

**CL 6**

8 October 2004

The Director – Accounting & Professional Standards  
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Dear Sir/Madam

**Comments on IASB Exposure Draft 7 *Financial Instruments: Disclosures***

The following submission on ED 7 is on behalf of ASB Bank Limited.

**General Comments**

Although we support the IASB's process of ongoing development and improvement of accounting standards, the timing of the issue of ED 7 is far from ideal. For entities such as ASB Bank Limited, which is adopting in 2005, all efforts and resources are concentrated on complying with the stable platform of IFRSs. We would much prefer to consider further changes only once we have successfully made the transition to IFRS.

ED 7 appears to be reducing the disclosures for banks and increasing the disclosures for corporates. We are concerned that in the absence of SME standards, entities with no public accountability will need to comply fully with IFRS, including ED 7. We consider that compliance with ED 7 should be optional for entities with no public accountability. Alternatively, the changes should be restricted to banks by maintaining a separate standard for banks.

We note that entities are encouraged to adopt the IFRS to be based on ED 7 earlier than its effective date of 2007. We do not think that this option is practicable given the short timeframe involved and the remaining uncertainties around the application of IAS 39 for banks and the development of SME standards.

There are also a number of New Zealand specific issues, set out more fully under New Zealand specific issues below, which affect our ability to comment fully on ED 7 at this time.

## Specific Matters for Comment

*IASB Question 1 – Disclosures relating to the significance of financial instruments to financial position and performance*

*IASB ED 7 incorporates disclosures at present contained in IAS 32 Financial Instruments: Disclosure and Presentation so that all disclosures about financial instruments are located in one standard. It also proposes to add the following disclosure requirements:*

- (a) financial assets and financial liabilities by classification (see paragraphs 10 and BC13);*
- (b) information about any allowance account (see paragraphs 17 and BC14);*
- (c) income statement amounts by classification (see paragraphs 21(a), BC15 and BC16); and*
- (d) fee income and expense (see paragraphs 21(d) and BC17).*

*Are these proposals appropriate? If not, why not? What alternative disclosures would you propose?*

Yes, it is appropriate to locate all risk disclosures relating to financial instruments in one standard, subject to appropriate exemptions for entities with no public accountability. For example, many banks have closely held subsidiaries which hold large financial instruments but are not themselves financial institutions. Considerable cost and effort would be required to comply with full disclosure of financial instruments in the individual statutory accounts of the subsidiaries as well as in the consolidated parent accounts, for no discernable benefit.

*IASB Question 2 – Disclosure of the fair value of collateral and other credit enhancements*

*For an entity's exposure to credit risk, IASB ED 7 proposes to require disclosure of the fair value of collateral pledged as security and other credit enhancements unless impracticable (see paragraphs 39, 40, BC27 and BC28).*

*Is this proposal appropriate? If not, why not? What, if any, alternative disclosures would you propose to meet the stated objective?*

We do not agree with the proposal to disclose the fair value of collateral received. Disclosing the value of collateral received without linking it to the exposure it secures would be of limited value to the user of financial statements. Full disclosure of this information would, however, be onerous and commercially sensitive.

As noted in BC28, preparing quantitative data on collateral, particularly for banks and other financial institutions in the business of lending, is onerous and often impracticable. We consider that qualitative information, together with the other proposed disclosures on credit risk and the disclosures of risk weighted assets required by banks under the Basel Accord, provides sufficient information in the financial statements.

*IASB Question 3 – Disclosure of a sensitivity analysis*

*For an entity that has an exposure to market risk arising from financial instruments, IASB ED 7 proposes to require disclosure of a sensitivity analysis (see paragraphs 43, 44 and BC36–BC39).*

*Is the proposed disclosure of a sensitivity analysis practicable for all entities?*

*If not, why not and what, if any, alternative disclosures of market risk would you propose to meet the stated objective of enabling users to evaluate the nature and extent of market risk?*

We are broadly comfortable with the proposed disclosures being applicable to banks. Most banks will already have in place the necessary systems and processes to perform sensitivity analysis as part of their risk management policies. Disclosure of sensitivity to risk provides useful information to investors and is in line with other global initiatives such as the new Basel Accord.

