

Date
1 October 2008

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Sir David Tweedie
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Dear Sir David,

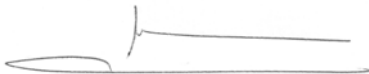
Re: IASB Discussion Paper *Reducing Complexity in Reporting Financial Instruments*

1. FEE (Fédération des Experts Comptables Européens - Federation of European Accountants) is pleased to submit its comments on the IASB Discussion Paper *Reducing Complexity in Reporting Financial Instruments* (the "DP").
2. FEE as a founding organisation of EFRAG has also contributed to the EFRAG consultation process by submitting its views on the EFRAG Draft Comment Letter through the FEE comment letter to EFRAG dated 29 September 2008. We have also considered EFRAG's final submission to the IASB of 30 September 2008.
3. In summary:
 - We agree that there is significant complexity in the current reporting of financial instruments and that there is a need to reduce this complexity recognising that by nature the subject of financial instruments is complicated, given the diversity of financial instruments and the related management methods ("business models"). The current market turmoil is a good practical example which illustrates the complexity of arriving at fair value for financial instruments when there is no longer an active market and this may be in practice a further trigger for reconsidering the existing reporting requirements. We welcome in this respect the creation of the IASB Expert Advisory Panel with the objective to assist the IASB in reviewing best practices in the area of valuation techniques, and formulating any necessary additional guidance on valuation methods for financial instruments and related disclosures when markets are no longer active;
 - We agree with EFRAG that adopting one measurement basis for all financial instruments will not always inevitably reduce complexity. Having a mixed-model for financial instruments should be favoured, as the accounting treatment should be driven to the extent possible by the business model under which financial instruments are held by the entity. Since both banks and other preparers usually manage their financial instruments under different business models (for example keeping financial assets for a continuing use in order to benefit from the cash flows associated over time or managing financial assets and liabilities based on their fair value), the importance of the business model should be a key consideration for determining what measurement basis to apply for all different types of financial instruments (amortised cost or fair value);

- On the basis of the above, we think that fair value may not always be the appropriate measurement. In addition, in our letter to the IASB dated 12 June 2007, we detailed our objections to certain of the Board's proposals regarding fair value measurements. We feel that there is a need for a clear and broadly accepted understanding of the term "fair value";
 - Regarding hedge accounting, we agree with EFRAG that the focus should be on reducing its complexity. We do not think that hedge accounting should be eliminated;
 - Furthermore, in our opinion the two-steps process presented (with a split between intermediate approaches and the long-term solution) is not necessarily the most appropriate approach. We suggest focusing on an appropriate solution in the short-term that works in practice and which could be retained, in an ideal case, as the long-term solution. We do not believe that this is the right time to reach conclusions on a long term solution;
 - The results of this Discussion Paper cannot be considered in isolation from other IASB related projects. For instance, should the performance reporting standard result in only one performance statement, this would justify the merger of the "fair value through profit or loss" and "available-for-sale" categories. We agree with EFRAG that the current IASB project on Financial Statement Presentation should consider the issues discussed in the commenting process to develop an appropriate approach to presentation. Other IASB projects which we believe should be completed or considered in conjunction with this are the Fair Value measurement Project and the project on the revision of the Framework;
 - We presume that the IASB will carry out field-testing in order to ensure that any suggested solutions are practical.
4. Our responses to the questions in the Invitation to comment Section of the DP are contained in the Appendix to this letter.

We would be pleased to discuss any aspect of this letter that you may wish to raise with us.

Yours sincerely,



Jacques Potdevin
President

Ref: ACC/JP/LF-SR

**Appendix: Responses to the questions in the Invitation to comment - IASB Discussion Paper
*Reducing Complexity in Reporting Financial Instruments***

Questions for respondents of the DP

Section 1 Problems related to measurement

Question 1

Do current requirements for reporting financial instruments, derivative instruments and similar items require significant change to meet the concerns of preparers and their auditors and the needs of users of financial statements? If not, how should the IASB respond to assertions that the current requirements are too complex?

