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Le Président

JFL/PB

N° 24

PARIS, 3 APRIL 2009

Financial Crisis Advisory Group

Re: Financial Crisis Advisory Group (FCAG) seeking input from constituents – set of questions

Dear Sir or Madam,

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

The Financial Crisis Advisory Group (FCAG) issued on 10 March 2009 a set of seven questions in order to seek written input from constituents in the form of responses to these questions. This input will assist the FCAG in discussing accounting and reporting matters related to the financial crisis and making recommendations thereon to the IASB and FASB.

The CNC fully supports the objective of the FCAG to 1) consider how improvements in financial reporting could help enhance investor confidence in financial markets, 2) help identifying significant accounting issues that require urgent and immediate attention of the boards, as well as issues for longer-term consideration.

The CNC believes that one of the most important questions to be raised is the ability of general purpose financial reporting to provide to investors in a timely manner appropriate information on risk exposures as well as an appropriate assessment of resulting losses. When trying to answer this question, one should have in mind that many investors make their decision with a medium and long term perspective.

Many analysts of the financial crisis agree that the worst risk taking decisions happened in 2005 and 2006 until mid-2007. However, during this period, neither IFRS nor US GAAP gave appropriate signals on risks taken and on related expected losses they would entail. Therefore, one of the main avenues for improving financial reporting would be to consider changes in accounting frameworks that would result in a more complete and timely representation of risk exposure and recognition of related losses. In this respect, the CNC considers that the following avenues should be explored:

- Review, and replace or complement the current incurred loss approach used to determine impairment related to credit risk with the objective to ensure completeness and timeliness of credit loss recognition;
- Continue to develop reflection and work about the best way to measure fair value that would include time horizon of the holding and management of related instruments and their consequences in terms of risk exposures;
- Revise in the medium term the accounting categories related to financial instruments to ensure that valuation based on quoted prices are applied only to financial instruments that are in practice effectively negotiated by the entity on active markets;
- Provide appropriate information about risk exposure regarding off-balance sheet items and related risk exposures, especially when special purpose entities are concerned;
- Select the most significant and useful information to be disclosed and organise their presentation in order to make them more relevant and understandable, rather than providing more and more disclosure.

The CNC is also convinced that a “fast track” procedure is definitely useful. However it should be flexible and decided on a case-by-case basis after either the Monitoring Board’s or the Trustees’ intervention.

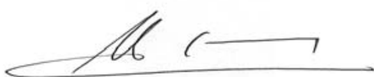
The CNC considers that financial stability-related issues are not necessarily different from those related to financial reporting, as long as information needs of long term investors are taken into account. Constructive dialogue with authorities in charge of prudential supervision or financial stability could therefore help identifying in which areas and to which extent common objectives could be shared.

Finally, the CNC considers that including own credit risk changes in the fair valuation of financial liabilities could result in counter-intuitive information. This issue should be addressed.

Further details are provided in the Appendix I to this letter.

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

Yours sincerely,



Jean-François Lepetit

Appendix I

Question 1. From your perspective, where has general purpose financial reporting helped identify issues of concern during the financial crisis? Where has it not helped, or even possibly created unnecessary concerns? Please be as specific as possible in your answers.

To our opinion, this question should also encompass the ability of general purpose financial reporting to identify issues of concern before the financial crisis.

Assuming that the main objective of general purpose financial reporting is to provide information to present and potential investors who do not have other privileged access to financial information, one of the most important questions to be raised is the ability of general purpose financial reporting to provide to investors in a timely manner an appropriate information on risk exposures as well as an appropriate assessment of resulting losses. When trying to answer this question, one should have in mind that many investors (both shareholders and creditors) make their decision with a medium or long term perspective. In such a respect, reflecting the financial situation of an entity only as a flash picture of the immediate state of play may not appear sufficient.

Numerous analyses undertaken since the beginning of the financial crisis in order to identify and understand the causes of the crisis point out that wrong assessment of risk exposure and underestimation of their expected negative consequences in terms of losses is one of the main causes of the financial crisis. It brought investors, including financial institutions, to accumulate excessive risk exposures and leverage through the acquisition of assets and derivatives contracts whose value and quality was assessed on the basis of a too optimistic view of their risk components. This was particularly the case when credit and liquidity risks were concerned.

