

IASB  
30 Cannon Street  
London EC4M 6XH  
UK

Paris, September 14th, 2009

Re: ED – Financial Instruments: Classification and Measurement

Dear Sir or Madam,

MAZARS welcomes the opportunity to comment on the *IASB Exposure Draft: Financial Instruments: Classification and Measurement*. Our answers to the exposure draft's questions are shown in the appendix to this letter which summarises our concerns and opinion.

We support a complete revision of IAS 39 rather than an ad hoc piecemeal approach of small changes to accommodate market participants' requests. We believe that a piecemeal approach would further increase complexity rather than reduce it. We also appreciate the Board's time constraints regarding this project and therefore understand its pragmatic approach in 3 phases even if, ideally such a revision should be done as one comprehensive project in which all interrelated aspects of financial instruments accounting are reviewed at the same time. In this context, we wish to draw the Board's attention on the difficulty to comment on the proposed classification and measurement approach whereas the other aspects of IAS 39 "impairment" and "hedging" remain outstanding. Therefore our comments below may, to a certain extent, be tentative and contingent to the Board's proposals on impairment and hedging.

We also welcome the Board's proposal to retain a mixed model approach. We are convinced that amortised cost and fair value measurements are both needed to reflect the way entities actually manage their financial instruments.

We agree with the Board's proposal to remove the current Held to Maturity category and its related tainting constraints.

We especially welcome the Board's proposal of an approach relying on the entity's business model. We are convinced that this criteria is the most relevant to improve the decision-usefulness of financial reporting and to help the financial statements' users understand the way financial instruments are actually managed. We therefore believe that the business model should be the driving principle defining the boundary between amortised cost and fair value whereas the instrument's characteristics should represent a safeguard for a consistent application of the principle that certain instruments are unsuitable to be managed on a contractual cash-flow basis. Our proposal would result in a wider amortised cost category supported by the business model primarily involving holding the instrument to pay or receive cash flows while equity instruments and clearly leveraged financial instruments (such as derivatives) would remain in the fair value category.

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We agree with the Board's opinion expressed in paragraph BC32 of the Exposure Draft Basis for Conclusions. An entity's business model is a matter of fact that can be observed by the way that an entity is managed, and information is provided to the management of the entity. It should not be assimilated to management's intent. Consequently, if an entity in rare circumstances actually changes the manner in which it manages its financial instruments, reclassification should be required together with relevant disclosures. We therefore disagree with the Board's intention to forbid any kind of reclassification. We rather consider that prohibiting reclassification would increase the complexity and reduce transparency for financial statements' users as some financial instruments would not be classified in accordance with the way they are managed.

We agree with the Board's proposal to provide an option to recognise change in equity instruments' fair value in other comprehensive income. This option will be particularly useful to entities who actually manage their equity portfolios with a long term objective. However we disagree with the Board's proposal to recognise dividend distributions into other comprehensive income and to forbid any recycling from other comprehensive income to profit or loss. We consider that this position preempts the outcome from the *Performance Reporting* and *Financial Statements Presentation* projects. Given the divergence of stakeholders' opinion on this sensitive issue, the Board should consider an alternative approach in the short term until the end of the due process on *Performance Reporting* and *Financial Statements Presentation* projects. For this purpose, we recommend the Board to retain the current available for sale category measurement model for equity instruments. We are conscious that this would imply defining an impairment policy in the course of the project's phase 2. The only issue to be considered at this stage is the removal of the prohibition for equity impairment reversal.

We have also concerns on the proposed approach outcome on the liability side. We consider that the Exposure Draft's approach would result in an increased number of financial liabilities measured at fair value compared to the current situation under IAS 39. This is a critical issue as fair value measurement will not reflect the business model of a large majority of entities which issue financial liabilities primarily to fund their core operational activity. This situation would create significant accounting mismatches as entities' core activities are generally not measured at fair value. In addition, we are concerned about the consequences of accounting for changes in own credit risk<sup>1</sup>. Consequently, we recommend that the Board should, as a pragmatic solution, retain the current embedded derivative provisions for liabilities.

