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Le Président

JFL/MPC
N° 493

PARIS, 18th September 2008

IASB
30 Cannon Street
LONDON EC4M 6XH
UK

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

Dear Sir / Madam,

I am writing on behalf of the Conseil National de la Comptabilité (CNC) to express our views on the above-mentioned Discussion Paper.

1. Priority should be given to the relevance of the accounting treatment.

The CNC is in favour of improvements which could be made to IAS 39 in order to make the standard easier to apply and to better reflect the economic substance of transactions.

The CNC considers that IAS 39 is indeed a really complex standard. Nevertheless, this complexity should be considered in relation to the subject matter dealt with, as accounting for financial instruments is by nature a complicated subject, because of the diversity of financial instruments on the one hand, and the diversity of management methods and "business models" on the other hand. If a certain amount of complexity for such a subject is inevitable, it should be said that complexity has been increased because the accounting models are not adapted to the management methods for these instruments. In particular, one of the sources of complexity comes from discrepancies between the required accounting treatment and the way the instrument is used.

In these circumstances, it remains vital to give priority to the relevance of the accounting treatment, relevance meaning that related accounting treatment is necessarily consistent with the way the transactions are managed.

2. Fair value is appropriate for certain financial instruments, but not for all.

The CNC is in favour of a mixed model of accounting for financial instruments, with certain instruments re-valued at fair value, like financial instruments held for trading, others being measured at cost, with recognition of impairment if appropriate, such as financial assets and liabilities managed on a cash flow basis without leverage features. The financial instruments managed on a cash flow basis refer to assets for which initial value is recovered by cash flows rather than disposal or transfer and to liabilities which are extinguished in a same way. Amortised cost is the measurement attribute which is the most appropriate for representing the return on these transactions and their cash flows.

The CNC is against the principle of measuring all financial instruments at fair value because the fair value measurement attribute is not suitable for all activities. The CNC considers that accounting models should not ignore the relevant "business models" and should take into account the way the instruments are managed, in particular when financial assets or liabilities are managed on a cash flow basis.

Moreover, this measurement approach introduces undue fluctuations without any economic justification into reported equity and earnings, which is detrimental to the interpretation of the financial statements and a potential source of systemic risk.

3. Genuine simplifications of IAS 39 with a view to adapting the standard to reflect management methods are necessary.

Certain requirements of IAS 39 which reflect the way transactions are managed should remain unchanged. Accordingly the requirements with respect to financial assets and liabilities held for trading and financial liabilities at amortised cost can be maintained without introducing any major simplifications.

Moreover, the CNC is in favour of maintaining the principles relating to hedge accounting made necessary by the mixed model, and for hedges of non financial items.

Nevertheless, genuine simplifications are necessary to make the standard less complex and better adapted to the economic substance of transactions. Simplifications and improvements are necessary with respect to accounting for :

- hedging of future transactions, with less stringent definition of highly probable transactions to include other transactions such as tendering transactions for which forward cover is available,
- foreign currency risk hedging transactions,
- hedging transactions for non-financial instruments (and in particular the hedging of commodity prices included in the prices of transformed products),
- and the hedging of net exposures (such as macro-hedging transactions).

Further, the CNC is in favour of maintaining partial hedges and allowing partial hedges for non financial contracts. The CNC considers that deleting partial hedges is not a satisfactory solution and does not lead to defining principles consistent with the way these transactions are managed.

Lastly, the CNC notes that the Discussion Paper only deals with issues relating to the measurement of financial instruments and certain aspects of hedge accounting. However, two other topics have been identified as a source of complexity in applying IAS 39. On the one hand, the breadth of the scope of IAS 39 which includes subjects relating to a wide range of different activities and is unclear as far as contracts to buy or sell non-financial items are concerned, is a source of difficulty. Consequently, the CNC suggests that further work be done on instruments to be included in the scope. On the other hand, the issues relating to the de-recognition of financial assets and liabilities also remain complex. The CNC welcomes the fact that further research on this subject will be carried out as part of the convergence policy with FASB.

We hope you find these comments useful and would be pleased to provide any further information you might require.

Yours sincerely

Jean-François Lepetit

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?

