ASC
ACCOUNTING STANDARDS COUNCIL

20 July 2010

International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
United Kingdom

(By online submission)

Dear Sir

RESPONSE TO EXPOSURE DRAFT – FAIR VALUE OPTION FOR FINANCIAL LIABILITIES

The Singapore Accounting Standards Council (ASC) appreciates the opportunity to comment on the Exposure Draft on the above exposure draft (ED) issued by the International Accounting Standards Board (the IASB or the Board) in May 2010.

We appreciate the IASB's attempt to simplify the accounting for financial instruments through its IAS 39 replacement project and have, in fact, supported most of the proposals made in the project thus far. However, we strongly believe that whilst there is urgency in replacing the current IAS 39 with the simpler IFRS 9, what is more important is to ensure that global convergence is not compromised in the process. We noted that the recently issued IFRS 9 (which addresses the accounting of financial assets) is not totally aligned to the FASB's approach and this ED on financial liability is also heading in a different direction from the FASB. We urge the Board to work closely with the FASB so as to achieve global convergence in accounting.

Our comments on the specific questions in the ED are as follows:

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?

Yes, we agree that except in the case of an accounting mismatch (as highlighted in our response to Q2), changes in the credit risk of all liabilities designated under the fair value option should not affect profit or loss. For better clarity, the IASB could consider specifying that the "credit risk" being considered is that arising from the credit standing of the reporting entity

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?

To the extent that the reporting of the change in credit risk of a liability within OCI would create a mismatch, it will be appropriate to record such changes in profit or loss. We believe, however, that such instances would be rare; a possible example would be where the fair value of a financial asset held is somehow impacted by an entity's own credit risk. As the application of this principle will be an exception to what is intended as the prevailing practice, it will be useful to provide specific examples as guidance and introduce measures to guard against possible abuse.

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?

First and foremost, we would like to highlight our concerns over the lack of clarity in the purpose and role of the OCI in the context of measuring and reporting an entity's performance. It appears, from the recent issuance of IFRS 9 and this ED on fair value option for financial liability, that there is a tendency to use OCI to "warehouse" certain components of fair values changes. For example, in IFRS 9, the Board allows the use of OCI to warehouse the fair value changes of certain strategic investments in order to address issues on impairment of equities. While the current proposal would reduce the volatility in profit or loss emanating from own credit risk, one would wonder how a user would interpret the corresponding volatility in OCI when assessing the financial health of the reporting entity.

We strongly believe that with the increasing use of OCI in financial reporting, the Board should expedite its on-going project on Financial Statement Presentation and have a comprehensive review on the presentation of items in OCI. Specifically, the Board should consider: (1) the characteristics of OCI items; (2) what it means to present items in OCI; and (3) the types of items that should be presented in OCI.

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 of the view that under the two-step approach, no additional information is provided to the users of financial statements. Instead, it is more likely to create unnecessary confusion, as there is no net impact on the profit or loss.

We would suggest that the fair value of credit components be taken directly to OCI instead of the two-step approach. Please see our response to Question 5 below.

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Question 5

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

Yes, we believe that the one-step approach is preferable to the two-step approach. In the one step-approach, the user can easily obtain the same information by adding the gross amount of the change in fair value presented in other comprehensive income (which is attributed to changes in own credit risk), and the gross amount of the change in fair value presented in profit and loss (which is attributed to factors other than changes in own credit risk, e.g. change in interest rates). This is a much simpler and straight forward approach than the two-step approach.

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?

No, we do not believe that the effects of changes in the credit risk of the liability should be presented in equity. Based on the accounting principles set out in IAS 1 Presentation of Financial Statements, only changes in an entity's net assets resulting from transactions with owners in their capacity as owners should be presented directly in equity. We do not think that changes in the credit risk of a financial liability represent transactions with owners in their capacity as owners.

Question 7

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

We believe that the accounting of a transaction should reflect its economic substance of transactions, particularly when the transaction represents the culmination of an earnings process. As such, it would be appropriate to allow recycling when fair value gains or losses are crystallised (e.g. through settlement).

Moreover, from a consistency angle, there is no basis to differentiate the treatment, at the point of derecognition, for a financial liability that used to be carried at amortised cost or one that is designated under the fair value option..

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?

Yes, we agree that the guidance in IFRS 7, despite perceived drawbacks such as the failure to recognize the effect of liquidity risk, remains relevant and practical.

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?

Yes, we agree with the proposals related to early adoption.

Question 10

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

We do not agree with the proposal to disallow entities from making new designations or revoke its previous designations. Reporting entities should be given a one-off opportunity to re-designate existing financial liabilities in the light of the proposed changes so that due consideration can be given to new requirements and considerations that were not present when the original election was made.

For example, on origination, an entity may have chosen the fair value option for a debt instrument containing an embedded derivative requiring bifurcation, as any movements on own credit would be recorded in profit or loss. If that is no longer applicable, the entity should be able to re-designate the liability as a bifurcated debt instrument and derivative.

Also, given that retrospective application is proposed, we believe an extension of the effective date (beyond the current proposed date of 1 Jan 2013) would be useful to provide sufficient preparation time.

Other comments

We note that the option on bifurcation, while retained for financial liabilities, is prohibited for financial assets with embedded derivatives (IFRS 9, paragraph 4.7). We recommend that the IASB reconsiders the possibility of allowing the application of the same principles to financial assets (i.e. to retain the option to bifurcate financial assets with embedded derivatives) as we believe such accounting best reflects the economic reality of those transactions from the standpoint of the issuing financial institution. In so doing, consistency in the accounting of financial assets and liabilities can be achieved as well. If this approach is not possible, we would urge the Board to at least consider allowing bifurcation for financial assets with embedded derivatives in cases where it presents a fairer picture (e.g. where it eliminates accounting asymmetry).

We hope that our comments will contribute to the IASB's deliberation on this exposure draft. Should you require any further clarification, do contact me (kate_ho@acra.gov.sg). Thank you.

Yours faithfully
Kate Ho (Ms)
Secretariat, Singapore Accounting Standards Council