The transitional provisions of the proposed standard are another critical issue that needs to be considered carefully in particular in the light of early adoption and application by certain industries. The proposals need to be simplified in order to facilitate (early) adoption. Early adoption would represent a demanding project and early adopters should not be disadvantaged for choices made now. Therefore, we support an approach to transition based on the IFRS 1 requirements for entities that first adopted IAS 39. This would result in the opening balance sheet at 1/1/09 being stated as if the new requirements had always been applied, but would avoid the need to re-create comparatives for earlier periods.

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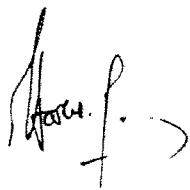
<sup>1</sup> Please refer to our comment letter to the discussion paper: *Credit risk in liability measurement*.

Eventually, we would like to draw the Board's attention on the specific issues faced by the insurance industry due to the future issue of *Insurance Contracts* phase 2. It seems important to us that any entity impacted by this future standard could have the opportunity to reassess its financial instruments' classification in the light of the accounting treatment of its insurance liabilities in order to avoid any accounting mismatch.

Our detailed answers are set out in the Appendix.

Do not hesitate to contact us should you wish to discuss our comments.

Best regards,



Michel Barbet-Massin  
*Head of Financial Reporting Technical Support*

## APPENDIX

### CLASSIFICATION APPROACH

#### Question 1

**Does amortised cost provide decision-useful information for a financial asset or financial liability that has basic loan features and is managed on a contractual yield basis? If not, why?**

Yes it does.

We consider that amortised cost is the best measurement method for financial instruments managed for collection or payment(s) of cash flow rather than primarily managed on a fair value basis.

As mentioned in our cover letter, we welcome the Board's proposal to retain a mixed model approach. We are convinced that amortised cost and fair value measurements are both needed to reflect the way entities actually manage their financial instruments.

We are also convinced that a business model criterion is the most relevant to improve the decision-usefulness of financial reporting and to help the financial statements' users understand the way financial instruments are actually managed. We believe that the business model should be the driving principle defining the boundary between amortised cost and fair value whereas the instrument's characteristics should represent a safeguard for a consistent application of the principle that certain instruments are unsuitable to be managed on a contractual cash-flow basis.

Our proposal would result in a wider amortised cost category supported by the business model primarily involving holding the instrument to pay or receive cash flows while equity instruments and clearly leveraged financial instruments (such as derivatives) would remain in the fair value category.

## Question 2

**Do you believe that the exposure draft proposes sufficient, operational guidance on the application of whether an instrument has ‘basic loan features’ and ‘is managed on a contractual yield basis’? If not, why? What additional guidance would you propose and why?**

We are convinced that a principle based approach is the best way to grant comparability, transparency and relevance of financial statements’ information to users.

We consider the proposed approach as being too rule based at this stage. We therefore encourage the Board to clarify the principle underlying the proposed approach in order to make the concept operational and to promote consistency and appropriate application.

### **Basic loan feature**

We understand that the underlying of the basic loan feature criteria is a leverage notion. We encourage the Board to provide a clear definition of what is leverage. This definition would ensure that certain standard debt features that would meet the definition of basic loan features would appropriately be treated as such. These features include inter alia: inflation linked debt, debt instruments paying CMS, extension provisions and other usual structured components which do not provide significant leverage.

If the Board chooses to propose in the final standard a list of basic loan feature’s examples such as in paragraph B3 of the Exposure Draft, we would recommend to clarify that the list is not limitative and only for illustrative purpose in order to avoid any rule based interpretation.

Besides, we would appreciate clarification on the interaction between IAS 32 and the exposure draft on classification. Let’s take the example of a compound instrument such as a convertible bond which is split into an equity component and a debt component. It is unclear whether the classification analysis should be applied to the whole contract or only to the debt component.

### **Regarding the “managed on a contractual yield basis” condition**

Please refer to our answer to question 1 regarding the importance that a business model condition should have, in our opinion, in a financial instruments’ classification approach.

We believe that “managed on a contractual yield basis” is a misleading wording which should be improved. Under current IAS 39 the effective yield of a debt instrument is based on expected cash flows rather than contractual cash flows. Therefore we would favour a wording such as “managed for collection or payment(s) of cash flow rather than primarily managed on a fair value basis”.