Whilst recognising that IAS 39 needs simplifying, the CNC also considers that certain of the standard's requirements should be maintained because they reflect the way that certain transactions are managed. By way of illustration, the CNC wishes to maintain the following categories of financial assets and liabilities :

- Assets and liabilities held for trading ;
- The categories of financial assets "loans and receivables" and "available-for-sale" ;
- Non-trading financial liabilities.

Other comments relating to the 'held-to-maturity' category are presented below on question 3.

Finally, to the extent that the accounting treatment should be consistent with the way transactions are managed, it is legitimate to consider the issues of recognition and measurement of derivative instruments managed on a cash flow basis. Whilst, it is consistent with this approach to account for these derivative instruments managed on a cash flow basis on an accrual basis, the CNC considers it inappropriate at this stage to reconsider the principle of measuring all derivative instruments at fair value. The CNC nevertheless notes that this principle involves fair valuing all hedged instruments (even those managed on a cash flow basis) or creating an accounting mismatch when hedged instruments are not fair valued. This is an additional source of complexity.

The issue of maintaining the requirements for hedge accounting and their simplification remains open in this context, in order to make application of the standard less complex and better adapted to the economic substance of transactions.

As mentioned below, the requirements that need being simplified relate to hedge accounting of future transactions meeting the definition of highly probable, foreign currency risk hedging transactions, hedging transactions for non-financial instruments (and in particular the hedging of commodity prices included in the prices of partially transformed products) and the hedging of jointly-managed assets and liabilities (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.*

The CNC welcomes simplifying measures provided that they give priority to the relevance of the accounting treatment with respect to the way the instruments are managed. The subjects of measurement and recognition in respect of hedge accounting are indeed topics that require research.

The simplification of IAS 39 makes it possible to maintain a certain stability in the principles of accounting for financial instruments according to the mixed model as is currently envisaged by IAS 39 and this is certainly beneficial for preparers, auditors and users.

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

We have the following remarks on the criteria in paragraph 2.2 relating to the objectives to be met for reducing complexity :

§ 2.2 a, As already mentioned above, relevance is a priority objective when considering any changes to a standard, to the extent that it enables a better adaptation of accounting treatment to the way transactions are managed.

§ 2.2 b, The CNC disagrees with the objective of increasing the number of financial instruments measured at fair value. The CNC does not think that this can be an objective in itself since the relevance of fair value as a measurement attribute for all financial instruments has not been demonstrated. Moreover certain subjects relating to fair value are still under discussion, such as how to measure fair value, and others have yet to be addressed, such as the fair value of financial liabilities and the consequences of measuring own credit risk.

§ 2.2 c, The CNC agrees that complexity must not increase. Nevertheless relevance is the priority objective and the issue of complexity cannot be considered separately from the latter.

§ 2.2 d, The CNC notes effectively that all changes to standards have a cost whether for preparers, auditors and users. Nevertheless the principal source of cost is linked to the fact that the standard is not adapted to the way transactions are carried out, which means that artificial documentation is sometimes necessary to meet its requirements. The positive effect of reducing this justification after the event will not be negligible.

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?

1. The CNC is in favour of maintaining the “held-to-maturity” category only if the anti-abuse rules relating to this category are eliminated (§ 2.10 of the Discussion Paper).

The CNC is in favour of eliminating the “held-to-maturity” category as currently defined, to the extent that it is little used, since the eligibility conditions for this category do not correspond to the way in which fixed-income instruments are managed, either in financial institutions or in industry and commerce because the anti-abuse rules are too restrictive. As mentioned in the IASB’s Discussion Paper, the “tainting” rules, which are an anti-abuse measure, are too restrictive. Moreover, the restrictions applicable to hedge accounting in this category (“held-to-maturity” assets cannot be hedged against interest rate risks) are not compatible with the way fixed-interest instruments are actually managed.

For this reason, the CNC thinks the elimination of this category should be considered, if these restrictions were to be maintained.

In this respect, the CNC has taken note of the proposal in paragraph 2.13 of the Discussion Paper to maintain the "held-to-maturity" category whilst replacing the "tainting" rules with appropriate disclosure requirements, but nevertheless considers it insufficient. This proposal should be accompanied by the elimination of the rule forbidding interest-rate risk hedging of held-to-maturity instruments.

Assuming that the held-to-maturity category is eliminated, this raises the issue of how to reclassify the debt instruments initially classified in this category.

Since the debt instruments initially eligible for the "held-to maturity" category are managed with a view to realising a return over a long period, a reclassification in the category of "loans and receivables" which already exists in IAS 39 would be justified.

