

Department of Treasury and Finance

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Ms Stephenie Fox
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International Public Sector Accounting Standards Board
International Federation of Accountants
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Dear Ms Fox

IPSASB PROPOSED STANDARDS ON FINANCIAL INSTRUMENTS

The Australian Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board on ED 37 *Financial Instruments: Presentation*, ED 38 *Financial Instruments: Recognition and Measurement* and ED 39 *Financial Instruments: Disclosures*.

HoTARAC is an intergovernmental Committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee is comprised of the senior accounting policy representatives from all Australian States, Territories and the Australian Government.

HoTARAC commends the IPSASB's efforts to issue, within its planned deadline, the suite of financial instrument Standards that converge with equivalent Standards issued by the International Accounting Standards Board as at 31 December 2008. HoTARAC considers that these updates are necessary to bring the current IPSASB Standards into line with International Accounting Standards and to provide additional guidance on complex accounting issues facing the public sector.

As the IPSASB is aware, the IASB is revising its financial instruments Standards. It could be argued that IPSASB should delay introducing its financial instruments Standards to take account of the IASB changes. HoTARAC is strongly of the view that a delay is not warranted because:

- at the time of the global financial crisis, it is important for public policy that governments apply comprehensive financial instruments Standards (including disclosure); and
- the revised IASB Standards may not be applicable for some time.

For this reason, while there are aspects of the IASB's financial instruments Standards that could be improved, HoTARAC supports the IPSASB proposals set out in the Exposure Drafts.

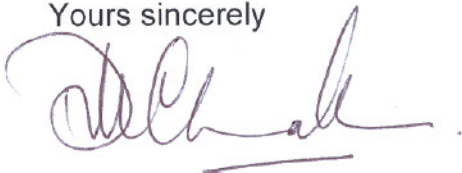
In particular, HoTARAC supports:

- the application guidance provided to issuers of concessional loans. This guidance is consistent with how the Australian public sector accounts for these loans and is in line with the Government Finance Statistics system;
- the distinction between a concessional loan and a waiver of debt;
- the application guidance relating to financial guarantees provided for nil or nominal consideration (but noting that this is different to statutory guarantees); and
- the additional disclosure requirements set out in ED 39.

HoTARAC believes that the clarity in a number of areas could be improved, as identified in the attachments to this letter. HoTARAC notes that it has largely confined its comments to the additions and amendments proposed by IPSASB, and with minor exceptions has not commented on unaltered elements of the underlying IASB Standards. Consequently, HoTARAC's comments should not be interpreted as a wholesale endorsement of the underlying IASB Standards.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on +61 2 6215 3551.

Yours sincerely



D W Challen

CHAIR

HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

29 July 2009

Encl

Contact: Amy Huxley
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ED 37 Financial Instruments: Presentation

1. ED 37 allows entities to treat financial guarantee contracts issued through an exchange transaction as insurance contracts if the issuer elects to recognise and measure them in accordance with the international or national accounting standard dealing with insurance contracts.

However, all financial guarantee contracts issued at no or nominal consideration are required to be treated as financial instruments. Do you agree with this approach? Please state your reasons for either agreeing or disagreeing with this approach.

HoTARAC agrees with this approach. HoTARAC is of the opinion that financial guarantees issued at no or nominal consideration may be different in substance to financial guarantee contracts issued through exchange transactions. Therefore, HoTARAC is comfortable with excluding the option to account for non-exchange financial guarantee contracts as insurance contracts.

2. The transitional provisions to ED 37 do not provide any relief for entities initially adopting accrual accounting from preparing and presenting comparative information. Do you support this proposal? If additional transitional provisions are necessary, please indicate what these should be and state your reasons.

HoTARAC does not support this proposal. Although all jurisdictions in Australia currently apply accrual accounting, HoTARAC is of the opinion that transitional provisions requiring retrospective application may be costly and time-consuming for those entities required to convert cash-based information to accrual comparative information. This is a particularly acute issue for governments, which often have very long-term financial instruments – for example the Australian Government still has loan assets originating in the 1940's and some equity instruments in Government-owned Companies dating back to the early 1900's. HoTARAC also notes that, although IAS 32 *Financial Instruments: Presentation* does not contain any transitional provisions, the AASB did not require Australian entities to present comparative information on transition to IFRS.

If transitional provisions remain, some HoTARAC members are of the view that the transitional provisions contained in Paragraph 57 are confusing to read and could be simplified by relocating the second, third and fourth sentences to the Basis for Conclusions.

