



DRSC e. V. • Zimmerstr. 30 • 10969 Berlin

Mr. Russell G. Golden  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116  
United States of America

Telefon +49 (0)30 206412-12  
Telefax +49 (0)30 206412-15  
E-Mail info@drsc.de

Berlin, 1 September 2010

**File Reference No: 1810-100**

Dear Mr. Golden:

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the FASB Exposure Draft “Proposed Accounting Standards Update – Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities” (herein referred to as ‘FASB-ED’). We appreciate the opportunity to comment on the FASB-ED. Please note that this is a preliminary comment letter highlighting the GASB’s view on the major proposals in the FASB-ED. We are in the process of preparing a more detailed comment letter but send this letter early to qualify for participation in the round tables on the topic.

The GASB appreciates the efforts of the FASB intended to improve the accounting for financial instruments by reducing complexity, enhancing transparency, and providing more representative information for users of financial statements about an entity’s involvement in financial instrument. However, we doubt that the proposals in the FASB-ED are heading into the right direction.

We also believe that obtaining one single set of high quality global accounting standards, especially in the complex area of financial instruments, is a very important objective. Therefore, the GASB regrets that the FASB and the IASB – despite deliberation undertaken jointly – could not agree on a joint model in this important area and, hence, could not reach convergence so far.

We would like to underline that our analysis of and comments on the FASB-ED were taken from an IFRS constituent’s perspective. Due to that reason, our letter does not focus on whether, or to what degree, the proposals within the FASB-ED differ from the current Topic 815/825. This means on the one hand, that we rather compare the FASB-ED proposals with the current IFRS requirements or proposals, including the current IASB discussion on proposals still to come. On the other hand, we consider the FASB proposals as potential alternative and stand-alone pro-

posed accounting model for financial instruments. Having this in mind, we have analysed the FASB-ED in comparison to the IASB's model, but not without considering the essential, which is, whether the FASB proposals are ultimately appropriate.

The remainder of this letter is divided into the following four sections: (1) classification and measurement, (2) credit impairment, (3) hedge accounting, and (4) other issues.

### Classification and measurement

The GASB does not agree with the proposals in the FASB-ED because it proposes the use of fair value in areas where we do not believe that it is the most appropriate measurement attribute. We hold the view that fair value is the appropriate measurement attribute for financial instruments without contractual cash flows, for derivatives, and for all financial instruments which are intended to be sold or settled in the short term, but fair value is not a relevant measure for measuring debt instruments held for longer-term investment purposes. For such investments fair values do not necessarily provide information that helps to predict the most likely future cash flows as management may have no intention to sell or discharge itself of the financial instruments but may have other plans with them that are expected to result in cash flows different from the current fair value. Therefore, the GASB is in favour of retaining a mixed model for the accounting of financial instruments with the two measurement categories 'fair value' and 'amortised cost', which is the basic concept underlying IFRS 9.

The exception in the FASB-ED that permits certain financial liabilities to be measured at amortised cost is, in our view, an attempt to mitigate the shortfalls of the general requirement to measure financial liabilities at fair value, thus evidencing the inappropriateness of the general requirement. In our view, the criterion for qualifying financial liabilities – less than 50% of recognised assets subsequently measured at fair value – is rule-based and arbitrary. The first criterion – a financial liability contractually linked to an asset not measured at fair value – will hardly be applicable, particularly for larger entities (or entities that are part of a group) for which the financing of the business activities is centrally managed by a treasury department.

The GASB disagrees with the proposed measurement approach for core deposits. In our opinion, core deposits should be measured at amortised cost, which is the amount due on demand.

As noted in the summary of the FASB-ED, the eligibility criteria for financial instruments to be categorised as recognising the qualifying portion of the fair value change in other comprehensive income (FV-OCI) are similar to those under IFRS 9 to determine whether financial assets are measured at amortised cost. However, we have the impression that the criteria of the business strategy to collect or pay the related cash flows of the financial instrument are stricter in



the FASB-ED, as par. 22 requires that the business strategy shall be to hold instruments for a significant portion of their contractual terms. As the question of how many early sales/settlements are acceptable within a holding business strategy has a big practical impact, we would like to remind the Board of addressing this possible difference in the eligibility criteria jointly with the IASB in future deliberations.

The GASB believes that it is not appropriate to continue an accounting treatment regardless of whether facts and circumstances have changed, or to not allow an accounting treatment simply because the required conditions are met at a date later than day one. Accordingly, we do not agree with the proposals in the FASB-ED prohibiting any reclassifications of financial instruments, even though the changes in conditions are expected to be infrequent (e.g. changes in business models).

### Credit Impairment

The GASB welcomes the proposals to introduce a single model for estimating credit losses for all financial instruments that requires a more timely loss recognition. However, the restriction on past events and existing conditions in determining the expected future cash flows of a financial asset does, in our mind, not fit in the overall model. Firstly, as the entity shall estimate future cash flows, the required distinction whether these estimates are based either on past events and existing conditions or on forecasts and expected future events may be difficult or even impossible in some instances in practice. Secondly, assuming that economic conditions existing at the balance sheet date would remain unchanged for the remaining life of the financial assets is not realistic.

Another point of critique is that the proposed model will result in recognising the initially expected credit losses in the first period after initial recognition of the financial assets. This can be seen as a frontloading of credit losses (while the proposed IASB model is intended to avoid a frontloading of interest income) that conflicts with the matching principle.