In this category, the following financial assets managed on a cash flow basis would be accounted for :

- Loans and receivables which the holding entity has no intention to sell immediately or in the near term ;
- Debt instruments (quoted or not) acquired by the entity as a long term holding.

This classification is nevertheless conditional on making appropriate disclosures in the notes on sales and the income from these instruments. Where there is a sale or arbitrage the relevant disclosure should be made in the notes even though it is not currently required for this category of "loans and receivables". A disclosure indicating whether the instruments are traded on an active market (quoted or unquoted) should also be required.

2. The CNC is in favour of maintaining the "available-for sale" category (§ 2.11 of the Discussion Paper).

The CNC is in favour of maintaining the "available-for sale" category, to include those instruments which are neither in the "trading" category nor loans nor acquired debt instruments (quoted or not) which the entity intends to hold in the long term and therefore do not correspond to the rationale of accounting at amortised cost suited to instruments managed on a cash flow basis. The unrealised changes in value relating to these instruments, with the exception of impairment, should nonetheless not be recognised in profit or loss like realised gains.

The CNC is therefore not in favour of the proposal in paragraph 2.11. of the Discussion Paper which consists of eliminating this category of "available-for-sale" assets and classifying them as "trading" or in a category of "fair value through profit or loss".

However, one of the difficulties encountered in the utilisation of this "available-for-sale" portfolio for equity instruments is linked to the criteria determining whether there is a "significant or prolonged decline in fair value". In this respect, the CNC considers there is no justification for not allowing the reversal of impairment on equity instruments. Consequently, the CNC proposes that all impairment of these portfolios should be reversible as envisaged in the draft IFRS for SMEs standard.

3. The CNC is not in favour of measuring all instruments exchanged on an active market at fair value (§ 2.12 of the Discussion Paper).

The fact that an instrument can be exchanged on an active market should not determine its measurement basis as the business model should prevail over whether the instrument is quoted or not. In addition the notion of an active market is also under debate.

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?

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.

The CNC considers the variability of cash flows of instruments an interesting distinguishing criterion. The CNC would however point out that the effect of this distinction on accounting for financial liabilities would 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 are variable cash flows might be extremely complex.

The CNC notes that this approach based on the nature and characteristics of the instrument ignores the way the instruments are managed and the relevant "business models", and may introduce comparability issues.

Because of the consequences of this approach in particular for financial liabilities, the CNC is not in favour of introducing this distinction.

Our comments on the consequences of the approach set out in the Discussion Paper are presented below :

1/ The CNC considers that this approach does not introduce a major change for financial assets as compared to the current requirements of IAS 39 or as compared to a requirement distinguishing instruments managed on a cash flow basis from trading instruments.

- Trading assets which are usually instruments with very variable cash flows are in effect measured at fair value under current requirements.
- The current category of loans and receivables is measured at amortised cost.
- Arbitrage assets with a leverage effect are accounted for today in the "available-for-sale" category, which should be maintained.
- Finally, derivative instruments are measured at fair value.

2/ The CNC considers, with respect to financial liabilities, that trading liabilities should be distinguished from other liabilities. There is therefore the issue of liabilities with an indexation feature which can generate highly variable cash flows .

At this stage, the CNC is not in favour of measuring these liabilities, which are not trading liabilities, at fair value. Consequently, 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. In this respect, the CNC considers that the guidance for identifying and accounting for embedded derivatives should be revised in order to simplify this subject which is also considered complex.

(b) How should instruments that are not measured at fair value be measured?

The CNC considers that the instruments that are not measured at fair value would be measured at amortised cost with impairment as appropriate.

(c) When should impairment losses be recognised and how should the amount of impairment losses be measured?

The CNC is in favour of recognising impairment where there is a deterioration of the credit risk for financial assets in the "loans and receivables" category.

The CNC is in favour of maintaining the current requirements of IAS 39 for financial assets in the "available for sale" category including both equity and quoted debt instruments.

However, the standard should be amended to allow for the reversal of impairment of equity instruments classified in this portfolio where it is no longer justified.

(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?

The CNC is in favour of recognising changes in the value of trading portfolio financial instruments through profit or loss as is currently required by IAS 39.

Changes in the value of "available-for-sale" financial assets net of accrued income and excluding impairment should continue to be recognised through equity .