5. The DP is welcomed. Particularly, we appreciate the open approach taken in proposing the simplification options in the intermediate approach. Overall we agree that there is significant complexity in the current reporting of financial instruments and that there is a need to reduce this complexity. The current market turmoil is a good practical example which illustrates the complexity of arriving at fair value for financial instruments when there is no longer an active market and this may be in practice a further trigger for reconsidering the existing reporting requirements. We welcome in this respect the creation of the IASB Expert Advisory Panel with the objective to assist the IASB in reviewing best practices in the area of valuation techniques, and formulating any necessary additional guidance on valuation methods for financial instruments and related disclosures when markets are no longer active.
6. It should be noted that most of the transactions linked to certain financial instruments are very complex by nature, so in any “appropriate” accounting treatment suggested one must expect some inherent degree of complexity. However, we agree that the current requirements are too complex and that any changes that will improve the understanding of the requirements (for example when the requirements apply and how they should be applied) and increase consistency in reporting should be welcomed.
7. The solution needs to be a principles-based solution. In practice, it has proven difficult having requirements that are not rules-based. However, we believe that efforts should be made to find a compromise; there is a need for better and more relevant disclosures rather than more disclosures.
8. We agree with EFRAG that hedge accounting should not be eliminated and that the focus should be on reducing its complexity. This could make the current application of the standard less complex and better adapted to the economic substance of transactions. In particular, the requirements that need being simplified relate to hedge accounting of future transactions meeting the highly probable criterion, foreign currency risk hedging transactions within groups, hedging transactions for non-financial instruments (mainly the hedging of portions) and the hedging of net positions (such as macro-hedging transactions).

Section 2 Intermediate approaches to measurement and related problems

Question 2

(a) Should the IASB consider intermediate approaches to address complexity arising from measurement and hedge accounting? Why or why not? If you believe that the IASB should not make any intermediate changes, please answer questions 5 and 6, and the questions set out in Section 3.

9. We believe that there is an immediate need to reduce the current complexity (see our response to Question 1). Like EFRAG we encourage the IASB to address complexity in reporting financial instruments, and we suggest it considers intermediate approaches to reduce complexity.

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10. However, we agree with EFRAG that adopting one measurement basis for all financial instruments will not always inevitably reduce complexity. In addition, we share EFRAG's view that it may be premature to decide that the long-term objective should be fair value for all financial instruments. In our view, a mixed-model should be favoured (see also our response to Question 9).

Question 2

(b) Do you agree with the criteria set out in paragraph 2.2? If not, what criteria would you use and why?

11. With one exception, we concur with the criteria the IASB specifies in paragraph 2.2 as those, which any proposed intermediate change/s must meet. We share EFRAG's comments on criterion 2.2(b) (i.e. "must be consistent with the long-term measurement objective") and we consider that it unnecessarily restricts potential practical solutions to acknowledge difficulties arising in the application of IAS 39.
12. We query the exclusion of proposals for beneficial changes, which have broad international and cross-economic sector support, solely on the grounds of inconsistency with the long-term measurement objective stated in Section 3 of the DP. Furthermore, as the practical experience of applying the interim solution will be essential in determining the need for, and nature of, long-term change, it would be unfortunate to limit the potential beneficial impact of that interim solution. For the selection of measurement attributes, we stress the importance of achieving a solution, which is coherent with the business models adopted.

Question 3

Approach 1 is to amend the existing measurement requirements. How would you suggest existing measurement requirements should be amended? How are your suggestions consistent with the criteria for any proposed intermediate changes as set out in paragraph 2.2?

Measurement requirements

13. We support a principles-based solution and as a matter of principle we also strongly support an accounting model that would allow the reflection of the existing business models applied to financial instruments. Therefore, we have a preference for approach 1, as it offers a mixed model for measurement. However, we think that under approach 1 there should be no choice for the measurement attributes, as the accounting should be driven by the business model.
14. As mentioned above, like EFRAG we favour a mixed-model (see also our response to Question 9). Instruments that are not measured at fair value should be measured at amortised cost.

Presentation requirements

15. Should the performance reporting standard result in only one performance statement, such result would justify the merger of the "fair value through profit or loss" and "available-for-sale" categories, so the results of this Discussion Paper cannot be considered in isolation from other IASB related projects. In particular, we agree with EFRAG that the current IASB project on Financial Statement Presentation should consider the issues detailed in paragraph 19 a) and 19 b) of the EFRAG Final Comment Letter to develop an appropriate approach to presentation. This would also justify further the removal of the "available-for-sale" category. Other IASB projects which we believe should be completed or considered in conjunction with this are the Fair value measurement project and the project on the revision of the Framework.