This wrong assessment of risk exposure and related expected losses is the result of a number of reasons and factors. Many stakeholders may be blamed for having contributed to this situation. The financial crisis may be seen as the result of the combination of multiple misbehaviours and failures of economic actors to appropriately assess risks and prevent resulting losses.

Many analysts of the financial crisis agree that the worst risk taking decisions happened in 2005 and 2006 until mid-2007. During this period neither IFRS nor US GAAP gave appropriate signals on risks taken and on related expected losses they would entail (although there are some differences between these frameworks, for example in the accounting treatment of impairment tests or consolidation of securitization vehicles). Therefore, accounting weaknesses cannot be considered as mainly related to one specific framework.

The wrong assessment and misrepresentation of risks can be noted whatever the valuation approach used, i.e. both when amortized cost or fair value measurement approaches are concerned.

In the current amortized cost measurement approach in place under IAS 39, impairment tests on credit risk are based on an incurred loss approach that requires the identification of objective evidence of impairment before recognising a loss. When analysing practices in areas that appeared to be major vectors of the crisis (such as the sub-prime loans market), one may note that recognition of credit losses could be delayed by contractual schemes and business practices that aimed at – and in practice succeeded in – delaying the occurrence of objective evidence of impairment (such as occurrence of a default in payments), although the credit risk inherent to the transactions concerned was obviously high. This may question the ability of accounting for impairment based on an incurred loss approach to appropriately reflect credit risk and provide useful information to investors on this kind of risk in a timely manner.

In the current fair value measurement approach, the fundamental statement is that the best evidence of fair value is quoted prices in an active market, when the amount does not reflect a

forced transaction, involuntary liquidation or distress sale. Although this statement is generally considered as fully relevant for the measurement of financial instruments that are "held for trading"[1], it has also been applied to determine the fair value of many other financial instruments which were not actively traded by the entity in the short term (available-for-sale assets, instruments designated as at fair value through profit or loss to avoid accounting mismatches or difficulties to separate embedded derivatives, derivatives held to maturity or used for economic hedge but not eligible to hedge accounting,…) and in some cases not traded at all (only at inception with no real secondary market). In fact, until recently[2], the notions of inactive market and distress sale were understood in practice in a very restrictive way. Therefore, most transactions resulting in setting a price were considered as providing a market price. This resulted in using many transactions prices as reference of quoted prices, although few corresponded to transactions realised in the context of assets actively negotiated in a short term perspective. This may raise questions about the ability of quoted prices generally determined by market participants who are managing their business with a short term perspective to appropriately reflect the fair value of financial instrument held beyond a short-term horizon including the fair value of their related risks (especially, credit risk, liquidity risk, volatility risk).

The financial crisis – as well as the preceding financial and real estate bubbles – also evidenced pro-cyclical attitudes of market participants who seem to be over-optimistic in good times (and therefore over-evaluating traded assets at these times) and over-pessimistic in bad times (undermining the value of traded assets at these times). Normally, fair value reflects the amount for which a transaction can be settled between knowledgeable willing parties. This presumes that these parties are well informed before concluding the transaction, which should prevent pro-cyclical attitudes. The problem is that investors who have no privileged access to financial information outside the general purpose financial statements rely mainly on accounting figures to make up their mind in such a respect. If accounting figures are based on quoted prices, they reflect assumptions of market participants themselves about the fair value of traded assets. This kind of information appears therefore circular and may not prevent wrong assumptions about the fair value of a traded asset and related risks. It may also not provide the opportunity to correct them. Therefore, this circularity of information based on quoted prices may have contributed to pro-cyclical effects by providing a self-confirmation of wrong assumptions. In order to avoid these self-confirming and pro-cyclical effects, sources of information used to determine fair value should not be based solely on quoted prices.

