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Mouvement des Entreprises de France MEDEF

A F E P

Association Française des Entreprises Privées

Financial Accounting Standards Board
Attn. Technical Director, File
Reference No. 1810-100,
401 Merritt 7
PO Box 5116
Norwalk
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USA

Paris, September 27, 2010

Re: *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*

We welcome the opportunity to comment on the FASB's exposure draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (the ED) presenting its approach for a new accounting model for financial instruments.

We do not, however, support the overall approach which consists in the use of fair value as the main measurement attribute for financial instruments.

It is our understanding that the FASB and the IASB were committed to working together towards a converged approach to the accounting for financial instruments. We are therefore surprised and disappointed that the ED's approach appears to be very different from the proposals the IASB has been developing, and we wonder how the two will be converged. Even though the model proposed by the IASB is still not satisfactory, it appears to us to be a better starting point as it has the merit of acknowledging that ***the Business Model has a key role to play in determining accounting principles.***

Major concerns about the fair value model in the ED

As stated in the alternative view to the ED, many financial instruments are held for payment or collection of their contractual cash-flows. We think that amortized cost is much more relevant than fair value in such cases. Furthermore, if the business model approach is considered relevant for the income statement, as it appears to be according to paragraph BC58, we cannot see any valid reason to come to a different conclusion for the statement of financial position. In our view, the FASB's proposals in this area will lead to meaningless information on the face of the statement of financial position and a great deal of confusion among users.

If one believes that the fair value of all financial instruments, even those accounted for at amortized cost, is useful information, then we believe that such information should be provided in the notes (which are, of course, an integral part of the financial statements), and not on the face of the statement of financial position. In our view, the main financial statements should reflect only the most relevant measurement attribute and should be as simply and clearly laid out as possible to facilitate the user's understanding

We are also sensitive to the arguments concerning the marketability of financial instruments as mentioned in the alternative view. We believe that one of the lessons learned from the recent financial crisis is that any unrealised gains arising from level 3 fair value measurements should no longer be recognised in the income statement, and that a cost exemption should be maintained for unquoted equities. Extending fair value to all financial instruments will inevitably lead to more complex valuations and ultimately result in many cases in unreliable, and arguably meaningless, information.

We also do not agree with the elimination of bifurcation for hybrid contracts as it leads to the fair valuing of the whole instrument, without reference to the business model. Host contracts (assets and liabilities) held and managed on a contractual-yield basis should be accounted for at amortized cost, as this is the most relevant measure for such items.

Our final major concern concerning fair value is that we note with regret that the FASB has decided not to deal with the change in an entity's own credit risk. We think that this is an issue that has generated more comment and controversy than any other issue related to fair value. In this respect, we appreciate the efforts made by IASB, even though we believe they do not go far enough, since we support a "frozen approach".

Other major concerns about the current FASB proposals

- ***Credit impairment of financial assets***: We encourage the FASB to consider the expected loss model that is currently being developed by the IASB. Even though it needs some improvement (to make it easier to implement), the IASB's model seems to us to be a better approach as it reflects the economics of the transaction by requiring the recognition of the initially expected loss over the life of the financial assets or portfolio of assets, and not at the outset. In this way, the premium added to the interest rate in the contract to cover such losses is treated consistently with the return.

  Nonetheless, we have some concerns about this model when it is applied to trade receivables, and we think that these should be scoped out as proposed in our response to the IASB exposure draft

  Extract from our response to the IASB ED on Amortised Cost and Impairment:

  Credit losses tend to be customer-specific, and many entities undertake credit checks before selling to them, thereby reducing the potential scale of losses. Actual losses will become apparent relatively quickly and can be dealt with as they arise. We do not think that the effort and cost involved in setting up statistical provisioning matrices, as suggested in paragraph B16 as a practical expedient, can be justified where credit checks are carried out. For these reasons, and as a practical expedient to deal with credit losses in these cases, we would suggest that the principle should be to recognise these receivables initially at the full transaction price unless there are specific indicators that the receivable will not be recovered.

On the contrary, where there is a large portfolio of homogenous receivables a reliable statistical data base could be used to set up a provision on an expected loss basis, but this should not be a requirement for all non-financial entities. We agree, however, that the expected loss approach will be relevant to sales involving significant credit terms.

- ***Reclassification and de-designation:*** We are very supportive of a business model approach, both for classification and measurement and for hedge accounting, since hedging is carried out for a business purpose. We therefore strongly disagree with any prohibition from reclassifying or de-designating a hedging relationship. Instead, in order to ensure that the Business model is faithfully depicted in the financial reports, reclassification or de-designation should be required each time the business model changes. This should be accompanied by appropriate disclosures.

- ***Equity method of accounting for investments in associates:*** We disagree with the change to the criteria for the use of the equity method of accounting that the FASB proposes as part of a standard on financial instruments. We believes that the right place to debate the accounting for investments in associates is in the context of the relevant accounting standard taking into account the Business Model and the purpose of such investments.

Nonetheless, we see some significant improvements

- ***Hedge effectiveness requirements***: We support the effort made relating to the effectiveness test, which we see as a step forward towards a model which more closely reflects the management of risk as it is actually carried out by entities. However we encourage the FASB to go further by also amending all other hedging provisions in such a way as to permit all the hedging activities of an entity to be reflected in its financial statements, without generating too heavy an administrative burden or unnecessary constraints. We thus suggest that the FASB work jointly with the IASB to provide solutions to major difficulties encountered today by preparers (such as in the areas of hedging portions of commodities, portfolio hedging and the hedging of future cash in- and outflows based on budgets)

  We also support the FASB’s decision to continue to permit entities to defer the changes in fair value associated with the time-value component of a purchased option, as it avoids undue volatility in net income.***Initial measurement***: We welcome the distinction made in order to make initial measurement consistent with the accounting for subsequent changes in accounting value. This distinction could also be usefully applied in a mixed model based on the business model.

- ***Use of recycling from OCI to net income:*** We strongly support the recycling of all fair-value changes that have been initially recognised in OCI, in order to ensure that all realized gains and losses arising upon sale and settlement are reflected in the income statement. .We therefore agree with the use of OCI for debt instruments as proposed by the ED, but we think that this treatment should be extended to all financial assets not held for trading. We think that it is a sound principle that all gains or losses resulting from management decisions should ultimately be reflected in the income statement, as an element of performance, and not just in other comprehensive income.

This is why we are opposed to the IASB's proposals to prohibit any recycling from OCI to net income for equity instruments measured at fair value through OCI (even though we agree that some equity instruments not held for trading should be measured at fair value through OCI to best reflect the business strategy).

Concerning this issue, we urge both the FASB and the IASB to undertake a comprehensive conceptual debate on what performance means and the best way to depict it in financial reporting. We strongly advocate the establishment of robust principles relating to performance, the use of OCI and recycling. The current piecemeal approach is unsatisfactory, although we do recognise that in this exposure draft the FASB has made an effort to explain the principles used to distinguish those changes in fair value that can be recorded first in OCI from those that should be recognised immediately in net income.

We hope the above will be of use to the FASB in its deliberations and would be very pleased to provide further information or explanations should they be required.

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