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Categorisation requirements

16. Regarding the suggestions in paragraph 2.9 (a) and 2.9 (b) to amend the existing measurement requirements, we are not convinced why one would favour reducing the number of measurement categories, except for the matter raised in paragraph 15 above and “loans and receivables” and “held-to-maturity” categories, where a principle based approach might achieve an easy merger of these two. Eliminating the restrictions in the use of the current “held to maturity category” and particularly the tainting rules would permit entities to better reflect the way they are managing certain debt instruments. In addition to this removal, enhanced transparency should be required for the transactions affecting this category.
17. We share the comments in paragraphs 23 and 24 of the EFRAG Final Comment Letter; in particular we believe that the complexity in the current reporting of financial instruments is mainly due to the existing extensive rules, rather than the number of categories. It is because we strongly believe that the accounting should be driven by the business models in place, that following a principles-based approach we suggest implementing a mixed model.

Embedded derivatives

18. As explained above, we believe that the optimal approach for reporting should foresee a mixed model, also for the reporting of some embedded derivatives. We agree with paragraph 26 of the EFRAG Final Comment Letter and encourage a move towards a more principles-based reporting. For the choice of measurement attributes, consideration should be given to the business models.

Reclassifications

19. If the accounting is driven by the business models, reclassifications should only be permitted when there has been an actual change in the business model or hedge accounting designation/de-designation. This is in line with paragraph 33 of the EFRAG Final Comment Letter where it is clear that the question of whether reclassifications are permitted should not arise if the categorisation approach is based on facts.
20. However, even with no choice for reclassifying, it would be useful to require clear disclosures when reclassifications take place, obliging management to back up the change in the business model, rather than limiting the reporting to the disclosures under current IAS 32.

In summary:

21. We believe that in order to reduce the complexity of IAS 39 further, there should be;
 - Consideration of the business model as the main driver of accounting;
 - Substantial reduction in the existing rules surrounding the reporting of financial instruments (including the review of the guidance on transferring between categories);
 - Special focus on reducing the complexity of hedge accounting.

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Question 4

Approach 2 is to replace the existing measurement requirements with a fair value measurement principle with some optional exceptions.

- (a) What restrictions would you suggest on the instruments eligible to be measured at something other than fair value? How are your suggestions consistent with the criteria set out in paragraph 2.2?
- (b) How should instruments that are not measured at fair value be measured?
- (c) When should impairment losses be recognised and how should the amount of impairment losses be measured?
- (d) Where should unrealised gains and losses be recognised on instruments measured at fair value? Why? How are your suggestions consistent with the criteria set out in paragraph 2.2?
- (e) Should reclassifications be permitted? What types of reclassifications should be permitted and how should they be accounted for? How are your suggestions consistent with the criteria set out in paragraph 2.2?

Approach 2

22. Approach 2 is based on the principle that financial instruments with highly variable cash flows are measured at fair value whereas financial instruments with a low variability of cash flows are measured at amortised cost.
23. While we consider the variability of cash flows of instruments under approach 2 as an interesting criterion for deciding on the measurement of financial instruments, the effect of this distinction on accounting for financial liabilities could be considerable since, contrary to the current requirements of IAS 39, those with highly variable cash flows would be measured at fair value. Moreover, defining what highly variable cash flows are might be extremely complex.
24. Other reasons why we are not supportive of approach 2 are:
- No major simplification for financial assets compared to the current requirements of IAS 39 or compared to a requirement distinguishing instruments managed on a variability cash flow basis;
 - For financial liabilities, if distinguished on the basis of the variability in cash flows, liabilities with an indexation feature generating highly variable cash flows would be measured at fair value. We are not in favour of measuring these financial liabilities at fair value, to the extent they are not trading liabilities. The principle of identifying and valuing embedded derivatives for financial liabilities is justified in order not to have to systematically fair value the host contracts. However, the guidance for identifying and accounting for embedded derivatives could be revised in order to achieve simplification and improve clarity on this area.

Furthermore, we consider that the application of approach 2 would disregard a principles-based approach and the importance of achieving a solution which is coherent with the business models adopted.

25. In our opinion, the optional exceptions envisaged under approach 2 would lead to complexity.

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26. We prefer approach 1 to approach 2, since the mixed model is kept under the proposed approach 1. However, we think that there should be no choice/option under approach 1 for the measurement attributes, if the accounting is driven by the business model. Our responses to Question 4 (b) - (e) are still relevant in the context of approach 1 and we have addressed most of these Questions in our response to Question 3.