As a conclusion, the main issues identified during (and before) the financial crisis when general purpose financial reporting are concerned is the appropriateness and timeliness of the information provided to investors on risk exposures and related losses. In such a respect, the following avenues should be explored:

- **Review, and replace or complement the current incurred loss approach used to determine impairment related to credit risk**; Alternative approaches to the current incurred loss model may currently be designated as "expected loss" or "dynamic provisioning" approaches, depending on how they are defined – see answer to question 2;
- The implementation of new approaches should ensure the completeness of losses recognized in the Financial Statements and the timeliness of their recognition. this review should also include the question of harmonising impairment tests applied to Available-For-Sale assets (debt securities and loans) with those applied to loans and receivables and to Held-To-Maturity assets in order to provide impairment losses that are comparable and equally appropriate in terms of completeness and timeliness;

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[1] i.e. acquired or incurred principally for the purpose of selling or repurchasing them in the near term or managed together in a portfolio for which there is evidence of a recent pattern of short-term profit-taking

[2] in fact until the SEC Office of the chief accountant and the FASB staff issued "clarifications on fair value accounting" on 30 September 2008, the three French supervisory authorities (AMF, Commission Bancaire and ACAM) jointly issued with the French standard setter (CNC) a recommendation on fair value measurement of certain financial instruments on 15 October 2008, and the IASB issued "educational guidance on the application of fair value measurement when markets become inactive" on 31 October 2008

- **Continue to develop reflection and work about the best way to measure fair value** beyond what has already been done in guidance issued on 30 September by the SEC/FASB and 31 October 2009 by the IASB, which scope is limited to particular circumstances; the additional work currently undertaken by the FASB on not active markets and not distressed transactions is of interest in such a respect; furthermore, analysis should be undertaken to define a "value in use" that could take into account time horizon of the holding and management of related instruments and their consequences in terms of risk exposures and expected related losses (see answer to question 4);
- Complementary to this reflection, the issue of the non-reversibility of impairment related to Available-For-sale equity instruments should be addressed;

- **More generally, the accounting categories related to financial instruments should be revised in the medium term** (see answer to question 4);
- Valuations based on quoted prices should be limited to financial instruments that are in practice effectively negotiated by the entity on active markets; the characteristics of these kinds of financial instruments (standardised enough to be comparable, exchangeable and fungible on markets) as well as the related active markets (organised or regulated markets with systems that guarantee the settlement of transactions, sufficient regular transactions that may be organised by market makers, existence of a secondary market…) should be clearly defined;
- This implies the possibility under well defined conditions that financial instruments may be reclassified in order to take into account changes in their effective management in relation with changes in the economic environment; this should be done following the same logic as the Reclassification amendment adopted in October 2008 when objective events can justify such reclassification;

- **Appropriate information about risk exposure also includes question regarding the consolidation scope** of a parent entity and whether a risks and rewards approach should be used, at least complementary to a control approach, when special purpose entities are concerned; in IFRS the current provisions of IAS 27 and SIC 12 have not been significantly questioned during this crisis and we may wonder if they have to be changed in the short term; there seems to be more room for improvement when disclosure on off-balance sheet items and related risk exposures are concerned; in this respect work currently in progress within the IASB should continue (see answer to question 3);
- Similarly derecognition issues raise concerns; the current debate on securitizations should result in a continuing assessment of the remaining risk exposures and an appropriate representation of these risks in the financial statements, as well as in transparent disclosures (see answer to question 3);); We will develop further comments when replying to the ED on derecognition of financial instruments.

- **Finally, one may wonder if appropriate information of investors could be achieved by developing and enhancing disclosure** related to all the above mentioned issues; this may be investigated further (especially on off-balance sheet items); but we should have in mind that enhancing disclosure should not necessary mean adding new disclosure requirements; disclosure has already been developed to a very large extent with the implementation of IFRS; instead of providing more and more disclosure, that appears finally confusing and may discourage readers to use them, we should rather try to develop approaches that help to select the most significant and useful information, which may depend on changes in the economic environment, and that also help to organise the presentation of disclosure in order to make it more relevant and understandable.

Question 2. If prudential regulators were to require 'through-the-cycle' or 'dynamic' loan provisions that differ from the current IFRS or US GAAP requirements, how should general purpose financial statements best reflect the difference: (1) recognition in profit or loss (earnings); (2) recognition in other comprehensive income; (3) appropriation of equity outside of comprehensive income; (4) footnote disclosure only; (5) some other means; or (6) not at all? Please explain how your answer would promote transparency for investors and other resource providers.

