AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Dear Sir David,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, I appreciate the opportunity to comment on the Discussion Paper DP/2009/2 *Credit Risk in Liability Measurement* and the Staff Paper accompanying DP/2009/2 on the same topic. Principal authors of this comment letter were Julius Gaugusch, David Grünberger, Ingrid Jacob, Erich Kandler, Heiner Klein, Christoph Krischanitz, Michael Laminger, Andreas Rauter, Helmut Sorger and Roland Nessmann.

Q1. *When a liability is first recognised, should its measurement (a) always, (b) sometimes or (c) never incorporate the price of credit risk inherent in the liability? Why?*

The answer to this question is twofold:

- Wherever a liability is the result of a transaction at arm's length, the price reflects the debtor's credit risk from the creditor's point of view. Thus, risk is included.
- Wherever a liability is the result of a legal obligation – e.g., for decommissioning or asset removal – the debtor's credit risk should not be included.

The reason for this distinction is that, as set out in the Framework, a liability should always be a present obligation and valued at the amounts that are expected to be expended to meet the obligation (Framework, p. 60), which sometimes involves a substantial degree of estimation (Framework, p. 64).

However, where the fair value option is required for liabilities, the measurement of the liability includes own credit risk.

Q2. *Should current measurements following initial recognition (a) always, (b) sometimes or (c) never incorporate the price of credit risk inherent in the liability? Why?*

With the exception of those liabilities for which the fair value option has been chosen at the time of initial recognition, we do not see a need to take into account own credit risk in the measurement of own liabilities:

- Firstly, the obligation of the reporting entity has not changed (in most cases), and the definition of a liability in the Framework is based on the amount that is expected to be required to meet the obligation.
- Secondly, a measurement of liabilities that includes own credit risk would result in an worsening in an entity's credit risk being reflected in profits in the income statement – immediately prior to bankruptcy, liabilities might approach zero – which is not in accordance with the Framework. In our view, there can be no unrealised gain from the settlement of a liability as long as management has not the intent and the ability to repurchase the outstanding liability.

Additionally, to avoid the effects of growing volatility and higher liabilities for entities with a favourable economic outlook, many entities would probably reduce the term of their liabilities, which might destabilise the economy as a whole, especially in times of high liquidity demand.

Where the fair value option for liabilities is chosen, however, measurement must include credit risk.

Q3. *How should the amount of a change in market interest rates attributable to the price of the credit risk inherent in the liability be determined?*

We see no need for this, since own credit risk need only be taken into account for liabilities for which the fair value option has been chosen.

Q4. *The paper describes three categories of approaches to liability measurement and credit standing. Which of the three approaches do you prefer, and why?*

For financial liabilities we see a need to take own credit risk into account only

- for the measurement of a liability, that is is the result of a transaction at arm's length, and
- if for subsequent measurement the fair value option has been chosen.

For non-financial liabilities we do not see a need to take debtor's risk into account, because otherwise the liability would not qualify as a liability in the meaning of the Framework.

Please do not hesitate to contact me if you wish to discuss any aspect of our comment letter in more detail.

Kind regards,

Romuald Bertl
Chairman