Question 5

Approach 3 sets out possible simplifications of hedge accounting.

- (a) Should hedge accounting be eliminated? Why or why not?
- (b) Should fair value hedge accounting be replaced? Approach 3 sets out three possible approaches to replacing fair value hedge accounting.
 - (i) Which method(s) should the IASB consider, and why?
 - (ii) Are there any other methods not discussed that should be considered by the IASB? If so, what are they and how are they consistent with the criteria set out in paragraph 2.2? If you suggest changing measurement requirements under approach 1 or approach 2, please ensure your comments are consistent with your suggested approach to changing measurement requirements.

Question 6

Section 2 also discusses how the existing hedge accounting models might be simplified. At present, there are several restrictions in the existing hedge accounting models to maintain discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings. This section also explains why those restrictions are required.

- (a) What suggestions would you make to the IASB regarding how the existing hedge accounting models could be simplified?
- (b) Would your suggestions include restrictions that exist today? If not, why are those restrictions unnecessary?
- (c) Existing hedge accounting requirements could be simplified if partial hedges were not permitted. Should partial hedges be permitted and, if so, why? Please also explain why you believe the benefits of allowing partial hedges justify the complexity.
- (d) What other comments or suggestions do you have with regard to how hedge accounting might be simplified while maintaining discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings?

Response to Question 5 and Question 6

27. Like EFRAG, we do not think that hedge accounting should be eliminated. In addition, we note that businesses need to hedge non-financial items (including commodity risk in some non-financial contracts) which fall within the scope of other IFRS.

28. We are in favour of maintaining hedge accounting because:

- Hedge accounting enables hedging transactions to be reported in the accounts with due regard to the business model applied;
- Hedge accounting is necessary in the mixed model which we prefer;
- Hedge accounting is indispensable for reporting the hedging of non-financial instruments and future cash flows.

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29. In general, we favour simplifying the current hedge accounting rules by making them more flexible rather than expanding the use of fair value. Generalising the use of fair value would result mainly in two major disadvantages:
- Less comparability over time and between entities;
 - Allowing accounting arbitrage in some circumstances, in particular hiding losses by changing the measurement attribute of certain assets.
30. In addition, we agree that the fair value option as set out in IAS 39 is unsatisfactory in two respects, as already identified in the DP:
- The scope is limited exclusively to financial instruments, non-financial instruments are not covered by this option;
 - The requirements relating to designation and de-designation of this option need to be revised, as the current terms of the option do not address “mismatches” in a satisfactory manner. While the fair value option is necessary in the short term to resolve some of the existing difficulties, the options should not be considered as a substitute for hedge accounting requirements.
31. Partial hedges should be permitted. We do not necessarily think that the current requirements are that complex. We believe that it should be up to the reporting entity to demonstrate how the accounting adopted reflects the risk management policies.
32. We find some of the suggestions in the approaches to replace fair value hedge accounting too restrictive. We would welcome simplification of the documentation that is required; for example simplify the way the effectiveness of the hedge is documented and consider whether a qualitative test is needed at inception with a reassessment throughout the life of the hedging relationship. In addition a retrospective test would be made in order to determine if the factors enabling the documentation of the hedging relationship at inception are still met with respect of quantification of inefficiencies and stopping the hedging relationship if necessary.
33. We think that the approach in which the fair value option is amended allowing it to be applied to non-financial assets and liabilities and to specific risks or parts of the designated item and where entities are allowed to apply the fair value option after initial recognition and to redesignate the fair value option, should be explored further. We encourage the IASB to consider this approach further before any conclusions are reached on the best way forward.

Question 7

Do you have any other intermediate approaches for the IASB to consider other than those set out in Section 2? If so, what are they and why should the IASB consider them?

34. We think that there is a need for better and more relevant rules and disclosures rather than more rules and disclosures. It would be useful to review the practical application of IFRS 7, particularly in the light of the current market turmoil, and to assess the usefulness and necessity of all the required disclosures. See also our response to Question 3.

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Section 3 A long-term solution – a single measurement method for all types of financial instruments

Question 8

To reduce today's measurement-related problems, Section 3 suggests that the long-term solution is to use a single method to measure all types of financial instruments within the scope of a standard for financial instruments.