Before envisaging loan provisions methods that would be imposed by prudential regulators, we should first consider which changes to the current accounting requirements need to be made in order to enhance information provided to investors.

The following points may be highlighted in such a respect:

- The requirement to identify an objective evidence of impairment before recognising a loss implies that the explicit recognition of the credit risk will be done in a late stage compared to the whole duration of the lending transaction; however, the credit risk exposure begins as soon as the loan is granted and the lender is completely committed in being exposed to this risk from the beginning and until maturity; this risk is generally charged to the borrower from the beginning, as a component of the interest rate;

- This requirement to identify an objective evidence of impairment may delay the recognition of credit losses in the financial statements;

- The importance of the risk is assessed in relation to the duration of the loan (generally the longer the duration, the higher the risk) and the pricing of the credit risk is in principle based on such an analysis. Risk premiums are generally recognised as income on an accrual basis, whereas credit losses which they are supposed to offset will be recognised later; this creates a timing mismatch between the recognition of the revenue and the related expense;

- Exposure to credit risk is generally concentrated in specific types of entities (financial institutions), whose core business is to grant loan and manage the related credit risk; in particular, they have developed experience in mitigating this risk on large number of borrowers; therefore, their loan portfolios expose them to a global credit risk that is almost certain, while the probability of credit risk on each loan granted remains low[3].

In order to improve information provided to investors on credit risk, which is within the objectives of general purpose financial statements, it seems justified to analyse alternative accounting mechanisms in order to provide a more timely recognition of credit losses.

These alternative mechanisms could use information from the internal robust and reliable credit risk assessment systems that have already been developed by the entities concerned for regulatory purposes (prudential expected losses approach) but also – and in priority – for their own needs to consistently assess and price credit risk. In any case, these entities are generally obliged to develop internal control and audit procedures to check the robustness of their internal credit risk assessment systems (regulations on internal control), which are also normally reviewed by prudential supervisors and to some extent by external auditors.

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[3] this reasoning is similar to the one used in paragraph 24 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* when obligations are concerned "Where there are a number of similar obligations…the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognised"

The IASB developed in 2002 a proposal to amend IAS 39 that included at that time draft provisions on impairment that were consistent with an expected loss approach as would result from the mechanism proposed (see extract of the IASB 2002 Exposure Draft in appendix 2). An exposure draft was developed by the CNC at the time the IASB published its proposal. It was aiming at implementing for French GAAP purposes an impairment test consistent with the IASB proposal. Its main provisions were:

- Normally, no recognition of impairment at inception, as expected losses were supposed to be offset by an appropriate credit risk premium charged to the borrower in the contractual interest rate;
- Revenues recognised on an accrual basis in relation to the credit risk premium would be put aside through an "expected loss" provision equivalent to the corresponding credit loss not yet recognised;
- The "expected loss" provision would be released to the extent of credit loss recognised in later periods upon default of the borrowers and at the latest when the loans concerned are fully repaid.

The IASB's 2002 proposal as well as the CNC's work could be used as a basis and input for new developments in this respect.

Assuming that such information meets the objective of the general purpose financial statements, we consider that it would be appropriate to recognise it in (1) the profit and loss (earnings). This recognition procedure will also prevent a timing mismatch between the recognition (as a revenue on an accrual basis) of the credit risk premium included in the interest rate charged to the borrower and the recognition of the related credit loss.

The need expressed by users to distinguish between the current incurred losses and the expected losses recognised through the implementation of the new mechanism would imply that, these two kinds of impairment should be distinguished in the accounts.

This proposed change in accounting provisions related to the representation of credit risk and related losses in the general purpose financial statements may also address part or all the information needs of prudential regulators. If prudential regulators were to require additional provisions beyond those resulting from this proposal, it would worth that the FCAG, or the IASB and FASB, discuss with prudential regulators to understand the nature of these additional requests. Users of general purpose financial statements should also be consulted on their interest to have access to this kind of information and – if they are interested – through which kind of information channel (presumably to be chosen between solutions (3), (4) or (5)).

Question 3. Some FCAG members have indicated that they believe issues surrounding accounting for off-balance items such as securitisations and other structured entities have been far more contributory to the financial crisis than issues surrounding fair value (including mark-to-market) accounting. Do you agree, and how can we best improve IFRS and US GAAP in that area?

