



June 30, 2010

Via website posting: <http://www.iasb.org/>

Re: Exposure Draft Comment: **Fair Value Option for Financial Liabilities (ED/2010/4)**

Dear Sir/Madam:

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to comment on the Exposure Draft: **Fair Value Option for Financial Liabilities (ED/2010/4)**. We believe that the exposure draft represents an important step towards replacement of IAS39.

We have also provided additional comments at the end of our responses for the purpose of expressing our views on certain related matters.

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?

Comments

CGA-Canada agrees with the proposal that for all liabilities designated under the fair value option, changes in the credit risk of the liabilities should not affect profit or loss. It is contended that it is, in fact, counter-intuitive to record gain when an entity's credit rating deteriorates and to record loss when it improves. The entity is not likely to realize the effect of changes in its credit risk if the liability is held until maturity and discharged as per the terms of the contract. It is neither necessary, nor desirable, to maintain symmetry between classification and measurement of financial assets and financial liabilities as these two elements of financial statements possess different attributes. Unlike financial liabilities, financial assets are not affected by the changes in the entity's own credit risk.

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?

Comments

In the interests of simplicity and consistency, any exception to the proposal discussed under Question 1 above is discouraged. We conceive that determination of a possible mismatch is highly subjective and, even if otherwise, as noted above, financial assets and financial liabilities have different characteristics and sensitivities to the changes in the entity's own credit risk.

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?

Comments

CGA-Canada agrees 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 because such presentation would facilitate inter-firm and intra-firm comparisons by segregating effects of changes in an entity's credit risk on profit or loss. The proposal will maintain sanctity of the profit or loss statement by excluding non-business transactions and enhance transparency, as well as reliability of the performance indicators computed on the basis of this statement.

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?

Comments

The one-step approach, instead of the two-step approach, is favoured, as the former is less intricate, more direct and effectively achieves the same results as the two-step approach. Also, all information provided under the two-step approach is readily available under the one-step approach. Little value is added by adopting the two-step approach instead of the one-step approach. We also harbour concern that the two-step approach may make some of the performance indicators calculated on the basis of profit or loss statement less reliable and less comparable.

Question 5

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

Comments

The one-step approach is preferable to the two-step approach for the reasons articulated in our comments to Question 4.

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?

Comments

CGA-Canada does not believe that the effects of changes in the credit risk of the liability should be presented in equity rather than in other comprehensive income. We believe that if such effects are presented in equity, rather than other comprehensive income, they will be obscured and the calculation of performance indicators based on the statement of comprehensive income will be misleading. We are hesitant to ascribe to the view that a change in a liability's risk represents wealth transfer between liability holders and equity holders, and contend that effort should be made to restrict equity presentation to reflect transactions with owners.

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?

Comments

CGA-Canada agrees that gains or losses resulting from changes in a liability's credit risk included in other comprehensive income should not be reclassified to profit or loss because such option of reclassification serves to defeat the objective of the main proposal in this exposure draft. Such reclassification would misrepresent net income as well as other comprehensive income in the year of reclassification. Instinctively, we are compelled to appreciate that what is improper accounting *ab initio* cannot be proper accounting *ex post facto*. We have not identified any circumstances when such reclassification would be desirable, except when an error in an earlier period is discovered in the calculation of effect of a change in the entity's own 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?

Comments

CGA-Canada is in general agreement with the proposal 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. However, we note that the said guidance calculates the amount of the change in fair value that is attributable to changes in a liability's credit risk by way of the residual method, and no distinction is made between the price of credit and the quality of credit. The price of credit is sensitive to liquidity in capital markets and could be an important determinant of fair value of a liability, as demonstrated by the recent period of credit constraint. It is believed that effects of changes in a liability's credit risk should be determined more precisely and should reflect only changes in the credit quality of the issuer. We believe that coalescing items such as changes in the price of credit due to changes in liquidity is problematic.

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?

Comments

CGA-Canada notes that the effective date for the recently issued IFRS 9 is January 1, 2013 and the Board's tentative plan is to require a single effective date for all the phases of IAS 39 revision. We also note that, at the behest of G20 leaders, the IASB has adopted an aggressive agenda and major convergence projects are planned to be completed by mid 2011. In that case, entities will have insufficient time before implementing the changes in accounting for financial instruments. We believe that, in view of the complexity of changes, operational challenges and required system changes, entities should be given more time for implementing these changes and preparing comparative statements.

Question 10

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

Comments

CGA-Canada agrees with the proposals related to transition requirements. We note that the IASB has not changed the classification and measurement approach in IAS 39 for financial liabilities. Also, the Board is proposing to retain the existing eligibility conditions in IAS 39 for the fair value option for financial liabilities. Therefore, it is appropriate that the exposure draft does not allow entities to make new designations or revoke its previous designations as a result of the proposals.

Additional Comments

CGA-Canada notes that the FASB expects to publish shortly a proposed Accounting Standards Update (ASU) on accounting for financial instruments containing proposals for a new comprehensive standard on financial instruments, including proposals on the classification and measurement of financial assets and financial liabilities, impairment methodology, and hedge accounting. We further understand that, under the FASB proposals, almost all financial assets and liabilities would be measured at fair value in the primary financial statements. We also note that FASB proposals will be at variance with the 'mixed measurement approach' advocated by the IASB. We further note that the IASB will use feedback received on FASB proposals when it considers how to reconcile any differences between IFRSs and US GAAP.

Admittedly, stakeholders are concerned that this approach will seriously hamper the progress of the financial instruments convergence project. Moreover, numerous constituents would have seen well the development of joint proposals over separate proposals that subsequently attempt reconciliation. The proposed approach is likely to delay the convergence of this standard and cause inconvenience to the preparers of the financial statements, particularly in the jurisdictions like Canada which have planned transition to IFRS during this period of major conversion initiatives by IASB and FASB.

Should you wish to discuss the contents of this comment paper or require further elaboration on any of the items presented herein, please do not hesitate to contact Kamallesh Gosalia at kgosalia@cga-canada.org or alternatively the undersigned at rlefevre@cga-canada.org.

Sincerely,

[Original signed by:]

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Vice-President, Research & Standards