The CNC is in favour of recognising changes in the value of cash flow hedging derivatives in equity. The recognition of changes in the value of fair value hedging instruments in profit or loss should be maintained where the measurement of the risk of the hedged instrument is also dealt with through profit or loss.

(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?

The CNC is not in principle in favour of allowing portfolio reclassifications within a mixed model. The general principle should be to maintain the initial classification of the instrument. Where a trading instrument can no longer be exchanged because of the illiquidity of the market, the issue to be addressed is more one of measurement than of reclassification in another portfolio. Appropriate disclosures in the notes are required in the rare cases of market disappearance where assets are held in trading portfolios in these circumstances. Estimating criteria to evaluate market liquidity, especially in crisis period, need to be further examined by the IASB.

Nevertheless, if the IASB Board persists in asserting that even when market are inactive, current transaction price normally provides the best evidence of fair value, the CNC considers that fair valuing the illiquid trading instruments as such is not appropriate, and portfolio reclassifications should be permitted.

Question 5

Approach 3 sets out possible simplifications of hedge accounting.

(a) Should hedge accounting be eliminated? Why or why not?

The CNC is in favour of maintaining hedge accounting because :

- hedge accounting enables hedging transactions to be reported as such in the accounts ;
- hedge accounting is necessary in the mixed model supported by the CNC ;
- hedge accounting is indispensable for reporting the hedging of non-financial instruments and future cash flows.

(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?

The CNC examined the three methods proposed by the IASB in its Discussion Paper.

1/ The CNC considers that the Discussion Paper's proposal to make the fair value option more flexible could not be a substitute for hedge accounting, although it may nevertheless prove useful in certain cases (§ 2.40 of the Discussion Paper).

More generally, the CNC would like hedge accounting rules to be made more flexible rather than facilitating the use of the fair value, which has two major disadvantages :

- the first is that this option is detrimental to comparability over time and between entities,
- and the second is that this option would permit accounting arbitrage and may be seen as a means of hiding losses through changing the measurement attribute of certain assets.

In addition, this fair value option as set out in IAS 39 is unsatisfactory in the two following respects :

- the scope is limited exclusively to financial instruments, non-financial instruments are not currently eligible for this option. This point is moreover identified by the IASB in the Discussion Paper ;
- the requirements relating to designation and de-designation of this option need revising, as the current terms of the option do not address "mismatches" in a satisfactory manner. This point is also identified by the IASB in the Discussion Paper.

Nevertheless, in spite of these reserves, the CNC is well aware that this option is necessary in the short term to resolve certain difficulties but is in no case a substitute for hedge accounting requirements.

More precisely, the position of the CNC with respect to the three propositions of the IASB is as follows.

1. With respect to the possibility of extending the fair value option to non-financial instruments, the CNC is indeed in favour of more flexibility in accounting for the hedging transactions of non-financial instruments. The CNC would prefer the requirements for hedge accounting for parts of a risk to be introduced for non-financial instruments rather than introducing flexibility through an option.

2. With respect to the proposed possibility of making the fair value option applicable to parts of a risk, the CNC is also in favour of having the possibility of breaking down the risks of an instrument into components, but considers it preferable to make hedge accounting more flexible, in particular for non-financial instruments, rather than providing more flexibility in the fair value option as proposed.

3. With regard to the third proposal for introducing more flexibility into the fair value option by making it applicable at any date after initial recognition, it would in particular enable a certain number of "mismatches" between financial assets and liabilities to be resolved. To make the resolution of "mismatches" complete, the option would have to be applicable as soon as a mismatch requiring resolution occurs, and would have to cease as soon as the mismatch has been resolved. In this case an appropriate disclosure should be made in the notes. In conclusion, the CNC considers that a more flexible fair value option, as proposed in the Discussion Paper, could not be a substitute for hedge accounting but may be useful in certain cases, in particular in the three points identified above.

2/ The CNC is not in favour of the second proposal of the IASB (§ 2.44 of the Discussion Paper).

This proposals consists of measuring all financial instruments at fair value, certain instruments through profit or loss (derivatives and trading), others through equity, whilst hedged instruments would retain their initial classification.

The CNC considers that this solution would make it harder to interpret the accounts, as it would generate an important volatility in equity of an artificial nature because it is not representative of hedging.

3/ The CNC is not in favour of the third proposal of the IASB (§ 2.49 of the Discussion Paper).