No. The importance of the off-balance sheet issue in the financial crisis may depend of the accounting framework concerned. It is likely a more significant issue in US GAAP, especially when special purpose entities are concerned. Therefore, we consider of particular importance that any development in this area should be undertaken through a joint-work between the IASB and the FASB

As far as IFRSs are concerned, our impression is (as noted in answer to question 1) that the current provisions of IAS 27 and SIC 12 have not been significantly questioned during this crisis and we may wonder if they have to be changed in the short term. We think that there seems to be more room for improvement and more urgent needed changes when disclosure on off-balance sheet items and related risk exposures are concerned. In this respect work currently in progress within the IASB should continue. Our views have been expressed in the recent answer (20 March 2009) we sent to the IASB on ED 10 *Consolidated Financial Statements*. Please find below some extracts from our letter:

"The CNC strongly supported the IASB in its efforts to address as a matter of priority certain elements of the project, such as the additional disclosures, as these are urgently required by users of financial statements in the context of the global financial crisis.

The CNC is far less convinced that the same urgency applies to the reconsideration of the control model as, even if certain inconsistencies could be perceived between IAS 27 and SIC 12, the implementation of these standards was globally satisfactory and their revision is therefore less urgent.
…
For these reasons the CNC recommends that the IASB divide the project into two parts:

- a short-term priority project dealing with issues related to the financial crisis (essentially additional disclosures).
- a long-term project which would start from scratch at the conceptual level and be fully coordinated with other IASB projects. Such a long-term project should include:
    - a far more thorough analysis of what could work better with IAS 27 / SIC 12
- what are the users needs and therefore the objectives of consolidated financial statements
- links with the definition of assets and liabilities, the new derecognition project, control of an asset versus control of an entity, control versus risks and rewards.

Such a long-term project should also deal with the accounting for joint ventures and associates. It should be organized as a real joint project with the FASB in order to achieve a converged approach between IFRS and US GAAP."

Question 4. Most constituents agree that the current mixed attributes model for accounting and reporting of financial instruments under IFRS and US GAAP is overly complex and otherwise suboptimal. Some constituents (mainly investors) support reporting all financial instruments at fair value. Others support a refined mixed attributes model. Which approach do you support and why? If you support a refined mixed attributes model, what should that look like, and why, and do you view that as an interim step toward full fair value or as an end goal? Whichever approach you support, what improvements, if any, to fair value accounting do you believe are essential prerequisites to your end goal?

In the comment letter we sent to the IASB on 18 September 2008 related to the Discussion Paper *Reducing Complexity in Reporting Financial Instruments*, we made it clear that we support a refined mixed attributes model that should be viewed as an end goal.

Pleased note that, in this letter, the CNC indicated that it was in favour of maintaining three accounting categories of financial instruments based on the business model applied:

- Assets and liabilities held for trading, suitable for instruments traded on the short term, not managed on a cash flow basis;
- Assets available for sale;
- Assets "loans and receivables" (that would include items held to maturity) and non-trading liabilities.

Pleased find below some extracts from our answer to Section 3 *A long term solution – a single measurement method for all types of financial instruments* of the Discussion Paper's questions that relate to full fair value versus mixed attributes models:

"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.
…
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."

Please find also below general comments we made in our letter before answering to the specific questions raised in the 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."

Finally, our letter included, in answers to specific questions, some proposals aiming at refining the mixed attributes model:

"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.
…
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.
…
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."

5. What criteria should accounting standard-setters consider in balancing the need for resolving an 'emergency issue' on a timely basis and the need for active engagement from constituents through due process to help ensure high quality standards that are broadly accepted?

Please find below answer to question 11 of the IASCF Constitution Review –Part 2 included in our comment letter we sent to the IASB on 26 March 2009:

"11) Should a separate "fast track" procedure be created for changes in IFRSs in cases of great urgency? What elements should be part of a "fast track" procedure?

Such a procedure is definitely useful (it has been made use of for the first phase of the Constitution review as well as for the revision of IAS 39 in October 2008). It must however be flexible (criteria enabling its implementation should not paralyse the process), decided on a case-by-case basis after either the MB' or the Trustees' intervention, in order to ensure that it answers the concerns of a majority of constituents. Public consultation is, however, mandatory whatever the degree of urgency."