We agree with the Board's opinion expressed in paragraph BC32 of the exposure draft's Basis for Conclusions. An entity's business model is a matter of fact that can be observed by the way that an entity is managed, and information is provided to the management of the entity. It should not be assimilated to management's intent. Consequently, changes in business model should be possible, but rare.

We would appreciate clarification on what the Board means by "units" in paragraph B10 of the exposure draft. We agree that an entity can be in the position of identifying two different business models for two identical instruments which could result in the classification of these instruments in two different categories. We are convinced that this situation is actual and even usual in large entities. Therefore we consider that the business model should neither be determined on an instrument by instrument basis nor at the top management level but at an intermediate level (such as portfolio).

For avoidance of doubt, it should be clarified that the principle underlying the business model condition will not recreate the burden of the current Held to Maturity category through an explicit or implicit prohibition to sell the debt instrument before its contractual maturity. Such a prohibition would not allow insurers to reflect properly their actual management of bonds portfolio (i.e. investing bonds and that they often hold over an average of 5 years before selling them) through a classification in the amortised cost category.

We strongly disagree with the Board's position on financial assets acquired at a discount that reflects incurred credit losses. We find it very rule based and do not understand its rationale. We consider that a debt instrument held by an entity and managed for the collection or payment of cash flows should be accounted for in the same way without according any difference on whether it has been originated and later impaired or directly purchased with a discount reflecting incurred credit losses.

### **Question 3**

**Do you believe that other conditions would be more appropriate to identify which financial assets or financial liabilities should be measured at amortised cost? If so,**

**(a) what alternative conditions would you propose? Why are those conditions more appropriate?**

**(b) if additional financial assets or financial liabilities would be measured at amortised cost using those conditions, what are those additional financial assets or financial liabilities? Why does measurement at amortised cost result in information that is more decision-useful than measurement at fair value?**

**(c) if financial assets or financial liabilities that the exposure draft would measure at amortised cost do not meet your proposed conditions, do you think that those financial assets or financial liabilities should be measured at fair value? If not, what measurement attribute is appropriate and why?**

Please refer to our answers to questions 1 and 2.

## **EMBEDDED DERIVATIVES**

### **Question 4**

**(a) Do you agree that the embedded derivative requirements for a hybrid contract with a financial host should be eliminated? If not, please describe any alternative proposal and explain how it simplifies the accounting requirements and how it would improve the decision-usefulness of information about hybrid contracts.**

Yes we agree that on a long term perspective a principle based standard should lead to classify hybrid contracts in their entirety in order to avoid the complexity of bifurcation. In our opinion, the practical consequences of this removal are more significant on the liability side than on the asset side.

On the asset side, we agree that the embedded derivative provision can be removed provided the boundary between amortised cost and fair value is appropriately defined (please refer to our answer to question 1).

However on the liability side, in the short term, we have concerns with the removal of the embedded derivative provision. As mentioned in our cover letter, we consider that the exposure draft approach would result in an increased number of financial liabilities measured at fair value compared to the current situation under IAS 39. This is a critical issue as fair value measurement will not reflect the business model of a large majority of entities which issue financial liabilities primarily to fund their core operational activity. This situation would create significant accounting mismatches as entities' core activities are generally not measured at fair value. In addition, we are concerned about the consequences of accounting for changes in own credit risk<sup>2</sup>. Consequently, we recommend that the Board should, as a pragmatic solution, retain the current embedded derivative provisions for liabilities.

**(b) Do you agree with the proposed application of the proposed classification approach to contractually subordinated interests (ie tranches)? If not, what approach would you propose for such contractually subordinated interests? How is that approach consistent with the proposed classification approach? How would that approach simplify the accounting requirements and improve the decisionusefulness of information about contractually subordinated interests?**

No we do not.

Our concerns regarding this proposal on contractually subordinated interests are mainly twofold:

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<sup>2</sup> Please refer to our comment letter to the discussion paper: *Credit risk in liability measurement*.