The CNC considers that this approach is not acceptable because it consists of measuring all financial instruments at fair value with a resulting volatility of equity and earnings that is detrimental to users of financial statements.

(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.

The current requirements of IAS 39 with respect to hedge accounting cause difficulties and need improving.

The CNC suggests that hedging of portions of non financial instruments should be dealt with in the standard as this possibility exists for financial instruments. By way of example, IAS 39 does not allow the hedging of the commodity price included in the price of a non-financial contract where the price covers both commodity price and transformation costs, or if the contract contains an indexation formula based on the commodity price. The hedging of these risks is a common practice for entities which use raw materials that have undergone one or more transformations.

With regard to the hedging of future transactions, the conditions for making these future transactions eligible for hedge accounting could be made more flexible allowing for instance hedge accounting when the derivative financial instruments used is contingent to the transaction, i.e. comes into force only if the future transaction arises even if the hedged transaction cannot be considered highly probable according to the actual IAS 39 rule.

Moreover, as current documentation obligations often do not reflect the economic reality of hedging transactions, the CNC suggests that these requirements should be revised. The conditions for measuring effectiveness are considered difficult to apply and sometimes removed from the reality of the transactions. As a possible simplification, the CNC is in favour of a qualitative demonstration of retrospective effectiveness based on qualitative tests where there is no evidence of ineffectiveness. As the CNC is in favour of hedge accounting for risk components, the effectiveness of the hedging relationship with respect to the hedged component must be measurable.

Lastly, there are real difficulties in accounting for a future net currency position. The standard does not allow hedge accounting of a net currency position even though this is a current practice in group treasury management. The non recognition of this practice gives rise to numerous operational problems when groups wish to translate into their accounting the reduction of their exchange risks. This subject could be dealt with by further research.

Similarly, if hedged transactions could be recognised at the price guaranteed by a derivative this would simplify hedge accounting.

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?

The CNC is in favour of reducing documentation obligations and in particular quantitative effectiveness tests.

(b) Would your suggestions include restrictions that exist today? If not, why are those restrictions unnecessary?

Each of the proposals of the Discussion Paper has been examined by the CNC which makes the following remarks on each one of them :

- Designation et documentation (§ 2.57 and seq.) :

  The CNC welcomes the research undertaken to make the standard more flexible in this respect.

- Dedesignation and redesignation (§ 2.62 and seq.) :

  The CNC welcomes this proposal even though this aspect is not a priority, as dedesignations and frequent redesignations do not reflect the way these transactions are managed.

- Effectiveness assessment and recognition of ineffectiveness (§ 2.77 and seq.) :

  As a simplification, the CNC is in favour of eliminating retrospective quantitative effectiveness tests but only where there is no evidence of ineffectiveness. In all cases, changes in fair value of hedging instruments and the risk portion of the hedged item will be calculated separatly and recognized in the accounts so as to present ineffectiveness in earnings.

- Portfolio hedge accounting (§ 2.88 and seq.) :

  The CNC welcomes an examination of the requirements for portfolio hedging. To the extent that all of the items in the portfolio have similar risk components, hedge accounting for these components is justified.

- Reclassification to earnings of deferred gains and losses (for cash flow hedge accounting only) (§ 2.91 and seq.) :

  The CNC is not in favour of defining a date, fixed when the hedge is implemented, at which the hedged transaction is expected to occur, so that recycling takes place according to this forecast without reference to the actual transaction. The CNC considers that this measure is likely to increase complexity because of the difficulty of following up and reconciling cash flows from actual and forecast transactions. Moreover, this modification would not be consistent with groups' hedging practices.

- Others issues (§ 2.96 and seq.) :

  The CNC supports the choice of fair value or cash flow hedge accounting for a hedge of the foreign currency risk of a firm commitment.

  The CNC would be in favour of maintaining the "basis adjustment" requirements.

(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.

- Partial hedges (§ 2.65 and seq.) :

  The CNC is not in favour of eliminating partial hedges. The CNC considers that elimination is not a satisfactory solution and does not lead to defining principles consistent with the way these transactions are managed.

  By partial hedges, the CNC means the hedging of parts of risks as well as the hedging of specific periods.