Other Points for Comment:

Contractual and non-contractual arrangements, statutory obligations and binding arrangements

HoTARAC is of the view that the additional guidance on contractual and non-contractual/statutory arrangements is subjective and could be open to interpretation in its current form. HoTARAC considers that the IPSASB should state clearly the distinction between binding arrangements, contractual arrangements and non-contractual/statutory arrangements. Of particular importance, the IPSASB should clarify that statutory financial guarantees may not be reflected in contractual arrangements and, under those circumstances, do not qualify as financial instruments.

Equity Instruments (AG23-AG24)

The IPSASB needs to clarify under what circumstances designated transfers are equity instruments and whether equity instruments must be issued for the transfer to qualify for recognition as contributions by owners. The IPSASB could consider guidance provided by the AASB in Australian Interpretation 1038 *Contributions by Owners Made to Wholly-owned Public Sector Entities*, where "...the issuance of equity instruments in relation to a transfer is not essential for the transfer to qualify for recognition as contributions by owners..." (Interpretation 1038 Paragraph 23).

ED 38 Financial Instruments: Recognition and Measurement

1. Do you agree with the Application Guidance relating to the issuer of concessionary loans (Paragraphs AG83 to AG89), in particular:
 - a. The requirement that any difference between the transaction price of the loan and fair value of the loan at initial recognition should be expensed;
 - b. The distinction between concessionary loans and the waiver of debt?

If you do not agree with the Application Guidance please give your preferred alternative approach and state your reasons.

The majority of HoTARAC members support the application guidance relating to the issuer of concessional loans, and acknowledge that, while these types of loans are not unique to the public sector, the application guidance will assist entities with a limited understanding of the accounting implications of loans with non-commercial terms.

a) HoTARAC agrees with the requirement that any difference between the transaction price of the loan and fair value of the loan at initial recognition should be expensed by the lender, and notes that this is consistent with how the Australian public sector accounts for these loans and is in line with Government Finance Statistics.

Some HoTARAC members consider clarification is required of the implications of Paragraphs AG81 and AG88 which both discuss the treatment of differences between fair value and the transaction price, and whether mirror treatments between lenders and borrowers will always result. In particular, the last sentence of Paragraph AG81 differs from sub-Paragraph AG88(b).

b) HoTARAC agrees with the distinction between a concessionary loan which is provided below market terms and a waiver of debt on a loan provided on market terms. HoTARAC notes that, while there may be concerns that an entity may contrive accounting results from year to year by not accounting for its true intentions up-front, the requirement to treat these transactions based on the substance of the intention should mitigate this risk.

2. Do you agree with the Application Guidance relating to financial guarantees provided for nil or nominal consideration (Paragraphs AG91 to AG 96), in particular that entities should apply a mathematical valuation technique to obtain a fair value where this produces a reliable measure of fair value? Alternatively, where a fair value cannot be obtained through observation of an active market, do you think that initial recognition should be in accordance with IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. Please state your reasons.

HoTARAC agrees with the Application Guidance relating to financial guarantees provided for no or nominal consideration. HoTARAC believes this approach is consistent with the fair value measurement approach within IAS 39 *Financial Instruments: Recognition and Measurement*. HoTARAC notes that a financial guarantee provided for solely under legislation should not be a financial instrument, as it contains no element of contract or binding agreement between parties (in the same way that statutory receivables such as taxes should not be financial instruments).

However, regarding the alternative approach in the IPSASB's question, HoTARAC does not support the proposition that, where a fair value cannot be obtained through observation of an active market (eg level one), an entity should be allowed to jump directly to IPSAS 19 on provisions (eg level three), as this would deviate from the IAS 39 hierarchy.

HoTARAC suggests that, when measuring financial guarantees given at nil or nominal consideration, in taking into account the probability of default, consideration be given to the level of gearing, stability of the industry and the funding framework.

HoTARAC notes that the IPSASB should be mindful of the references to levels 1, 2 and 3 (AG94-AG96) as these have not been included elsewhere in the ED.

HoTARAC believes that the IPSASB should monitor the International Accounting Standards Board's *Fair Value Measurement* Project, especially in relation to the proposed fair value hierarchy and the implications this may have on measuring financial instruments. HoTARAC also believes that the IPSASB should monitor the outcome of the current IASB Project on IFRS 4 *Insurance Contracts*, and its application to accounting for financial guarantees.

