



The South African Institute of Chartered Accountants

15 December 2008

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

Email: CommentLetters@iasb.org

Dear Sir/Madam

SAICA SUBMISSION ON EXPOSURE DRAFT *IMPROVING DISCLOSURES ABOUT FINANCIAL INSTRUMENTS* – PROPOSED AMENDMENTS TO IFRS 7

In response to your request for comments on the IASB's exposure draft, *Improving Disclosures about Financial Instruments – Proposed Amendments to IFRS 7 - Financial Instruments: Disclosures* ('IFRS 7'), attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

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GENERAL COMMENTS

We support the need for further disclosure to be provided for financial instruments that are recognised at fair value, and believe that the proposed fair value hierarchy disclosures provide useful information for users of financial statements. We have however noted in this submission several comments that we have with regard to the proposed amendments. Our principal concerns are with respect to:

- The proposed effective date, as this will require certain entities to start sourcing comparative information even before the proposed amendment has been finalised;
- The banking and financial services industry is, in particular, concerned with providing fair value hierarchy disclosures for instruments that are not measured at fair value, but for which fair value information is disclosed. They believe that the cost of obtaining such information may exceed the benefits to users of that information and also question the usefulness of that information, especially where those instruments are neither realised nor managed on a fair value basis; and
- Certain detailed disclosures surrounding fair value adjustments in total comprehensive income which we believe will not be practical to obtain and have limited benefit to the users.

We do not agree with the revised definition of liquidity risk. We have recommended a revised definition and, whilst we support the other recommended changes to the liquidity risk disclosures, we have provided additional comments and suggestions below.

SPECIFIC COMMENTS

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?

We agree with the proposal to disclose the fair value of financial instruments using a fair value hierarchy. We believe that the proposed amendment provides both relevant and useful information to the users of financial statements. Paragraph 27A seeks to formalise the process of what is required to be disclosed by both linking the fair value measurement requirements of IAS 39 - *Financial Instruments: Recognition and Measurement* ('IAS 39') to disclosures of fair value as well as providing a description of each level of the fair value hierarchy. However, we believe that IAS 39 should also be revised by incorporating specific reference to the fair value hierarchy as proposed by IFRS 7 in paragraph 27A.

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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?

We agree in principle with the three-level fair value hierarchy that has been proposed. We do however have concerns that there is a level of subjectivity surrounding the allocation of financial instruments into each of the proposed levels of the hierarchy.

We propose that further clarification be provided for each of the levels of the hierarchy by way of examples. We propose that such examples be provided in the application guidance to IFRS 7 so that the standard is principle rather than rule-based, but that the guidance is provided. We also note that FASB Statement No. 157- *Fair Value Measurements* provides further guidance which regard to the levels of the hierarchy and recommend that, to seek convergence between US GAAP and IFRS, this guidance be inserted into the amendment.

We also recommend that the proposed amendment require qualitative disclosure of the specific types of inputs and assumptions that an entity has used to classify financial instruments as level 1, 2 and 3. This will permit an entity to link the fair value disclosure as set out in the proposed amendments with the specific types of inputs that it has used in its financial instruments.

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?

We agree with the proposal to provide further expanded disclosures about fair value measurements for instrument that have been recognised at fair value in the statement of financial position. We have however noted below the following principal comments:

- We do not believe that the cost of providing certain of the disclosures provides sufficient benefits;
- We question whether requiring these disclosures by class of financial instrument is appropriate or whether such disclosure could instead merely be required by category of financial instrument (as set out in IG13B of the amendment); and
- We do not believe that the proposed amendment should mandate that the proposed disclosures be provided in a tabular format. We recommend rather that this requirement be suggested rather than being required as a rule.

