around instruments that are deemed to trade in non-active and/or distressed markets, inclusive of illiquidity discounts that may be applied.

Regardless of the direction of the Board on the above items, we recommend that the guidance on existing fair value measurements and disclosures be improved, and that the Board coordinate this project with the financial statement presentation and conceptual framework projects. Improved disclosures may include the significant inputs and associated risks, quantification of realized and unrealized portions, quantification of the impact of own credit, and the impact of liquidity. Improved disclosures are necessary in order to provide greater transparency into the subjectivity, uncertainty, and risks inherent in an entity's fair value measurements.

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We appreciate your thoughtful consideration of the comments raised in this letter. If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at 202-551-5300.

Sincerely,

Julie A. Erhardt
Chair
IOSCO Standing Committee No. 1