  The elimination of partial hedging would be tantamount to rejecting the basic principles of hedge accounting for instruments covered by derivatives. Effectively, derivative instruments are generally used to hedge market risks such as interest rate and foreign currency risks. An interest rate swap is used to cover interest rate risk (but not credit risk). Hedged instruments usually have components of risk which are not hedged by derivative instruments. The principles of partial hedging optimise the reporting of the hedging of related risks.

Furthermore, the elimination of the partial hedging principle would lead to an artificial increase in ineffectiveness, which is unsatisfactory.

Finally, the CNC believes that partial hedging should be extended to non-financial instruments to enable hedge accounting to apply to raw material prices.

(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?*

As already indicated above, improvements are required for :

- hedging of future transactions, with less stringent definition of highly probable transactions allowing for instance hedge accounting when the derivative financial instrument used is contingent to the transaction, i.e. comes into force only if the future transaction arises even if the hedged transaction cannot be considered highly probable according to actual IAS 39 and hedge accounting of tendering transactions for which forward cover is available,
- foreign currency risk hedging transactions,
- hedging transactions for non-financial instruments (and in particular the hedging of commodity prices included in the prices of transformed products),
- and the hedging of net exposures (such as macro-hedging transactions).

  On this last point, the CNC would support a principle-based hedge accounting system that would allow a portfolio of financial instruments to hedge the net exposure on a portfolio of instruments.

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?

As already mentioned above, the CNC is in favour of simplifying hedge accounting principles and in particular of reducing documentation obligations and quantitative effectiveness testing.

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?

The CNC is opposed to the principle of measuring all financial instruments at fair value because the fair value measurement attribute is not suitable for all activities. The CNC considers that accounting models should not ignore business models and should take into account the way the instruments are managed, in particular when financial assets and liabilities are managed on a cash flow basis.

Whilst measurement at fair value through profit or loss is suitable for trading instruments, it is questionable whether this model is suited to financial instruments managed on a cash flow basis. By instruments managed on a cash flow basis, we mean financial instruments without leverage features. For the latter, measurement at amortised cost better translates the management view and facilitates comparison between entities.

The fair value measurement basis can also be a source of complexity when instruments are not traded in a liquid market as illustrated by the recent market liquidity crisis.

Lastly, the measurement of financial debts at fair value raises the question of measurement of the the issuer's own credit risk. The CNC is not in favour of this valuation item being recognised. The recognition of profits when the credit spread is degraded is a counter-intuitive and unhelpful presentation for both management and other users of financial statements. Moreover, the entity is not generally in a position to realise these profits. Lastly, the measurement of own credit risk is problematic for unquoted entities which are not issuers and which do not have a credit rating.

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?*

The CNC disagrees with the assertion that fair value is the only appropriate measurement attribute for all financial instruments. Whilst this measurement attribute appears suitable for financial trading instruments and derivatives, its superiority has not been demonstrated for instruments generating regular cash flows without leverage features and for which cost, taking into account possible impairment, is equally suitable.

When the business model of an entity is not based on the short term trading of financial instruments but on the creation of long term cash flows, measurement at amortised cost provides a more relevant presentation of the entity's activity.

Subsequent measurement at fair value generates volatility of earnings and equity which is unhelpful to users of financial statements where the unrealised profits or losses on instruments held to their maturity are not ultimately realised.

This volatility can amplify the effect of economic cycles and create systemic risk.

(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?*

Cf. response to the above questions.

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?

The limits of the fair value model should not be ignored, on the one hand for complex financial instruments and on the other hand in periods of market crisis.

As an illustration, for complex financial instruments, issues relating to whether an active market exists, to models (standard versus entity- specific), to the quantifying of model risk or as to whether it is necessary to define rules in this respect, should not be ignored.

The CNC encourages the IASB to continue thinking about the fair value measurement of financial instruments. The IASB should continue to have technical discussions with constituents about estimating criteria to evaluate market liquidity, especially in crisis period.

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?*

As already mentioned, the CNC considers that de-recognition of financial assets and liabilities and subjects related to non-financial instruments should also be addressed as a priority.

A simplification of the guidance for identifying and accounting for embedded derivatives, necessary in particular for maintaining measurement at amortised cost for host contracts of unhedged financial liabilities with embedded derivatives should also be considered.

(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?

Whilst in disagreement with the IASB's long term objective of generalising fair value, the CNC considers that the four themes identified by the Board require further research.

Question 12

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

The CNC has no further comments.

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