The best way to ensure that there will be enough time for a due process is to identify "emergency issue" as soon as possible. Criteria for such an identification may include:

- significance of the issue (quantitative impact, number of stakeholders involved, crucial importance for a specific kind of activity or for stakeholders involved);
- reasons that may the issue emerge (sudden and dramatic change in the environment that has not be forecasted, evidence of weaknesses in accounting standards in such a context);
- the level of difficulties raised (technical difficulties to solve the issue with current accounting provisions, resulting confusion and misunderstanding in the information provided).

6. Are there financial crisis-related issues that the IASB or the FASB have indicated they will be addressing that you believe are better addressed in combination with, or alternatively by, other organisations? If so, which issues and why, and which organisations?

Please find below answer to question 4 of the IASCF Constitution Review –Part 2 included in our comment letter we sent to the IASB on 26 March 2009:

4) Should the Constitution be amended to allow for the possibility of closer collaboration with a wider range of organisations, whose objectives are compatible with the IASC Foundation's objectives? If so, should there be any defined limitations?

The wide implication of all of the constituents is fundamental to reinforce the legitimacy of accounting standards and fulfil the first objective assigned by the Constitution to the IASB which is to promote the standards over the widest economic area possible.

Financial stability-related issues are not necessarily different from or antinomic to those related to financial reporting, as long as the information provided to a long term investor is taken into account, as opposed to only the information provided to a short term investor.

In such a context, the contribution of official organisations ensuring prudential supervision over regulated financial industries on the one hand and financial stability on the other hand should be sought, so that accounting standards and prudential regulation are apprehended in a combined manner, thus making them more robust and legitimate."

As indicated in answer to question 2, there may be areas (such as enhancing the representation of credit risk) where both accounting standard setters and other regulatory authorities may have a common interest to work on. Constructive dialogue with these authorities (securities supervisors, prudential authorities, authorities in charge of organising and supervising the functioning of markets) could be fruitful and could help identifying in which areas and to which extent the IASB and the FASB could share common objectives with these authorities.

Users of general purpose financial statements may have an interest to be provided with information in relation to financial stability and pro-cyclicality phenomena, as the resulting consequences of these phenomena may be very significant on their own business.

In such a perspective, the IASB and the FASB should review the work already undertaken under Phase A *Objectives and qualitative characteristics* of their respective Conceptual Frameworks in the light of lessons to be learn from the financial crisis.

7. Is there any other input that you'd like to convey to the FCAG?

Profit due to deterioration of own credit risk are counter-intuitive and could be misunderstood by users of financial statements. Therefore, we consider that it should not be allowed to book profit and losses resulting from own credit risk on fair values of liabilities. Moreover, we question the relevance of including changes of own credit risk into the valuation of financial liabilities.

Appendix II

Extract from:

PROPOSED AMENDMENTS FINANCIAL INSTRUMENTS JUNE 2002 EXPOSURE DRAFT OF REVISED IAS 39

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Impairment and Uncollectability of Financial Assets

109. ***~~A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount.~~ An ~~enterprise~~entity ~~should~~shall assess at each balance sheet date whether there is any objective evidence that a financial asset or group of assets may be impaired. If any such evidence exists, the ~~enterprise~~entity ~~should~~shall ~~estimate the recoverable amount of that asset or group of assets and recognise any impairment loss in accordance with~~apply paragraph 111 (for financial assets carried at amortised cost), paragraph 116 (for financial assets carried at cost), or paragraph 117 (for available-for-sale financial assets ~~remeasured to fair value~~).***

110. Objective evidence that a financial asset or group of assets is impaired or uncollectable includes information that comes to the attention of the holder of the asset about:

(a) significant financial difficulty of the issuer;

(b) a~~n actual~~ breach of contract, such as a default or delinquency in interest or principal payments;

(c) granting by the lender to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, of a concession that the lender would not otherwise consider;

(d) a high probability of bankruptcy or other financial reorganisation of the issuer;

(e) recognition of an impairment loss on that asset in a prior financial reporting period;

(f) the disappearance of an active market for that financial asset ~~due to~~ because of financial difficulties; or

(g) a historical pattern of collections of a group of financial assets ~~accounts receivable~~ that indicates that the entity will not be able to collect all amounts due (principal and interest)~~the entire face amount of a portfolio of accounts receivable will not be collected~~.

