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International Accounting Standards Board
30 Cannon Street
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Exposure Draft ED/2010/4 Fair Value Option for Financial Liabilities

Grant Thornton International is pleased to comment on the International Accounting Standards Board's (the Board) Exposure Draft ED/2010/4 *Fair Value Option for Financial Liabilities*. We have considered the ED as well as the accompanying draft Basis for Conclusions.

We set out our main comments below. Our responses to the specific questions raised in the ED's Invitation to Comment section are set out in the Appendix.

We support the Board's proposal to retain most of IAS 39's existing requirements for the classification and measurement of financial liabilities for the time being. We agree that the accounting issues arising during the financial crisis related primarily to financial assets. We therefore agree that there is no pressing need for fundamental changes to IAS 39's classification and measurement model for financial liabilities. In addition, given the extent of change planned in other areas of IFRS in the near future, limiting the changes to this aspect of IAS 39 may be welcomed by many constituents at this time.

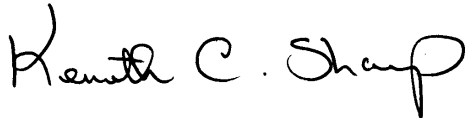
Having said this, we think the Board should revisit the classification and measurement of financial liabilities at a later date. In particular, we believe that a review of IAS 39's requirements on embedded derivatives is merited. We believe that retaining the current rules is inconsistent with the Board's long-term objective of improving and simplifying the reporting for financial instruments.

In relation to the treatment of own credit risk, we broadly agree with the proposals in the ED. In our comment letter of 24 August 2009 on credit risk in liability measurement, we noted that we shared the concerns of many constituents that reporting gains (or losses) as a result of changes in an entity's own credit standing is counter-intuitive. We also noted that we were not convinced that the same approach to own credit risk is necessary or appropriate for all types of liability. We therefore support the ED's proposal that changes in a liability's credit risk do not affect profit or loss unless the liability is held for trading. We believe however that gains or losses resulting from changes in a liability's credit risk that have been included in other comprehensive income should be reclassified to profit or loss if the instrument is derecognised prior to maturity.

We expand on these comments in our responses to the questions in the ED's Invitation to Comment Questions, which are set out in the Appendix to this letter.

If you have any questions on our response, or wish us to amplify our comments, please contact our Executive Director of International Financial Reporting, Andrew Watchman (andrew.watchman@gtuk.com or telephone + 44 207 391 9510).

Yours sincerely,

A handwritten signature in black ink that reads "Kenneth C. Sharp". The signature is written in a cursive style with a large initial 'K' and a distinct 'S'.

Kenneth C Sharp
Global Leader - Assurance Services
Grant Thornton International

Invitation to comment questions

Question 1 - Do you agree that for all liabilities designated under the fair value option, changes in the credit risk of the liability should not affect profit or loss? If you disagree, why?

We agree. We note that, in some limited cases, excluding the effect of credit risk from profit or loss can result in the fair value designation being less effective in reducing an accounting mismatch. On balance, however, we consider that treating all liabilities designated under the fair value option in the same way is preferable on the grounds of simplicity and comparability.

There is also a wider question (not raised in the Invitation to Comment questions) of whether changes in credit risk should be excluded from profit or loss for all liabilities that are measured at fair value through profit or loss. While it seems appropriate for changes in the credit risk of liabilities that are held for trading to be recognised in profit or loss, the same does not necessarily apply for derivative liabilities. A derivative liability may be held for the long term as an economic hedge but accounted for at fair value through profit or loss (for example because it does not meet the criteria for hedge accounting or because management chooses not to use hedge accounting because of its complexity). There does not seem to be a strong reason why changes in the credit risk of such liabilities should not also be excluded from profit or loss. We believe however that it is desirable to have symmetry with the treatment of derivative assets given that the value of a derivative may switch from positive to negative from one day to the next. The level of own credit risk associated with such derivative liabilities is also likely to be difficult to ascertain and may be relatively low. On balance therefore, we feel that the benefits to be gained from excluding changes in the credit risk of such derivative liabilities from profit or loss are outweighed by the simplicity of the ED's proposed approach.

Question 2 - Or alternatively, do you believe that changes in the credit risk of the liability should not affect profit or loss unless such treatment would create a mismatch in profit or loss (in which case, the entire fair value change would be required to be presented in profit or loss)? Why?

As set out above, we believe that changes in credit risk should be excluded from profit or loss for all liabilities designated under the fair value option.

While we recognise that the proposals will result in the fair value option being less effective as a means of reducing an 'accounting mismatch' in profit or loss in certain situations, we support them for the reasons set out in our response to Question 1 above.