We have further analysed each of the respective paragraphs within paragraph 27B and have provided detailed comment on each paragraph below:

- a) We agree with proposal (a) to provide disclosure of the level in the fair value hierarchy into which the fair value measurements are categorised in their entirety. However, we believe that the wording “*in their entirety*” causes ambiguity, particularly with respect to financial

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instruments that have embedded derivatives. The sentence could be interpreted as stating that fair value disclosure is required in terms of paragraph 27B for an entire financial instrument, even if only the embedded portion of the instrument is measured at fair value. Alternatively, the requirement could be read to require disclosure only for those components of an instrument that are measured at fair value, which we believe to be the true intention of the amendment. Accordingly, we propose that the sentence be amended to require disclosure of “*the level in the fair value hierarchy into which the fair value measurements are categorised for each separately recognised financial instrument that is measured on a fair value basis*”.

b) We agree with proposal (b) to require disclosure of a reconciliation of all level 3 items from the opening balances for the period to the closing balances for the period. We question whether requiring these disclosures by class of financial instrument is appropriate or whether such disclosure could instead (or alternatively) be required by category of financial instrument (as set out in IG13B of the amendment). Should the IASB not consider it appropriate for such disclosures to be provided by category of financial instrument, we propose that example IG13B be amended so that the example shows the information by class of instrument as opposed to by category. We further believe that the following changes should be made to the reconciliation to ensure that the reconciliation is complete:

- Delete the reference to “*realised and unrealised*” in item (i) as the disclosure only requires total gains and losses to be shown. The disclosure of all gains and losses, whether realised or unrealised, is implied by the fact that disclosure of both gains and losses and items that are settled during the period are also required;
- Insert the word “*net*” for item (iii) at the beginning of the sentence instead of in brackets at the end, as the current placement of the word in the sentence could be interpreted to mean that only issues and settlements are required to be disclosed net. The example in IG13B clearly shows that all purchases, sales, issues and placements should be shown on a net basis. We also propose that all other non-fair value movements, such as acquisitions through business combinations be included in this disclosure item. We propose the following wording, “*net of purchases, sales, issues, settlements and other non-fair value movements*”;
- In addition to requiring disclosure of transfers into and out of level 3, an inter-class (or inter-category) transfer line should be required. Although this type of movement would be limited, the recent IAS 39 amendment (‘Reclassification of financial assets’) has shown that there may be instances where these types of transfers do occur.

c) We question whether the proposal (c) to require disclosure of the total amount of unrealised gains and losses for the period included in profit or loss for items held at the end of the period provides sufficiently useful information for the following reasons:

- Differentiating realised gains and losses from unrealised gains and losses becomes judgemental and may lead to inconsistent application (e.g. interest and foreign exchange movements); and
- Entities may determine the amount of unrealised gains and losses differently in terms of how the financial assets and liabilities are realised, i.e. some entities may account for its

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securities on a first-in-first-out (FIFO), last-in-first-out (LIFO), weighted average or by specific identification method – each method of which will result in different amounts of unrealised gains and losses.

We further question why disclosure is only required for realised and unrealised losses for items that are measured through profit and loss (item b(i)) and not for items that are measured through other comprehensive income (item b(ii)). We believe that any required disclosure should be consistent both for profit or loss and other comprehensive income.

- d) We agree with the fact that disclosure should be provided when changing fair value assumptions that would change fair value significantly.

We note that paragraph 27B contains a mixture of disclosures for all levels of the hierarchy and those that only pertain to level 3 disclosures. To avoid confusion, we recommend that all of the proposed level 3 disclosure requirements be grouped together within IFRS 7 as a separate paragraph (i.e. paragraph 27B (b), (c) and (d)).

- e) We note that the proposal (e) to require disclosure of movements between levels of the hierarchy in addition to those proposed in paragraph 27B(b)(iv) could either be read as requiring quantitative or qualitative disclosure. Furthermore, it is not clear whether this disclosure item is required for all financial instruments during the period or whether it is only required with respect to items that still exist at the balance sheet date.

We also question whether the cost of sourcing and disclosing this level of information warrants its benefits. This is because the split between level 1 and 2 requires less judgement by management and values that are derived from both of these levels carry fairly similar levels of reliance in terms of fair value determination.

- (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?*

We note that the proposal to provide disclosure of fair value information by the level of the fair value hierarchy for instruments that are not recognised at fair value in the statement of financial position does provide additional information to the users of the financial statements. However, this proposed disclosure requirement poses considerable requirements for entities such as those operating in the banking and financial services industry. The assessment of which inputs are more significant than others could prove to be highly subjective and, given that in most instances entities would not realise such instruments on a fair value basis, we believe that it is questionable whether the cost of establishing systems to gather this information would warrant its benefits.

