

IASB  
30 Cannon Street  
London EC4M 6XH  
UK

Paris, July 16, 2010

Re: ED – Fair Value Option for Financial Liabilities

Dear Sir or Madam,

MAZARS welcomes the opportunity to comment on the IASB Exposure Draft, *Financial Instruments - Amortised cost and Impairment*. Our answers to the Exposure Draft questions are shown in the appendix to this letter which summarises our concerns and opinion.

As already mentioned in our answer to the Discussion Paper “Credit risk in Liability measurement”, we are convinced that changes in the credit risk component of a financial liability should not impact profit or loss, except when the financial liability is classified as Held For Trading.

Including changes in own credit risk in the measurement of a financial liability on the face of the balance sheet:

- Results in a counter-intuitive impact in comprehensive income as it could lead an entity experiencing a deterioration of its financial situation to recognise a gain in its comprehensive income.
- Does not in our view provide relevant information to financial statement users as these changes in value are rarely realised in practice and therefore do not predict reliably the future cash flows of the entity

Therefore we recommended to the Board to exclude changes in own credit risk from the subsequent measurement of financial liabilities designated under the fair value option. We are still convinced that this approach, generally called “frozen credit spread”, combined with relevant disclosure requirements provides the most relevant information for users of financial statements. However, we note that the Board has not taken up this approach and therefore address our response to the approach that is being proposed.

We support:

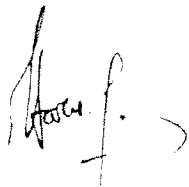
- Presenting the effect of own credit risk in other comprehensive income rather than in equity as it is not a transaction with existing equity holders;
- Retaining a one-step approach since the proposed two-step approach increases complexity without additional benefit in terms of clarity and transparency
- Requiring any realised gain or loss to be recognised in profit or loss similarly to any other financial liability in order to ensure consistency.

We agree with the Board's proposal on Transition even if we consider that presenting this amendment as an improvement to IAS 39 could be an alternative in order to avoid dealing with the interaction with other IFRS 9 phases. This is a relatively small, self contained change which represents an improvement to IAS 39 and it is difficult to see why it should not be adopted at an earlier date than other changes to financial instrument accounting.

Our detailed answers are set out in the Appendix.

Do not hesitate to contact us should you want to discuss any aspect of our comments.

Best regards,



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

## APPENDIX

### Presenting the effects of changes in a liability's credit risk in profit or loss

#### Question 1

**Do you agree that for all liabilities designated under the fair value option, changes in the credit risk of the liability should not affect profit or loss? If you disagree, why?**

Yes, we agree.

Nevertheless, as mentioned in our answer to the Discussion Paper “Credit risk in liability measurement”, we are in favour of a solution that would exclude changes in own credit risk from the subsequent measurement of financial liabilities designated under the fair value option.

We consider that the request of users interested in the total change in fair value of the liability can be addressed through relevant disclosures as it is already done for financial liabilities measured at amortised cost.

One could also consider that implementing the “frozen credit spread” approach would increase complexity and reduce transparency of financial statements due to the introduction of an additional measurement method. We consider that this position is flawed since this measurement approach results in impacts very similar to the one obtained on financial liabilities subject to bifurcation of embedded derivatives.

#### Question 2

**Or alternatively, do you believe that changes in the credit risk of the liability should not affect profit or loss unless such treatment would create a mismatch in profit or loss (in which case, the entire fair value change would be required to be presented in profit or loss)? Why?**

No, we do not.

An accounting mismatch occurs when offsetting economic exposures (generally an asset and a liability) are measured on a different basis.

Two main components are usually identified within “own credit risk”: (i) the issuer's risk of default and (ii) the “liquidity risk” of the instrument issued. It does not include credit risk more generally or the credit risk of assets which are contractually linked to the liability. The wording of the final standard should make this point more clearly.

If the issuer's risk of default is obviously present on the liability side, an entity rarely bears the same exposure on the asset side. An investor may be exposed to other credit risk exposures but rarely to its own credit risk. We have identified few situations where assets embedded the investor's own credit risk. It generally results in either a trading position or non-material position (such as through the investment in the shares of a non-controlled fund which bears, among other credit exposures, the investor's own debt instrument).

We consider that liquidity risk is very difficult to isolate and measure. Moreover, our understanding is that liquidity risk is not "generic". It is rather specific to an instrument (i.e. a market) and an issuer. As a consequence, situations where an accounting mismatch can be identified and reliably measured on liquidity risk are rare in practice.

