



24 August 2009

International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH,
United Kingdom

Dear Board Members:

Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF), the accounting standard setting body in Mexico, welcomes the opportunity to submit its comments on the Exposure Draft on Financial Instruments, Classification and Measurement issued for exposure on 14 July 2009. Set forth below you will find our comments on the topics included in the Exposure Draft.

We believe that the approach taken by the IASB of segregating from IAS 39 the standard on classification and measurement is the right one. However, once this important step has been taken we believe that the standard to be issued should be a complete and standalone standard, including the related presentation and disclosure standards, to avoid going back and forth from this standard to IAS 32, *Financial Instruments: Presentation*, and to IFRS 7, *Financial Instruments: Disclosures*.

It is an inconsistent approach to carve out from IAS 39 what relates to classification and measurement and not follow the same approach regarding the presentation principles in IAS 32 and the disclosure principles included in IFRS 7. We believe the incremental effort to do this is not significant, as the main paragraphs in these two standards have already been identified in Appendix C, Amendments to other IFRS, in the exposure draft.

Responses to the questions raised in the Exposure Draft.

Question 1

Does amortized cost provide decision-useful information for a financial asset or financial liability that has basic loan features and is managed on a contractual yield basis?

We believe that amortized cost provides the best information from the lender's perspective, i.e., a bank or other financial institution, since it allows determining the financial margin of the financial intermediary basic operations, which includes both the funding costs of the bank and the revenue from loans to the customers, which is a key performance indicator of banks and similar financial institutions.

What we did not find in the definition of amortized cost is that commissions and other charges made to the customer at the inception of the loan should be included in the cash flows to be received, and any originating cost for the bank should be deducted, to properly determine the effective interest rate or yield of the loan. This also applies to the liability side for any additional amounts paid (issuance costs) on deposits or financial instruments issued to obtain funding. This probably comes from the current interpretation of IAS 39, but since we are moving toward a new standard for financial instruments, we believe further explanation on this topic should also be included in the new narrative to avoid differences in the treatment in both operating and issuance costs and their impact on the calculations of amortized cost, especially for non-financial entities.

Question 2

Do you believe that the exposure draft proposes sufficient operational guidance on the application of whether an instrument has basic loan features and is managed on a contractual yield basis? If not, why? What additional guidance would you propose and why?

We believe that what is included in the application guidance regarding basic loan features and managed on a contractual yield basis provide sufficient operational guidance for financial instruments such as loans and other financial instruments to be managed under this business model.

However, we did not find guidance for trade receivable or payable portfolios whose terms exceed the normal collection term and have, therefore, loan features included within their contractual cash flows. This is common for certain commodities, where the trader allows several months for his customer to make payment, and, in fact, this provides a form of credit feature as the trader is lending and the customer is borrowing. The invoice does not segregate the embedded interests, but there is an effective interest rate built into the transactions that should be identified. IAS 39 indicates that "loans and receivables" should be carried at amortized cost in paragraphs 46a) and AG68. However, there is no explicit reference to trade receivables in this Exposure Draft, and we believe there should be sufficient guidance on such matter.

This guidance should be targeted toward non financial entities that during their normal course of business typically extend credit through either short to medium-term receivables or obtain short to medium-term supplier financing, both of which emulate the profile of zero coupon bond portfolios, which have usually not considered the need to segregate and separately accrue interest from such financial assets and liabilities.

Question 3

Do you believe that other conditions would be more appropriate to identify which financial assets or financial liabilities should be measured at amortized cost? If so,

- a. what alternative conditions do you propose? Why are those conditions more appropriate?*

No, we agree that amortized cost is to be used only when a known return or payment is established based on the principal amount of the financial asset or liability. The known return or payment is the effective interest to be received or paid.

- b. *If additional financial assets or financial liabilities would be measured at amortized cost using those conditions, what are those additional financial assets or financial liabilities? Why does measurement at amortized cost results in information that is more decision-useful than measurement at fair value?*

We do not believe there are other conditions to be used. However, there are other financial assets or liabilities such as trade receivables and payables, which in certain cases include a loan feature and should also be measured based in their implicit effective interest rate. This is probably assumed from current IAS 39 narrative, but it is not addressed in the exposure draft.

