



Accounting Standards Board

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International Accounting Standards Board
30 Cannon Street
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Dear Sirs

Exposure Draft of proposed amendments to IFRS 7 'Financial Instruments: Disclosures'

The ASB is responding to the Exposure Draft (ED) 'Improving Disclosures about Financial Instruments: Proposed Amendments to IFRS 7'. The ASB's responses to the questions asked in the ED are set in an Appendix to this letter.

The ASB fully supports the IASB's objective to improve the information provided about financial instruments to enable users to form judgements about their potential implications on an entity's financial position and performance. The proposed amendments will also serve to address some of the issues preparers have raised about the practicalities of applying IFRS 7. Present market conditions have highlighted the importance of relevant and reliable information about financial instruments.

The ASB is concerned that not requiring disclosure of contractual maturities may lead to a loss of information which is useful to users of the financial statements. Our working assumption is that users are keen to understand an entity's maximum exposure arising from a derivative financial liability, in addition to management's expectations about its settlement value. For that reason, in our Financial Reporting Exposure Draft, we have invited UK constituents to comment on whether additional disclosure of contractual maturities is warranted where an entity does not manage liquidity risk on that basis.

Should you have any queries regarding our response please contact me or Mario Abela, Project Director, on 020 7492 2442 or by email m.abela@frc-asb.org.uk.

Yours sincerely

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Appendix – Response to Invitation to Comment

Fair Value Disclosures

Question 1

Do you agree with the proposal in paragraph 27A to require entities to disclose the fair value of financial instruments using a fair value hierarchy? If not, why?

ASB response:

We support the proposal to introduce a fair value hierarchy as it should improve the ability of users to assess the decision-usefulness of information disclosed about the fair value of financial instruments.

Question 2

Do you agree with the three-level fair value hierarchy as set out in paragraph 27A? If not, why? What would you propose instead, and why?

ASB response:

We support the introduction of a three-level hierarchy.

However, it is not clear to us what is required in terms of assessing a “significant input” for the purposes of fair value hierarchy (last two sentences in paragraph 27A). The issue is about what reference point to use to make assessments of “significance”. We think that “significant to the fair value measurement in its entirety” can be interpreted in a number of ways, given the absence of guidance which accompanies that phrase in SFAS 157.

For that reason, we believe that paragraph 27A needs to be expanded to explain that “significance” relates to the importance of the input to the pricing of a financial instrument rather than the materiality of its effect on the value of a class of instruments as a whole. In the case of equity instruments where there is an observable market price, the fair value measurement clearly falls within Level 1 of the hierarchy. For pricing a share option, a valuation technique may need to be employed where:

- (a) all significant inputs are based on observable market data (Level 2); or
- (b) one or more significant inputs are not based on observable market data (Level 3).

This distinction is made in the table at paragraph IG13A but as it is so fundamental to applying the hierarchy, it should be explained within the Application Guidance.

It would also be useful to remove the circular reference: “...a significant input is an input that is significant”. We would suggest the following wording “...a significant input is determined by reference to its importance and impact in the determining the fair value of a financial instrument”.

Question 3

Do you agree with the proposals in:

- (a) paragraph 27B to require expanded disclosures about the fair value measurements recognised in the statement of financial position? If not, why? What would you propose instead and why?*
- (b) paragraph 27C to require entities to classify, by level of the fair value hierarchy, the disclosures about the fair value of the financial instruments that are not measured at fair value? If not, why? What would you propose instead, and why?*

ASB response:

We broadly support the expanded disclosures.

However, as part of the FRC's research and consultation with UK constituents for its Complexity of Corporate Reporting Project, some have raised concerns about the disclosure requirements in IFRS 7. In particular, we are not convinced that materiality is applied consistently to these disclosures. As a result, we have observed extensive disclosures in financial reports for non-material financial instrument exposure.

We note that the Implementation Guidance to IFRS 7 at paragraphs IG3-4 restates the definition of materiality from IAS 1 but it does not offer guidance on applying that overall principle to IFRS 7. We accept that the application of materiality is a matter of judgement, based on facts and circumstances, but it would be useful for the IASB to provide some guidance on how to relate that principle to the objective of IFRS 7. In our view, such clarification could be achieved by inserting a paragraph after IG2 that relates the point about coherence between disclosures to the role of qualitative characteristics (including materiality) in guiding that judgement.

Liquidity risk disclosures

Question 4

Do you agree with the proposal in paragraph 39(a) to require entities to disclose a maturity analysis for derivative financial liabilities based on how the entity manages liquidity risk associated with such instruments? If not, why? What would you propose instead, and why?

ASB response:

We support the proposal to disclose expected maturities of derivative financial liabilities on the basis that it will provide insights to users about how management manages liquidity risk. However, we also consider contractual maturities to be relevant to users in providing a 'worst case' position of what an entity is contractually bound to settle at. The absence of information about remaining contractual maturities may impair users' understanding of liquidity risk. Where markets are fluctuating and unstable, management's expected values may be unrealistic and, therefore, in the interests of transparency, information about maximum exposure may be of particular relevance. We note that in the IASB's discussions with constituents on the implementation of IFRS 7, this was raised as one of the problem areas. For that reason, we have asked, in our Invitation to Comment, whether UK constituents believe it is warranted to require both expected and contractual maturities to be disclosed for derivative financial liabilities.

Although our comment period does not close until 30 January 2009, we would be willing to share the feedback we receive from constituents on this issue if you consider that helpful.

Question 5

Do you agree with the proposal in paragraph 39(b) to require entities to disclose a maturity analysis for non-derivative financial liabilities based on remaining expected maturities if the entity manages the liquidity risk associated with such instruments on the basis of expected maturities? If not, why? What would you proposed instead, any why?

ASB response:

We support the proposed disclosure of maturities for non-derivative financial liabilities.

Question 6

Do you agree with the amended definition of liquidity risk in Appendix A? If not, how would you define liquidity risk, and why?

ASB response:

We support the amended definition of liquidity risk.

We note that paragraph B11E (Application Guidance) states that “if appropriate, the entity shall disclose a maturity analysis of financial assets it holds for managing liquidity risk”. In our view, the IASB should make clear that in satisfying the requirements of paragraph 39(c) the overriding principle is to provide users with an understanding of *how the entity* manages liquidity risk – that is likely to involve both quantitative and qualitative information. If an entity manages it on the basis of expected maturities then presentation of financial liability and financial asset maturities is relevant and should be disclosed. However, where an entity manages liquidity risk on a net basis, information on that net position may also be useful for users in understanding and forming judgements about the strength of those management approaches. There is a danger that the requirements of paragraph 39(c) can be interpreted too narrowly and fail to provide users with sufficient information to enable them to understand how the entity manages liquidity risk.

Accordingly, we would suggest that the IASB makes two changes:

- (i) Paragraph 39(c) needs to be expanded to reflect not just a “description” but other relevant information to assist users to understand how liquidity risk arising from financial instruments is managed (which is consistent with the overall objective of this section of the Standard as set out in paragraph 31); and
- (ii) the emphasis of B11E should be to expanded to explain the types of both quantitative and qualitative information that may be relevant to enhancing users’ understanding of an entity’s liquidity risks.

Effective date and transition

Question 7

Do you agree with the proposed effective date? If not, why? What would you propose instead and why?

ASB response:

We support the proposed effective date.

Question 8

Are the transition requirements appropriate? If not, why? What would you propose instead and why?

ASB response:

We support the proposed transition requirements.