Question 3 - Do you agree that the portion of the fair value change that is attributable to changes in the credit risk of the liability should be presented in other comprehensive income? If not, why?

We agree. We share the concerns of many constituents that reporting profit or loss as a result of changes in an entity's own credit standing is counter-intuitive, especially given that most of these changes are not realisable in practice. We therefore support the proposal to exclude

from profit or loss the portion of any gain or loss that is attributable to own credit risk.

Question 4 - Do you agree that the two-step approach provides useful information to users of financial statements? If not, what would you propose instead and why?

We are not convinced that a mandatory two-step approach will provide more useful information in practice, although we suggest that this is primarily a question for users.

We note that financial liabilities are commonly designated as at fair value through profit or loss to reduce an accounting mismatch. We suggest that a mandatory two-step approach in presenting the gain or loss on the liability will not necessarily provide the best reflection of the economic offset underlying the designation. The two-step approach will result in extra lines being added to the Statement of Comprehensive Income (or separate Income Statement). We note that some other current projects might also introduce requirements for additional line items and suggest that the Board should bear this in mind when finalising those projects.

Having said this we acknowledge that the proposed two-step approach has the advantage that the entire change in fair value of the liability is included in profit or loss with the amount attributable to changes in the credit risk of the liability then being backed out in a clear and transparent manner.

Question 5 - Do you believe that the one-step approach is preferable to the two-step approach? If so, why?

See our response to Question 4.

Question 6 - Do you believe that the effects of changes in the credit risk of the liability should be presented in equity (rather than in other comprehensive income)? If so, why?

We do not believe that the effects of changes in the credit risk of the liability should be presented in equity.

We note that there is a conceptual argument that a change in a liability's credit risk represents a wealth transfer between liability holders and equity holders. Under the current Framework for the Preparation and Presentation of Financial Statements, however, income and expenses are defined in terms of increases and decreases of assets and liabilities other than those relating to contributions from or distributions to equity participants. A remeasurement of a liability is not a contribution from or distribution to equity participants and should not therefore be presented directly in equity.

Question 7 - Do you agree that gains or losses resulting from changes in a liability's credit risk included in other comprehensive income (or included in equity if you responded 'yes' to Question 6) should not be reclassified to profit or loss? If not, why and in what circumstances should they be reclassified?

It is difficult to form a view on this issue in the absence of a conceptual basis to determine which types of gain or loss should be "recycled". Moreover, some IFRSs require recycling of specific gains and losses while others prohibit it. However, our intuitive preference is to require recycling if the liability in question is extinguished prior to maturity.

We have previously argued that profit or loss should not be affected by changes in a liability's credit risk partly on the grounds that the burden of the obligation is unchanged if the entity has no practical ability to extinguish the liability before maturity. In the rarer cases when a liability is extinguished for more or less than its face value, we believe that the entire fair value gain or loss has been realised and should then be recognised in earnings. We note also that own credit effects are also recognised in profit or loss when an entity extinguishes a liability measured at amortised cost (prior to its maturity).

However, we also acknowledge that there is merit in the Board's view that gains or losses should only be recognised once. We recognise that, in more recent developments, the IASB has tended to prohibit reclassification adjustments. Examples include the Board's decisions on IFRS 9 and equity investments designated as at fair value through other comprehensive income, and the current proposal in ED/2010/3 on defined benefit plans and remeasurements.

Question 8 - For the purposes of the proposals in this exposure draft, do you agree that the guidance in IFRS 7 should be used for determining the amount of the change in fair value that is attributable to changes in a liability's credit risk? If not, what would you propose instead and why?

We agree. While the default method proposed might be criticised on the grounds that it may not provide a reliable approximation of changes in the liability's credit risk in all situations, we believe it is justifiable on cost-benefit grounds given that many users have noted the difficulty in determining that amount more precisely. Where an entity can demonstrate a method that more accurately calculates the change in fair value attributable to the entity's credit risk, we believe it should be able to use that method.

Question 9 - Do you agree with the proposals related to early adoption? If not, what would you propose instead and why? How would those proposals address concerns about comparability?

We agree. The proposal is part of the overall project to replace IAS 39, and it is therefore appropriate that an entity should be required to apply the other parts of IFRS 9 if it elects to apply the proposals in the ED early. To allow entities to do otherwise, would result in a lack of comparability between entities.

Question 10 - Do you agree with the proposed transition requirements? If not, what transition approach would you propose instead and why?

We agree. Given that IFRS 7 requires entities to disclose the amount of the change in the fair value of a liability that is attributable to changes in the liability's credit risk, it should be possible for them to use that information to apply the proposed changes retrospectively.