- c. *If financial assets or financial liabilities that the exposure draft would measure at amortized cost do not meet your proposed conditions, do you think that those financial assets or financial liabilities should be measured at fair value? If not, what measurement attribute is appropriate and why?*

We do not have additional conditions to identify what financial assets or financial liabilities should be measured at amortized cost.

Question 4

- a. *Do you agree that the embedded derivative requirements for a hybrid contract with a financial host should be eliminated?*

Yes, we agree there is no need to bifurcate and separately value a derivative embedded in a financial instrument that changes its payoff profile, so that it no longer has the basic loan features to be carried at amortized cost. This would be the case of an instrument whose principal amount is tied to the price of a commodity, such as oil. Also, we agree that if the nature of the financial asset or liability does not change because the derivative just sets a cap or a floor on the interest rate or changes it from fixed to variable; the financial asset or liability still has to be accounted for at amortized cost, because the basic loan feature of an effective interest rate on a principal amount continues to exist.

- b. *Do you agree with the proposed application of the proposed classification approach to contractually subordinated interests (i.e. Tranches)? If not, what approach would you propose for such contractually subordinated interests? How is that approach consistent with the proposed classification approach?*

Yes, we agree that contractually subordinated interests, such as those found in CDO structures, do not have basic loan features, since subordinated tranches generally have a higher yield due to their credit risk, and investors are not lending in a normal course of business, but rather speculating. Therefore, those investments should be carried at fair value.

Question 5

- Do you agree that entities should continue to be permitted to designate any financial asset or financial liability at fair value through profit and loss if such designation eliminates or significantly reduces an accounting mismatch? If not, why?*

We agree that the option to designate any financial asset or financial liability at fair value through profit and loss to eliminate or significantly reduce an accounting mismatch should be permitted. Our concern is how to clearly relate the asset with the liability. We suggest that there be an association of the proceeds for the asset with the

related liability or that the liability gives rise to the asset or vice versa. Paragraph B18 indicates that a reasonable delay in entering into the asset and the liability is permitted, but it does not indicate if their term should also be within a reasonable delay. We suggest that this be indicated.

Question 6

Should the fair value option be allowed under any other circumstances? If so, under what other circumstances should it be allowed and why?

We do not believe the fair value option should be allowed under any circumstance other than for a clear accounting mismatch.

Question 7

Do you agree that the reclassification should be prohibited?

We agree that the reclassification between the amortized cost and fair value categories should be prohibited. We believe that once the features of a financial asset or a financial liability have been identified (either at origination, issuance or at the time of first adoption of IFRS) and the designation of the category in which these are to be classified made, there is no basis to change that category in a subsequent recognition, unless there was an error in identifying the features of the financial asset or liability. Therefore, a reclassification would be equivalent to a correction of an error.

Question 8

Do you believe that more decision-useful information about investments in equity instruments (and derivatives on those equity instruments) results if all such investments are measured at fair value? If not, why?

As far as equity instruments do not have a due date or a liquidation date, the only basis of accounting that can be used is fair value. Cost basis would not provide decision-useful information, as far as the objective of investments in equity instruments is to obtain a profit from its changes in market value. Although we are aware of the implications of measuring unlisted equity instruments at fair value, we believe the benefits of such information outweigh the costs of obtaining and subsequently measuring the fair value of these instruments, using a formal valuation technique (see our following response)

Furthermore, in the case of separate financial statements of a holding company, the best measure of the fair value of its subsidiaries and affiliates would be their value using the equity method of accounting and not the cost method, which does not recognize changes subsequent to acquisition or inception of a subsidiary or associate.

Question 9

Are there circumstances in which the benefits of improved decision-usefulness do not outweigh the costs of providing this information? What are those circumstances and why? In such circumstances, what impairment test would you require and why?

The only circumstance in which the benefits do not outweigh the costs of providing the information based in fair values is when the financial assets cease to be quoted on an exchange and a readily available fair value is not obtainable. This will require preparers of financial information to follow the fair value measurement hierarchy, estimating the

fair value based on other observable inputs, which in some cases will be difficult to obtain. We believe that it would be rare to have a case where there are no other observable inputs. In such a case, it is very likely that the value of the financial instrument will be obtained from formal valuation techniques.

