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Mr. Steve Ong
Director, Standard Setting
Hong Kong Institute of Certified Public Accountants
37/F., Wu Chung House
213 Queen's Road East
Wanchai, Hong Kong

Dear Steve,

IASB Discussion Paper on Credit Risk in Liability Measurement ("Discussion Paper") and accompanying IASB Staff Paper

I refer to your separate letters dated 10 July 2009 to our Mr. Paul Chow and Mr. Archie Tsim on the above which have been passed to me for my attention.

We have completed our review of the above papers and our views are set out in the paragraphs below.

The Discussion Paper addresses the impact of credit risk on an entity's liabilities, referred to as "own credit risk", and the accompanying IASB Staff Paper includes arguments for and against the inclusion of the effects of subsequent changes in the credit risk. The discussion of credit risk in liability measurement is a controversial topic. We have considered the arguments for and against the inclusion of credit risk in the measurement of liabilities and are not convinced by the argument of accounting mismatch of assets and liabilities. We consider that a change in the credit risk of a company's liability does not justify re-measurement of the liability to mirror adjustments normally made for credit risk in measuring the carrying value of loans and trade receivables. We do not agree that a change in a company's own credit risk should be incorporated in the measurement of its liabilities.

We believe re-measuring the carrying value of a company's liabilities does not provide relevant information to the users of the financial statements and in fact would be misleading if the company is regarded as a going concern. Paragraph 23 of the Conceptual Framework requires that financial statements should be prepared on the underlying assumption that an entity is a going concern and will continue in operation for the foreseeable future. Under the going concern assumption, it is assumed that the entity is able, and will settle its liabilities in full when due. However, re-measuring liabilities to reflect changes in credit risk would appear to contradict the going concern assumption in that its liabilities as at the balance sheet date will be stated at amounts on the assumption that they would not be settled in full.

Paragraphs 48 and 49 of the IASB Staff Paper state that the most common objection to incorporating credit risk in the re-measurement of liabilities is the recognition of a gain from a decline in the credit quality of an entity's liabilities. We have a similar view.

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We consider recognising such gains is counter-intuitive and unrealistic. When an entity's credit standing declines, the financial position of the entity and its future prospects is deteriorating and recognising a gain sends a misleading message to users of the financial statements. If the company is a going concern, it will need to repay its liabilities in full when due. We believe that the recognition of a gain would only be justified if the lender has waived the obligation of the entity to repay, which will not normally be the case. We take the view that a decrease in the entity's credit standing does not reduce the entity's obligation and to pay less to settle its liabilities. There is no gain or inflow of economic benefits to the entity arising from a downgrade in its credit rating. The reverse is more likely to be true.

In our view, incorporation of credit risk in measuring liabilities also increases the complexity of preparing financial statements. It does not contribute to providing more meaningful and useful information. Rather, it is a move away from the objective of financial statements which is to provide useful information about assets and liabilities of an entity at a specified date. We also consider that the recognition of gains from re-measurement of liabilities as a result of changes in its "own credit risk" will be arbitrary and may possibly facilitate the manipulation of reported results. Moreover, the recent financial crisis has highlighted concerns on the independence and due diligence performed by rating agencies and this should also be considered by the IASB if it intends to pursue its proposals.

In summary, we do not agree that a company's own credit risk should be incorporated in the re-measurement of its liabilities. We have stressed many times before that the IASB is adopting an inappropriate approach in developing standards. It should consider and finalise the Conceptual Framework first. The issue considered by the Discussion Paper is in substance a conceptual framework issue of what is a "liability" and whether liabilities should be re-measured, and if so in what circumstances.

We hope that the above comments are helpful.

Yours sincerely,
For and on behalf of
The Stock Exchange of Hong Kong Limited

Colin Chau
Senior Vice President
Listing Division

CC/el

c.c. Mr. Paul Chow – Chief Executive
Mr. Archie Tsim – Chief Financial Officer
Mr. Mark Dickens – Head of Listing