3. Do you agree with the transitional provisions in Paragraphs 114 to 123? If you do not agree with these transitional provisions please indicate further transitional provisions that are necessary, or those transitional provisions that are unnecessary. Please state your reasons.

Consistent with HoTARAC's response to ED 37, HoTARAC does not support the transitional provisions in ED 38 to the extent that they require presentation of comparative information in accordance with the requirements in ED 38. As

mentioned in respect of ED 37, HoTARAC believes retrospective application would be costly and time-consuming for those entities required to convert cash-based information to accrual comparative information. HoTARAC also notes that, although IAS 32 does not contain any transitional provisions, the AASB did not require Australian entities to present comparative information on transition to IFRS.

Editorial issues

Sub-Paragraph 2(g) –

The reference to Paragraph 4 should be amended to Paragraph 3.

Sub-Paragraph 5(b) –

Although this omission also exists in IAS 39, it is recommended that Paragraph 5(c) of ED 38 has an extra word included as follows “... the entity has a practice of taking delivery of the underlying item and selling it within a short period ...”

Paragraph BC1 –

The reference to IAS 32 at the end of this paragraph should be amended to “IAS 39”.

References to LIBOR (London Interbank Offered Rate) –

HoTARAC notes that references to “LIBOR” throughout ED 38 have been replaced with other terminology for a public sector context – except for many references to LIBOR throughout the Illustrative Examples and Implementation Guidance sections in the latter part of ED 38. If LIBOR is not considered appropriate elsewhere in ED 38, HoTARAC considers the references to LIBOR in the many examples in those sections should similarly be replaced. (HoTARAC notes in this regard that LIBOR appears to be often used as a reference rate for government-to-government loans and in pricing government bond issues)

Implementation Guidance Example F.5.6 –

The heading for this example reads “Cash Flow Hedges: Firm Commitment to Purchase Inventory in a Foreign Currency”. However, certain journal entries on the following pages post amounts to “property, plant and equipment”, rather than inventory.

Given the postings to property, plant and equipment may be permissible according to Paragraph 17 of IPSAS 17 *Property Plant and Equipment*, it is recommended that either the relevant journal postings, or the example heading, be amended for internal consistency in the example.

ED 39 Financial Instruments: Disclosure

The IPSASB considered all of the required disclosures in IFRS 7 to assess whether any disclosures should be deleted for public sector specific reasons. Examples of disclosures specifically considered include sensitivity analyses and collateral. The IPSASB concluded that there is no public sector reason to depart from the requirements of IFRS 7 by deleting any disclosures. Do you agree?

HoTARAC agrees that there is no reason to delete any of the IFRS 7 disclosures.

The majority of HoTARAC members support the additional disclosure requirements set out in ED 39. HoTARAC, however, recommends that the IPSASB clarify whether the additional disclosure is to be provided at a loan level or a consolidated level (the latter being HoTARAC's preference, as it is the most practical approach). A minority of HoTARAC members consider that the current level of disclosure is sufficient and contemplated in IAS 39 Application Guidance and therefore do not support including additional disclosure requirements for concessional loans.

Regarding the option available under Paragraph AG6, HoTARAC strongly believes that all financial instrument risk disclosures should appear in the audited financial statements. By way of example, Australian entities must disclose all financial instrument risks in the financial statements as the Australian Accounting Standards Board's legal authority does not extend beyond setting Accounting Standards for application to the financial statements and associated notes. Therefore the option to disclose certain risks in a place beyond the boundaries of the audited financial statements and notes is not permitted in Australia.

Editorial Issues

Sub-Paragraph 3(a) –

All remaining references to subsidiaries need to be replaced with controlled entities.

Sub-Paragraph 3(b) –

The reference to IPSAS 26 needs to be amended to IPSAS 25.

Sub-Paragraph AG5(h) –

Given the discussion in paragraphs AG96 and BC12 of ED 38 regarding the application of IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*, it is recommended that sub-paragraph AG5(h) of ED 39 be re-worded to "For financial guarantee contracts at no or nominal consideration, where no fair value can be determined and a provision has been recognised in accordance with IPSAS 19, disclosure of the circumstances resulting in a

provision being recognised". The current wording could be interpreted as implying a contingent liability note disclosure is not possible.

Example IG36 –

All references to revenue or other revenue need to be amended to refer instead to net assets/equity.