Firstly the Board should clarify that its intention was only to affect securitisation vehicles or SPV with significantly leveraged tranching mechanism and not common corporate subordination mechanism such as subordinated bonds or preferred shares qualified as financial liability. We are convinced that credit risk is an integral part of a debt instrument and should not be considered as a non basic loan feature provided it is not significantly leveraged.

Secondly, we consider that the proposed approach on tranching is a rule based simplification and will therefore open the door to multiple structuring opportunities or prohibit the classification in the amortised cost category of tranches that are hold with a view of collecting cash flows.

We are convinced that the best way to perform an analysis on this kind of SPV is a look through approach. In our opinion, a note issued by a SPV with a tranching mechanism should be identified as a basic loan each time that:

- its characteristics meet the basic loan definition, and
- the SPV assets and derivative instruments do not provide significant leverage.

The analysis of the SPV assets requires judgement. For example, interest rates swaps which aim at hedging the interest rate risk of the SPV asset portfolio should not trigger a non basic loan qualification of the SPV's notes as they do not create a significant leveraged effect.

We acknowledge that a look through approach is rather complex and would even be proved to be impossible to perform if the entity has not sufficient access to the SPV's information. In this case we favour a classification in the fair value category.

## **FAIR VALUE OPTION**

### **Question 5**

**Do you agree that entities should continue to be permitted to designate any financial asset or financial liability at fair value through profit or loss if such designation eliminates or significantly reduces an accounting mismatch? If not, why?**

Yes we agree.

### **Question 6**

**Should the fair value option be allowed under any other circumstances? If so, under what other circumstances should it be allowed and why?**

If the Board chooses to take into account our proposal to maintain the current embedded derivative approach for financial instruments on the liability side, the related fair value option should be reintroduced too.



## **RECLASSIFICATION**

### **Question 7**

**Do you agree that reclassification should be prohibited? If not, in what circumstances do you believe reclassification is appropriate and why do such reclassifications provide understandable and useful information to users of financial statements? How would you account for such reclassifications, and why?**

No we do not agree.

As mentioned in our answer to question 1, we consider that the business model condition should have primacy in a classification approach.

As mentioned in our answer to question 2, changes in the business model should be possible but rare. Consequently, if an entity actually changes the manner in which it manages its financial instruments, reclassification should be required together with relevant disclosures. We therefore disagree with the Board's intention to forbid any kind of reclassification. We rather consider that prohibiting reclassification would increase the complexity and reduce transparency for financial statements' users as some financial instruments would not be classified in accordance with the way they are managed.

We consider that financial instruments subject to reclassification should be reclassified at their fair value on the date of reclassification.

Disclosure should be provided to financial statements' users for any significant reclassification in order to clarify why the reclassification occurred and its consecutive impacts on statement of financial position and income statement.

## **INVESTMENTS IN EQUITY INSTRUMENTS THAT DO NOT HAVE A QUOTED MARKET PRICE AND WHOSE FAIR VALUE CANNOT BE RELIABLY MEASURED**

### **Question 8**

**Do you believe that more decision-useful information about investments in equity instruments (and derivatives on those equity instruments) results if all such investments are measured at fair value? If not, why?**

No, we disagree with the Board's proposal to remove the fair value exemption for equity instruments whose fair value is not reliably determinable. We consider that it is irrelevant to use fair value measurement each time the fair value can not be reliably determined.

### Question 9

**Are there circumstances in which the benefits of improved decision-usefulness do not outweigh the costs of providing this information? What are those circumstances and why? In such circumstances, what impairment test would you require and why?**

Yes. On unquoted equity instruments, it often appears that the range of fair values obtained through different pricing methodologies is too broad to be reliable whereas the cost to reduce this range in order to increase its relevance outweighs the decision-usefulness of this information.

IAS 36 provisions could be the starting point of an impairment approach for equity instruments whose fair value can not be reliably determined.

### **INVESTMENTS IN EQUITY INSTRUMENTS THAT ARE MEASURED AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME**

### Question 10

**Do you believe that presenting fair value changes (and dividends) for particular investments in equity instruments in other comprehensive income would improve financial reporting? If not, why?**

No we do not agree not to recognise in profit or loss the performance realised during the period through dividend distribution and disposal of equity instruments. We rather recommend that the Board should keep the existing available for sale category with a limited amendment to permit reversal of impairment.