The disappearance of an active market because an ~~enterprise~~entity's securities are no longer publicly traded is not evidence of impairment. A downgrade of an ~~enterprise~~entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. A decline in the fair value of a financial asset below its cost or amortised cost is not necessarily evidence of impairment (for example, a decline in the fair value of an investment in a debt instrument that results from an increase in the basic, risk-free interest rate).

110A. In addition to the types of information in paragraph 110, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic, or legal environment in which the issuer operates and indicate that the cost of the investment in the equity instrument may not be recovered. A significant and prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

Financial Assets Carried at Amortised Cost

111. If there is objective evidence of impairment and it is probable that an ~~enterprise~~entity will not be able to collect all amounts due (principal and interest) according to the contractual terms of loans, receivables, or held-to-maturity investments carried at amortised cost, an impairment or bad debt loss has occurred. The amount of the loss is the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate (recoverable amount). Cash flows relating to short-term receivables generally are not discounted ~~(see paragraph 74)~~. The carrying amount of the asset ~~should~~shall be reduced to its estimated recoverable amount either directly or through use of an allowance account. The amount of the loss ~~should~~shall be ~~included~~ recognised in ~~net~~ profit or loss for the period.

~~112. Impairment and uncollectability are measured and recognised individually for financial assets that are individually significant. Impairment and uncollectability may be measured and recognised on a portfolio basis for a group of similar financial assets that are not individually identified as impaired.~~

112. An entity first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant and either individually or collectively for financial assets that are not individually significant. If an

entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics that are collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment or bad debt loss is or has been recognised are not included in a collective assessment of impairment.

113. Impairment of a financial asset carried at amortised cost is measured using the financial instrument's original effective interest rate because discounting at the current market rate of interest would, in effect, impose fair-value measurement on financial assets that this Standard would otherwise measure at amortised cost. If the terms of a loan, receivable, or held-to-maturity investment are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms. If a loan, receivable, or held-to-maturity investment has a variable interest rate, the discount rate for measuring recoverable amount pursuant to paragraph 111 is the current effective interest rate(s) determined under the contract. As a ~~surrogate for such a fair value calculation~~practical expedient, a creditor may measure impairment of a financial asset carried at amortised cost based on an instrument's fair value using an observable market price. The estimation of the recoverable amount of a collateralised financial asset reflects the cash flows that may result from foreclosure, whether or not foreclosure is probable. If an asset is collateralised and foreclosure is probable, then the holder measures impairment based on the fair value of the collateral less costs for obtaining the collateral.

113A. For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtor's ability to pay all amounts due according to te contractual terms (for example, on the basis of a credit risk evaluation or grading process that considers asset type, industry, geographic location, collateral type, past-due status, and other relevant factors).

113B. Impairment losses recognised on a group basis represent an interim step pending the identification of impairment losses on individual assets in the group of financial assets that are collectively assessed for impairment. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group.

113C. Expected cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Entities that have no entity-specific loss experience or insufficient experience use peer group experience for comparable groups of financial assets. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in expected cash flows reflect and are directionally consistent with changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating expected cash flows are reviewed on a regular basis to reduce any differences between loss estimates and actual loss experience.

113D. In discounting expected cash flows of a group of financial assets that are collectively evaluated for impairment, an entity uses a weighted average of the original effective interest rates of the assets in the group that is being assessed for impairment. To ensure that an impairment loss is not recognised immediately after initial recognition, the original effective interest rate for each asset in the group is computed as an expected rate based on the originally estimated cash flows. For example, if the original contractual effective interest rate for an asset is 12 per cent and the entity on initial recognition, based on past loss experience for assets with similar credit risk characteristics, determines that the discount rate that equates the initial carrying amount of the asset with the present value of the expected cash flows for the asset (considering expected losses and prepayments) is 10 per cent, then the original effective interest rate that should be used for the purposes of computing a discount rate for the group of assets to which the asset belongs is the expected rate of 10 per cent.