Consequently, accounting mismatch is not a convincing argument to include in profit or loss changes in the credit risk component of a financial liability designated under the fair value option.

Eventually, we consider that splitting the category of financial liability designated under the fair value option in two sub-categories, depending on whether or not there is an accounting mismatch on credit risk, does not reduce complexity.

### **Presenting the effects of changes in a liability's credit risk in other comprehensive income**

#### **Question 3**

**Do you agree that the portion of the fair value change that is attributable to changes in the credit risk of the liability should be presented in other comprehensive income? If not, why?**

Taking into consideration our general view expressed in our cover letter and further detailed in our answer to question 1, we agree that this portion of the fair value change should be presented in OCI.

#### **Question 4**

**Do you agree that the two-step approach provides useful information to users of financial statements? If not, what would you propose instead and why?**

No, we do not agree.

We do not understand the rationale for this proposal and what additional information is provided to users of financial statements through this two-step approach. The information would be better provided through disclosure rather than confusing the income statement presentation.

We do not understand the meaning of the transfer from profit or loss to other comprehensive income of the changes in fair value attributable to credit risk.

We consider that this two-step approach could trigger additional IT costs without any identifiable benefits.

#### **Question 5**

**Do you believe that the one-step approach is preferable to the two-step approach? If so, why?**

Yes, we do.

As explained in our answer to question 4, we believe that the one-step approach is preferable to the two-step approach for the sake of simplicity and clarity.

#### **Question 6**

**Do you believe that the effects of changes in the credit risk of the liability should be presented in equity (rather than in other comprehensive income)? If so, why?**

No, we do not.

We consider that changes in the net assets of an entity during a reporting period should be recognised within the comprehensive income. We agree with the Board's argument in BC 34 (b) that transaction impacting directly equity should be limited to those with equity holders.

#### **Reclassifying amounts to profit or loss**

#### **Question 7**

**Do you agree that gains or losses resulting from changes in a liability's credit risk included in other comprehensive income (or included in equity if you responded 'yes' to Question 6) should not be reclassified to profit or loss? If not, why and in what circumstances should they be reclassified?**

No, we do not agree.

This question relates to the lack of definition of what should be presented in profit or loss as opposed to comprehensive income. We urge the Board to address this issue through a relevant due process and not to pre-empt the conclusion of an issue which should be properly addressed by the Financial Statement Presentation project.

Under current IFRS, we do not understand why gains or losses related to own credit risk that are realised on the settlement of a financial liability designated under fair value option would impact Other Comprehensive Income whereas the same economic transaction would impact profit or loss for any other financial liabilities (even those measured at amortised cost).

We find this proposal inconsistent and misleading for financial statement users.

Moreover we question whether this accounting treatment could have some consequences in countries where dividend payments are contingent to the cumulative amount of recognised profit or loss. We note that there is nothing to prevent realised gains and losses from being transferred to the profit and loss account reserve and it would be helpful if the standard could make this point explicitly.

### **Determining the effects of changes in a liability's credit risk**

#### **Question 8**

**For the purposes of the proposals in this exposure draft, do you agree that the guidance in IFRS 7 should be used for determining the amount of the change in fair value that is attributable to changes in a liability's credit risk? If not, what would you propose instead and why?**

Yes, we agree with the proposal to retain the guidance existing in IFRS 7. Although entities should be encouraged to use and disclose their use of other methodologies that better measure the own credit risk component of the fair value movement.

### **Effective date and transition**

#### **Question 9**

**Do you agree with the proposals related to early adoption? If not, what would you propose instead and why? How would those proposals address concerns about comparability?**

We agree with the Board's proposal to require that an entity opting for early adoption of the requirements in this exposure draft shall apply all other previously published IFRS 9 requirements that it does not already apply.

However, we note that this exposure draft proposes to retain most of the current IAS 39 requirements related to financial liabilities classification and measurement with a limited amendment to financial liabilities designed under the fair value option. Therefore the Board could consider an alternative approach which would consist in presenting this amendment as an improvement of the current IAS 39 and consequently allowing early adoption of this exposure draft without any additional requirements related to the other phases of IFRS 9.

**Question 10**

**Do you agree with the proposed transition requirements? If not, what transition approach would you propose instead and why?**

Yes, we agree.