As mentioned in our cover letter, we agree with the Board's proposal to provide an option to recognise changes in equity instruments' fair value in other comprehensive income. This option will be particularly useful to entities who actually manage their equity portfolios with a long term objective. However we disagree with the Board's proposal to recognise dividend distributions into other comprehensive income and to forbid any recycling from other comprehensive income to profit or loss. We consider that this position preempts the outcome from the *Performance Reporting* and *Financial Statements Presentation* projects. Given the divergence of stakeholders' opinion on this sensitive issue, the Board should consider an alternative approach in the short term until the end of the due process on *Performance Reporting* and *Financial Statements Presentation* projects. For this purpose, we recommend the Board to retain the current available for sale category measurement model for equity instruments. We are conscious that this would imply defining an impairment policy in the course of the project's phase 2. The only issue to be considered at this stage is the removal of the prohibition for equity impairment reversal.

**Question 11**

**Do you agree that an entity should be permitted to present in other comprehensive income changes in the fair value (and dividends) of any investment in equity instruments (other than those that are held for trading), only if it elects to do so at initial recognition? If not,**

**(a) how do you propose to identify those investments for which presentation in other comprehensive income is appropriate? Why?**

**(b) should entities present changes in fair value in other comprehensive income only in the periods in which the investments in equity instruments meet the proposed identification principle in (a)? Why?**

No we do not agree.

As mentioned in our answer to question 1, 7 and 10, we are convinced that the classification of a financial instrument should primarily be based on a business model approach. Therefore, if the way the instrument is actually managed changes, its classification should be reassessed.

**EFFECTIVE DATE AND TRANSITION****Question 12**

**Do you agree with the additional disclosure requirements proposed for entities that apply the proposed IFRS before its mandated effective date? If not, what would you propose instead and why?**

No we do not support the additional disclosure requirements proposed for early adopters. We support a simplification of the transition provisions and related disclosures compared to those currently proposed.

Besides, given the 3 phases process adopted by the Board, we consider that the reassessment of options retained by an early adopter in the implementation of the project's first phase should be permitted on the date when it first applies phase 2 and/or phase 3.

Our proposal is detailed further in our answer to question 13.

**Question 13**

**Do you agree with applying the proposals retrospectively and the related proposed transition guidance? If not, why? What transition guidance would you propose instead and why?**

**MAZARS**  
We consider that the proposals need to be simplified.

We support an approach to transition based on the IFRS 1 requirements for entities that first adopted IAS 39. This would result in the opening balance sheet at, say, 1/1/09 being stated as if the new requirements had always been applied, but would avoid the need to re-create comparatives for earlier periods.

In all cases, there should be reconciliation between the closing balance sheet using the existing IAS 39 and the opening, restated balance sheet with explanations for the main changes in classification and measurement.

Eventually, we would like to draw the Board attention on the specific issues faced by the insurance industry due to the future issue of *Insurance Contract* phase 2. It seems important to us that any entity impacted by this future standard could have the opportunity to reassess its financial instruments' classification in the light of the accounting treatment of its insurance liabilities in order to avoid any accounting mismatch.

### **AN ALTERNATIVE APPROACH**

#### **Question 14**

**Do you believe that this alternative approach provides more decision-useful information than measuring those financial assets at amortised cost, specifically:**

**(a) in the statement of financial position?**

**(b) in the statement of comprehensive income? If so, why?**

No we do not agree as it results in a reduced importance of the business model condition which, in our opinion, should be the primary criteria for the sake of classification and measurement of financial instruments.

For example, we are convinced that listed bonds can be managed for collection or payment(s) of cash flow rather than primarily managed on a fair value basis and should therefore be eligible to an amortised cost measurement.

#### **Question 15**

**Do you believe that either of the possible variants of the alternative approach provides more decision-useful information than the alternative approach and the approach proposed in the exposure draft? If so, which variant and why?**

No we do not agree for the reasons expressed in our answer to question 14.