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Mouvement des Entreprises de France
MEDEF

A F E P

Association Française des Entreprises Privées

IASB
30 Cannon Street
London EC4M 6XH
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Paris, August 28, 2009

Re: *DP on Credit Risk in Liability Measurement*

We welcome the opportunity to comment on the DP on Credit Risk in Liability Measurement drafted by IASB staff and published by the IASB in June.

The publication of a DP dealing with the issue of credit risk in liability measurement is welcome, as this issue continues to raise strong and legitimate concerns for the relevance of financial reporting.

Two major projects, inter alia, interact with this issue, i.e. IAS 39 ongoing revision and “Fair value measurement” exposure-draft. We hope that the IASB makes decisions in those projects rejecting the reflection of changes in credit risk in the measurement of liabilities.

In addition to these main comments, answers to the detailed questions of the invitation for comment are provided in the appendix.

Should you wish any supplementary comment or explanation, please do not hesitate to contact us.

ACTEO	AFEP	MEDEF
Patrice MARTEAU Chairman	Alexandre TESSIER Director General	Agnès LEPINAY Director of economic and financial affairs

Appendix to our letter on IASB Discussion Paper on Credit Risk in Liability Measurement

Preliminary comments on the analysis of pros and cons presented in the DP.

In our letter of comments on the DP “Fair Value Measurement”, we had responded to the question whether the entity’s non performance risk should be reflected in the measurement of liabilities as follows:

“Here again we believe that financial reporting must be established from the entity’s perspective. And from an entity’s perspective the obligation embodied in the liability does not vary in any way because its credit risk (which heavily influences the credit risk of its liabilities) decreases or increases. Under the going concern assumption, the entity will repay the total amount due and no other scenario than settlement is appropriate. Reduction in liabilities can most often be generated only through heavy and lengthy negotiations, which would need to be considered as economic events of a subsequent period. This issue illustrates once more why we believe that valuing liabilities on the basis of a hypothetical transfer price is not relevant to depict an entity’s financial position, as transfer of a liability is a very remote scenario ».

The arguments displayed in the DP in favour of including credit risk in the measurement of liabilities leave us unconvinced. We share EFRAG’s analysis and refer to it, without feeling the need to repeat it here.

Question 1

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? If the answer is “sometimes”, in what cases should be the initial measurement exclude the price of the credit risk inherent in the liability? If the answer is “never”, (i) what interest rate should be used in the measurement, (ii) what should be done with the difference between the computed amount and cash proceeds (if any)?

Liabilities are diverse, and financial statements should reflect that diversity. Some liabilities arise out of transactions with third-parties, such as borrowings and debt instruments, when the entity bears an obligation in exchange for cash proceeds. In those cases, the transaction price (cash received) incorporates a premium for credit risk borne by the holder of the instrument. As a result, reflecting credit risk in the measurement at inception is relevant, because at that time credit risk is a component of the transaction price. It is the transaction price that is relevant for measurement purposes, not credit risk per se. The discount rate to present value of the liability will reflect the credit risk at inception.

Non-financial liabilities may arise out of transactions with third-parties also (maintenance contracts, employee benefits…).

The price agreed in transactions with third-parties could be said to incorporate an inherent credit risk component. There again, we believe that the transaction price is the best basis for measurement at inception. We however do not think that any credit risk component is identifiable or measured independently by who sets or agrees the price.

In all other circumstances (liabilities arising from legal requirements or litigations), the obligation is measured on the basis of the best estimate of net cash-outflows, without taking into account any non-performance risk of any sort.

When no credit risk component is either identifiable or included at inception, the discount rate used to measure the present value of the liability should not reflect any credit risk component.

Question 2

Should current measurements following initial recognition (a) always, (b) sometimes or (c) never incorporate the price of credit risk inherent in the liability? Why? If the answer is "sometimes", in what cases should subsequent current measurements exclude the price of the credit risk inherent in the liability?

We do not think that credit risk should play a role in subsequent measurement. Where measurement at inception has reflected a component of credit risk, that credit risk component should be locked up at inception, (unless changes in the entity's own credit risk are, by contract, a source of change in the future contractual cash outflows to which the entity is committed).

Indeed we do not think that changes in the entity's own credit risk have any impact on the future cash outflows to which the entity is contractually committed, until full repayment or renegotiation.

Question 3

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 do not think that any adjustment for credit risk should ever be taken into account. Attempts at doing so would most probably include some arbitrariness, be burdensome and deprive users of more relevant, more understandable information.

Question 4

The paper describes three categories of approaches to liability measurement and credit standing. Which of the approaches do you prefer, and why? Are there other alternatives that have not been identified?

We agree with alternative c), for the reasons explained above, except that we do not agree with the use of a current market rate in every circumstance for every liability's subsequent measurement.

We refer to our answer to the IASB DP on “Reducing complexity in the accounting for financial instruments” and our answer to come on the IAS 39 ED on “classification and measurement of financial instruments”, were we describe in what circumstances we believe that accounting at amortised cost should prevail.