Question 10

Do you believe that presenting fair value changes (and dividends) for particular investments in equity instruments in other comprehensive income would improve financial reporting? If not, why?

Comprehensive income has been referred to as the wastebasket for items that management does not want in income. We would prefer that another income account be used, with adequate disclosure, both for the change in value of the financial instrument and its dividends. There are other investments of a long-term nature (such as in associates) for which the change in value is reported in income.

When an investment in equity instruments is made for a purpose other than obtaining profits from trading, dividends or to exercise control or significant influence over such entity, the only purpose would be of a strategic nature to obtain a benefit from the entity itself, such as legitimize access to more detailed information from such entity, which may be the case in a competitive environment, rather than from the equity instrument itself. We agree that those benefits should be recognized in a separate account within income, but not necessarily within other comprehensive income. Therefore, we do not see how financial reporting is improved by presenting fair value changes for particular investments within equity in other comprehensive income, since when the investment is made for a strategic purpose, the effects of such managerial decision should be reflected in normal operating results.

Question 11

Do you agree that an entity should be permitted to present in other comprehensive income changes in the fair value (and dividends) of any investment in equity instruments (other than those that are held for trading) only if it elects to do so at initial recognition? If not,

- a. *how would you propose to identify those investments for which presentation in other comprehensive income is appropriate? Why?*

As we indicated before, we believe there is no sound basis to report the changes in value of certain equity instruments in other comprehensive income, other than to avoid the earnings volatility derived from such holdings, which is not a sound principle.

We do not find a principle that would support this segregation. Any investment an entity makes in any assets (e.g. financial instruments, equipment, etc.) is made with the purpose of obtaining a return on such investment. The return is to be classified correctly within the statement of income, whose objective is to measure the return the entity obtains from its operations (which include investments). Therefore, we find no valid argument to segregate the changes in value of certain equity instruments in other comprehensive income.

- b. *Should entities present changes in fair value in other comprehensive income only in the periods in which the investments in equity instruments meet the proposed identification principle in (a)? Why?*

As indicated above, there is no principle that would permit presenting in other comprehensive income what should be in income.

Question 12

Do you agree with the additional disclosure requirements proposed for entities that apply the proposed IFRS before its mandated effective date? If not, what would you propose instead and why?

We agree with the additional disclosures that an early adopter of this new IFRS should make.

Question 13

Do you agree with applying the proposals retrospectively and the related proposal transition guidance? If not, why? What transition guidance would you propose instead and why?

We agree that the proposals should be applied retrospectively, as that would be the only way to have consistent information among entities when the new IFRS becomes effective.

Question 14

Do you believe that the alternative approach provides more decision-useful information than measuring the financial assets at amortized cost, specifically:

- a. in the statement of financial position?*
- b. in the statement of comprehensive income?*

We do not believe the alternative approach would provide more decision-useful information for financial assets that would be both measured on an amortized cost basis and at fair value. If the assets have loan features and are managed as such, using a second measurement would not give any useful information as the return over its life is based on the interest earned.

We believe it would be confusing, since it would be a kind of “what if” information that is recognized in the financial statements. Also determining such information would be cumbersome. Therefore, if this information has only the purpose of making a second guess, if something different to what is happening would happen, including it in the financial statements would not be beneficial.

Question 15

Do you believe that either of the possible variants of the alternative approach provides more decision-useful information than the alternative approach and the approach proposed in the exposure draft? If so, which variant and why?

We believe that the approach proposed in the exposure draft is based on a sound principle, that only the financial assets and liabilities managed on an effective yield basis need to be recognized on an amortized cost and the remainder at fair value. Therefore, we do not support other variants.

Should you require additional information on our comments listed above, please contact Juan M. Gras at (52) 55 5596 5633 ext. 105 or me at (52) 55 5596 5633 ext. 103 or by e-mail at jgras@cinif.org.mx or fperezcervantes@cinif.org.mx, respectively.

Sincerely,

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Consejo Mexicano para la Investigacion y Desarrollo
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