We also note that within 27C the word categorised has been misspelt as 'catergorised'.

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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 the liquidity risk associated with such instruments? If not, why? What would you propose instead, and why?

We agree with the proposal to require disclosure of liquidity risk for derivative financial liabilities on the basis of how an entity manages that risk. However, since the liquidity risk of both derivative financial assets and derivative financial liabilities are often managed together, it would be more appropriate to disclose, in those instances, the net liquidity risk.

Furthermore, for derivatives that are settled on a gross basis, we recommend that disclosure be provided for the pay leg for all gross settled derivatives, i.e. both assets and liabilities, with disclosure being encouraged, but not required, of the receipt of cash or other financial asset leg.

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 propose instead, and why?

We agree with the proposal to require disclosure of a contractual maturity analysis for non-derivative financial liabilities. However, we do not believe that the disclosure of expected maturities should be made mandatory within IFRS 7, but rather be added as application guidance as part of B11E(g). IFRS 7 already requires disclosure in paragraph 39(b) of how the entity manages its liquidity risk, which is shown within the contractual maturity analysis. Where the entity believes that the risk is significantly different to the contractual analysis, it would be required to explain how it manages its liquidity risk, which could include an expected cash flow analysis.

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?

We disagree with the proposed definition of liquidity risk, as we believe that there are certain circumstances that will be excluded from the definition which would result in an entity having liquidity risk.

For example, if an entity had entered into a contract to buy coal for cash and the contract fails the own use exemption (due to historic practices), the entity would, in terms of IAS 39, account for the contract as a derivative. Based on the proposed definition of liquidity risk, some may argue that this contract would not be included in the computation of the entities liquidity risk since one leg of the contract would be settled in coal (a non-financial asset).

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Further, for entities that enter into a contract whereby delivery of a non-financial asset is required, but where the entity needs to pay cash to acquire the non-financial asset for delivery, the proposed definition would not include the outflow of cash in the computation of its liquidity risk. For example: entity A enters into a contract to deliver coal to entity B. Entity A does not have the coal to deliver and enters into a spot market transaction to acquire sufficient coal to deliver it to entity B.

We propose that the definition of liquidity risk be amended as follows: *“The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities and other cash settled commitments with the exception of those that are settled in an entity’s own equity instruments”*.

Effective date and transition

Question 7

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

We disagree with the proposed effective date as this will require certain entities to start sourcing comparative information even before the proposed amendment has been finalised. For instance, an entity with a financial year ending on 30 June 2009 would currently be required to source comparative information for all of the proposed amendments, even though the amendments have not been finalised.

While we note the urgency for which these disclosures are required, we propose the following as an alternative to the amendment’s proposed effective date and transitional requirements:

- a) The amendment only requires balance sheet disclosure for comparative information such as that required in paragraph 27B (a), (c) and(d); or
- b) The amendment does not require comparative information for the first period beginning on or after 1 July 2009.

Should the above-mentioned proposals not be considered appropriate by the Board, we recommend that, due to the significance of the system requirements that are required to be established in order to collate the required information, the effective date be moved to periods beginning on or after 1 July 2010.

Question 8

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

Please refer to our response to question 7.

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OTHER COMMENTS

We would like to note the following additional comments:

- a) No reference has been provided for consequential amendments to other standards such as IFRS 4 - *Insurance contracts* ('IFRS 4'). For instance, Para 39(d)(i) of IFRS 4 references to the old paragraph 39(a) of IFRS 7 which under the amendment has been changed to 39(b).
- b) We do not believe that B11C(c), which requires liquidity risk disclosure on financial guarantees and loan commitments, should be included under B11C as this paragraph pertains to derivative financial liabilities. Gross settled loan commitments and financial guarantees do not meet the definition of derivative financial liabilities.
- c) We question why the following items have been deleted out of IFRS 7's existing application guidance as they are still applicable and have not been included in the proposed amendments:
 - Paragraph B14 with specific regard to sub-paragraphs (a) & (b); and
 - Paragraph B16.

We recommend that these disclosure items be retained in IFRS 7.

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