Do you believe that using a single method to measure all types of financial instruments within the scope of a standard for financial instruments is appropriate? Why or why not? If you do not believe that all types of financial instruments should be measured using only one method in the long term, is there another approach to address measurement-related problems in the long term? If so, what is it?

Question 9

Part A of Section 3 suggests that fair value seems to be the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments.

(a) Do you believe that fair value is the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments?

(b) If not, what measurement attribute other than fair value is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Why do you think that measurement attribute is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Does that measurement attribute reduce today's measurement-related complexity and provide users with information that is necessary to assess the cash flow prospects for all types of financial instruments?

Response to Question 8 and Question 9

35. As stated earlier, we suggest focusing on an appropriate solution in the short-term that works in practice and which could be, in an ideal case, the long-term solution. We do not believe this is the right time to reach conclusions on a long term solution.
36. We should seek to reflect, as far as possible, what businesses actually do. As businesses, including banks, are managed in different ways depending on the circumstances of their business model, that model should be a key consideration in deciding what measurement attribute to apply for all different types of financial instruments.
37. In addition, we do not believe that the use of a single method to measure all types of financial instruments within the scope of a standard for financial instruments is the most appropriate solution. In our view, a mixed-model should be favoured. We think that fair value may not always be the only measurement attribute appropriate for all types of financial instruments. We support a principles-based approach which follows the business models. The way instruments are managed should be taken into account, in particular whether financial instruments are managed on a cash flow basis.
38. Prior to determining whether the fair value measurement is appropriate for all financial instruments, there must be a clear and broadly accepted understanding of the term "fair value". In certain circumstances, current entry price may be more appropriate than exit value. For example, the current exit value of a derivative which is part of a hedge may be irrelevant when management has no intention of closing this position. However, we are not rejecting fair value totally as there are circumstances in which its use is fully appropriate and preferable.

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Question 10

Part B of Section 3 sets out concerns about fair value measurement of financial instruments. Are there any significant concerns about fair value measurement of financial instruments other than those identified in Section 3? If so, what are they and why are they matters for concern?

39. Appendix B of the Discussion Paper presents some of the practical difficulties that arise from fair value. It would be important resolving these issues before determining whether the general fair value measurement is appropriate of all financial instruments. We stress the importance of the business model as a key consideration for deciding what measurement attributes to apply. It is because we strongly believe that the accounting should be driven by the business models in place, and thus following a principles-based approach, that we suggest implementing a mixed model. See also our response to Questions 8 and 9. We also refer to our comment letter to the IASB on Fair Value measurement of 12 June 2007.

Question 11

Part C of Section 3 identifies four issues that the IASB needs to resolve before proposing fair value measurement as a general requirement for all types of financial instruments within the scope of a standard for financial instruments.

(a) Are there other issues that you believe the IASB should address before proposing a general fair value measurement requirement for financial instruments? If so, what are they? How should the IASB address them?

(b) Are there any issues identified in part C of Section 3 that do not have to be resolved before proposing a general fair value measurement requirement? If so, what are they and why do they not need to be resolved before proposing fair value as a general measurement requirement?

40. We think that on top of the business model considerations discussed above the key issue that needs to be resolved is the reliability of the measurement.

41. It would be appropriate to consider the outcome of the IASB project on the Framework, to ensure that there is a stable platform on which to base any measurement attributes as a general requirement. The best solution should be developed when the Framework is defined.

42. See also our response to Question 8 and Question 9.

Question 12

Do you have any other comments for the IASB on how it could improve and simplify the accounting for financial instruments?

43. We support paragraph 61 of the EFRAG Final Comment Letter. In our response to Question 3, we mention simplification of disclosures (better and more relevant disclosures rather than more disclosures) as an issue that needs to be considered further, for example by reviewing the application of IFRS 7. Like EFRAG, we think it is the right time to assess the usefulness and necessity of all the required disclosures, particularly in the light of the current market turmoil and lack of active markets for certain financial instruments.

44. Other issues that could be considered are derecognition – in a very rules-based model it is difficult to apply –; issues related to of the hedging of portions or non-financial items; the unit of account/unit of valuation issue; fair valuation of credit risk on portfolios of derivatives, fair valuation of financial liabilities and disclosures about liquidity risk and credit risk.

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45. In addition, the scope is also a significant issue in practice, as to which instruments are covered by IAS 39. Determining whether contracts related to non-financial items are “own-use” and therefore outside the scope of the standard is particularly complex. Further research on this topic would be helpful.