### Hedge Accounting

With respect to the hedge accounting proposals, we take the view that the proposals are partly adequate, partly not.

The GASB agrees with focussing on a qualitative assessment of whether an economic hedging relationship is effective and qualifies for hedge accounting. Therefore, we agree with the FASB's "reasonably effective" criterion as well as with a qualitative effectiveness assessment



and only at inception of the hedge designation. We plan to encourage the IASB to consider these proposals in developing its own and comprehensive new hedge accounting model.

Nevertheless, we deem some proposals as not being appropriate. After discussing the inability to de-designate a hedging relationship, we agree with this proposal as it makes the hedge accounting model less complex and more principles-based. However, the proposals as to whether and to what extent an offsetting derivative may cause or justify a hedging relationship to be terminated, are neither reasonable nor consistent with the stated objective. If one derivative offsets another, and the original derivative was part of a hedging relationship that is “only” reasonably effective, we do not agree that the offset shall be more perfect than the hedge itself. Hence, we would like a hedge to be terminated if the offsetting derivative meets a “reasonable offset” threshold only. In addition, we do not agree that those derivatives may not be re-designated in a new hedging relationship. We have concerns with regard to practicability that those derivatives would be labelled as “not eligible anymore” for hedge accounting, while other derivatives can be designated in a hedge at any time after their initial recognition.

Overall, the GASB wonders whether the hedge accounting proposals are made from a perspective that primarily (or exclusively) considers one-to-one hedges, which inappropriately narrows the focus of hedge accounting. It is our understanding of the FASB proposals that dynamic or net position hedges would not qualify for hedge accounting, despite them being commonly used in various industries. Hence, the purpose of hedge accounting (which is to allow for reflecting risk management practises) could not be met, which is crucial. We therefore propose that the FASB joins the IASB in comprehensively reviewing and re-developing an overall hedge accounting concept; we plan to encourage the IASB to proceed in deliberating this issue.

### Other issues

#### *Definitions*

We agree with most of the definitions in the FASB-ED. Some FASB definitions seem in part clearer or more appropriate than those in the IFRSs, while they are not clear enough in other part or details. As such, we like to mention:

- Amortised cost: With regard to the additional adjustments for foreign currency exchanges (par. (c) of the FASB definition), this seems more appropriate. In contrast, while the FASB includes “write offs” by definition, the IASB includes “impairment” and “uncollectability” (the latter considered to be the same as “write offs”). We ask the FASB to note that both shall be included in the measurement, hence, should be mentioned in the definition.
- Financial Instrument: On the one hand we support the FASB definition since it distinguishes between “contracts” and other (non-contractual) instruments, such as cash or ownership in-



terests. On the other hand, we support the IASB definition since it mentions that a financial instrument constitutes a financial asset vs. a financial liability or equity instrument – while not mentioning yet what an asset, a liability or an equity instrument is, whereas the FASB definition already includes a short definition of the subset of a “financial asset” or a “financial liability”. Finally, we consider the IASB definition to be slightly more appropriate regarding the inclusion of contracts that will/may be settled with own equity instruments; however, this feature itself might not be appropriate but is currently under discussion while reviewing IAS 32.

- Derivative: The FASB definition includes derivatives with net cash settlement features, which we consider important, while the IASB definition does not. However, the IASB ends up in a similar place because commodity contracts that allow for net cash settlement are within the scope of the financial instruments standard. In contrast, “own use” derivatives without a net cash settlement feature, are similarly excluded from the scope, which we also consider important. To conclude, we prefer the FASB definition.
- Hybrid instrument / Embeddeds: We think that the (different) definitions of both boards are not appropriate since the term “hybrid” is ambiguous and, in addition, sometimes used synonymously with “combined” or “compound” instruments. We suggest that both boards elaborate what they think the terms “hybrid” and “combined” and “compound” stand for and agree on one identical definition for each term. We urge the boards to take into account which meaning for which term has already been established in the capital markets. E.g., we note that the term “hybrid instrument” is often used for instruments that contain features of equity and debt instruments and not necessarily of cash and derivative instruments. These are rather called structured instruments.

Finally, the definition of “effective interest rate” in the FASB-ED does not seem appropriate. From our view, it does not take into account (at least not explicitly) any early payments, since it refers to the “contractual” rates, hence, not covering any expectations of a period shorter than the instrument’s life. We propose that the FASB adopts the IASB definition or clarifies that the FASB definition is meant accordingly.

### *Disclosures*

The GASB did not evaluate each individual disclosure proposed. Generally, we have experienced that – from a user’s perspective – many disclosures are often not used or even ignored, as they are not considered to be decision-useful or relevant. We realise that both boards are constantly expanding the list of disclosures with any amendment of a Topic or an IFRS. Whilst we understand that different users have different views as to what constitute useful information (and, hence, each disclosure item can probably be justified by reference to a particular constituent), the overall picture of the entirety of the disclosures becomes more and more confusing, as



each single disclosure is more and more veiled. We urge both boards to take the opportunity for developing disclosures from a high-level approach, which might lead to proposing rather less than more disclosures.

If you would like to discuss our comments further, please do not hesitate to contact me. We will provide you with the final comment letter before the end of the comment period in which we will explain our views in more detail by answering selected questions posed in the FASB-ED in addition to our main comments described above.

Yours sincerely,

*Liesel Knorr*  
President