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Our ref mt/288

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Dear Sir or Madam

Adoption of IFRS 9: *Financial Instruments*

We appreciate the opportunity to comment on the European Financial Reporting Advisory Group's (EFRAG) draft endorsement advice regarding the International Accounting Standards Board's (IASB) *IFRS 9: Financial Instruments* (the standard). Our comments are based on the near-final draft of IFRS 9 made available by the IASB on its website on 2 November 2009. The IASB is expected to publish a final standard on 12 November. We will consider the final standard when it is published and write to you by 13 November if any of the views in this letter are impacted by differences from the near-final draft on which this letter is based. This letter expresses the views of the international network of KPMG member firms.

We have read and considered the standard and EFRAG's draft endorsement advice on the standard in which EFRAG considers the requirements of the Regulation (EC) No. 1606/2002 of the European Parliament and of the Council on the application of International Accounting Standards. Our consideration focused on EFRAG's conclusion regarding the assessment of the amendment against the endorsement criteria and in this response we are not addressing any points raised by EFRAG in Appendix 3 of its invitation to comment.

We provided comments to the IASB on Exposure Draft ED/2009/7 *Financial Instruments: Classification and Measurement* (the ED) in our comment letter dated 14 September 2009. We have followed the IASB's redeliberations on the comment letters on the ED and while not all of our suggestions were adopted by the IASB we are pleased that the Board has made a number of important changes to its proposals in response to comments received from its constituents.

Overall, we strongly support EFRAG's proposed endorsement of IFRS 9 to permit EU entities the flexibility to adopt that standard at the same time as it becomes available to other entities reporting under IFRSs. Factors we considered in reaching this conclusion include:

- We believe that the IASB, in working to issue a final standard addressing classification and measurement issues in 2009, has been responsive to the calls of the G20 leaders and the Financial Stability Board to address on an urgent basis issues regarding complexity of reporting for financial instruments and has followed its due process, including substantial consultation with various stakeholder groups;
- The direction taken by the IASB – simplifying but maintaining a mixed measurement model, with both amortised cost and fair value used to measure financial assets – is in line with the recommendations of the Financial Crisis Advisory Group in its report of July 2009. The simplified mixed measurement model in IFRS 9 strikes an appropriate balance between the characteristics of an instrument and reflecting an entity's business model, including a requirement to reclassify instruments when an entity's business model changes.
- IFRS 9 resolves an issue regarding impairment of investments in debt instruments classified as available for sale; this issue was considered a high priority by many constituents, as evidenced by the roundtables held by the IASB in late 2008.

In particular, we note that the boundary between financial assets measured at amortised cost and at fair value has been clarified by referring specifically to leverage as a characteristic that would preclude amortised cost accounting, by improving the guidance on prepayment options and by including examples of contracts that could, and those that could not, result in an instrument being measured at amortised cost. In addition, we believe that the change to require "looking through" a structured investment vehicle to the underlying instruments in order to determine the classification of an investment in the vehicle should result in a more meaningful classification of such investments.

In our view the improved guidance in Appendix B of IFRS 9 addresses concerns raised regarding the operability of the classification criteria proposed in the ED so as to assist companies and their auditors in applying the principles in chapter 4 of the standard to specific financial assets. In the course of our discussions on the exposure draft, and subsequently, we have not identified examples of 'plain vanilla' loans that, if held to collect the contractual cash flows, would fail to qualify for amortised cost measurement.

We agree that the IASB balanced appropriately the need to provide information that is relevant and reliable and at the same time focuses on key issues for users. In our experience, the requirements in IAS 39 for the separation of embedded derivatives have been extremely complex to understand and apply and the detailed rules sometimes have been difficult to reconcile to the underlying principle. Eliminating the requirement for separation of embedded derivatives that are part of financial assets is an important example of how the IASB has responded to the calls from the G20 and Financial Stability Board to simplify the accounting for financial instruments.

We note the concerns of some EFRAG TEG members on a potential lack of comparability and symmetry between the accounting for financial assets and financial liabilities due to IFRS 9 addressing only accounting for financial assets. We believe that the more relevant and understandable information that IFRS 9 will provide with respect to financial assets should outweigh such concerns.

IFRS 9 as published is only the first step in revising the accounting for financial instruments. We support the IASB's decision to issue this first instalment in relation to the classification and measurement of financial assets as many of the concerns raised by the G20, the Financial Stability Board and other stakeholders arose from the classification and measurement requirements for financial assets in IAS 39. The issuance of IFRS 9 allows these concerns to be addressed as expeditiously as possible consistent with the IASB's adherence to due process. The IASB has indicated that these first chapters of IFRS 9 are not intended as a temporary stopgap measure but as a foundation for subsequent chapters dealing with other aspects of the accounting for financial instruments.

We support consistent application of International Financial Reporting Standards globally and consistent with this objective we support EFRAG's recommendation to adopt for use in Europe the standard as issued by the IASB.

Please contact Andrew Vials or Mary Tokar at +44 20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours faithfully



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