European Federation of Accountants and Auditors for SMEs

European Financial Reporting Advisory Group (EFRAG)
35 Square de Meeûs
B-1000 BRUSSELS
Attn. Mr. Marius van Reenen

Brussels, 2 July 2010

Dear Mr. Van Reenen

Reaction to EFRAG's draft comment letter on the IASB's Exposure Draft Fair Value Option for Financial Liabilities

The European Federation of Accountants and Auditors for SMEs ("EFAA") represents accountants and auditors providing professional services primarily to small and medium-sized entities ("SMEs") both within the European Union and Europe as a whole. Constituents are mainly small practitioners ("SMPs"), including a significant number of sole practitioners. EFAA's members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, and tax and business advice) to SMEs.

EFAA appreciates the opportunity to comment on EFRAG's own draft comment on the IASB's Exposure Draft Fair Value Option for Financial Liabilities issued on 9 June 2010.

Basis of comment

The core of EFAA's members do not actively operate in markets where liabilities are traded on an open market basis and to this extent we have restricted our comments only to those instances where such liabilities are not traded on an open market basis. In addition, we make no comment on Appendix 2 (Note for EFRAG's constituents) at this time.

IASB proposal

The Exposure Draft proposes that in the circumstances where an entity measures its own debt at fair value, any subsequent gain or loss resulting from a change in credit standing of that entity, be recognised through Other Comprehensive Income ("OCI") instead of being affected through the Profit and Loss ("P&L") account. The choice not to recognise through P&L is a good one, because otherwise there would be a perverse incentive for persons with profit-dependant remuneration not to do the utmost to preserve a proper reputation of the company before the balance sheet date.

EFAA does not support the measurement of own debt at fair value where the subsequent resulting gain or loss provides limited use to readers of financial statements and in some circumstances may be misleading. The ED also allows for the possibility of a mismatch in accounting treatment where assets and liabilities are managed together under the fair value option. The downgrading of liabilities would be recognised in the OCI and the corresponding downgrading of assets recognised in the P&L.

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Whilst we accept that there may be some circumstances, particularly in the financial sector, where it may be appropriate, EFAA's primary concern is that the application of fair values for liabilities is not extended during the replacement of IAS 39.

Variations in fair value of debt have no impact on future debt payments (unless the debt is purchased and then cancelled) and as such the real benefit of financial statements as a tool to predict future cash flows is diminished.

For the limited circumstances when measurement at fair value for own debt is appropriate, EFAA believes that the recognition of the gain or loss from a change in credit standing through the OCI is preferable to that of the P&L.

We draw attention to an inconsistency; devaluing debt because of a change in the credit status is lead through OCI, but the accrual towards maturity is lead through the P&L.

General remarks

EFAA's main objective is to ensure that the interests of SMEs and of the SMPs who serve them are effectively represented and considered at European level.

We feel that the convergence process with FASB and IASB has moved towards an increasing Anglo-Saxon approach over the last decade. In that way IFRS has alienated itself from large European economies, especially France, as you saw with the consultation of the Commission at 25 May in Brussels. If IFRS for SMEs is to be successful in Europe, a European wide consensus must be achieved. EFAA encourages EFRAG to bridge the gap.

Finally, we note the opportunities for manipulation in circumstances where debt can be valued at fair value. Given the current economic climate this would be particularly relevant where the IPSAS 30 rules for government accounting of financial instruments follow IFRS. If devaluing debt is possible under IPSAS, politicians (not always principle-based) could seize the opportunity for a dramatic "improvement" of the debt position of their country and we should not wish IFRS to be a vehicle for such behaviour.

Should you have any question on our comments, please do not hesitate to contact us.

Yours sincerely,

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