We note, however, that considerable effort is required to construct systems and processes to perform the necessary calculations and question whether the benefit is commensurate with the cost involved for entities other than issuers or financial institutions.

*IASB Question 4 – Capital disclosures*

*IASB ED 7 proposes disclosure of information that enables users of an entity's financial statements to evaluate the nature and extent of its capital. This includes a proposed requirement to disclose qualitative information about the entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether during the period it complied with any capital targets set by management and any externally imposed capital requirements; and if it has not complied, the consequences of such non-compliance (see paragraphs 46–48 and BC45–BC54).*

*Is this proposal appropriate? If not, why not? Should it be limited to only externally imposed capital requirements? What, if any, alternative disclosures would you propose?*

We do not have any issues with disclosing descriptions and amounts of capital, or externally imposed capital targets. These requirements are similar to those already contained in the prudential framework under which banks must measure and report their financial information.

We question the requirement to disclose descriptions of what an entity regards as capital, given the prescriptive nature of IAS 32 regarding the classification of an instrument as liability or equity.

We strongly disagree with the proposal to require disclosure of internal capital targets and policies for managing capital, as this information is commercially sensitive. We also do not consider that it adds useful information to assist investors in decision-making.

*IASB Question 5 – Effective date and transition*

*The proposed effective date is for periods beginning on or after 1 January 2007 with earlier adoption encouraged (see paragraphs 49 and BC62–BC67).*

*Entities adopting IFRSs and IASB ED 7 for the first time before 1 January 2006 would be exempt from providing comparative disclosures for IASB ED 7 in the first year of adoption (see Appendix B, paragraph B9).*

*Are the proposed effective date and transition requirements appropriate? If not, why not? What alternative would you propose?*

As stated in our general comments we have strong concerns about the timing of ED 7 and its proposed effective date. Entities which are adopting in 2005 will already have invested considerable time and resources in working towards complying with IAS 32 and IAS 30. It is unlikely that, in the short timeframe available, they will be able to develop the necessary processes to enable disclosures to comply with an as yet unfinalised new standard, as well as complying with the other requirements of IFRS. On this basis, entities would need to change their disclosures to comply with the stable platform and then, within two years, make further substantial changes. Banks are also subject to new disclosures under the Basel Accord, which in many cases are still under review with local regulators. These factors will lead to significant extra costs and make consistency of reporting very difficult.

Given the timeframe available and the complexity of changes, especially around sensitivity analysis, the introduction of a new disclosure standard should be delayed and the exemption for providing comparatives should be extended.

*IASB Question 6 – Location of disclosures of risks arising from financial instruments*

*The disclosure of risks arising from financial instruments proposed by IASB ED 7 would be part of the financial statements prepared in accordance with IFRSs (see paragraph BC41). Some believe that disclosures about risks should not be part of financial statements prepared in accordance with IFRSs; rather they should be part of the information provided by management outside the financial statements.*

*Do you agree that the disclosures proposed by IASB ED 7 should be part of the financial statements? If not, why not?*

Yes, we agree that the disclosures should form part of the financial statements.

*IASB Question 7 – Consequential amendments to IFRS 4 (paragraph B10 of Appendix B)*

*Paragraph B10 of Appendix B proposes amendments to the risk disclosures in IFRS 4 Insurance Contracts to make them consistent with the requirements proposed in IASB ED 7. The requirements in IFRS 4 were based on disclosure requirements in IAS 32 that would be amended by IASB ED 7. The IASB's reasons for proposing these amendments are set out in paragraphs BC57–BC61.*

*Do you agree that the risk disclosures in IFRS 4 should be amended to make them consistent with the requirements proposed in IASB ED 7? If not, why not and what amendments would you make pending the outcome of phase II of the IASB's Insurance project?*

We have no comment on insurance issues.

#### *IASB Question 8 – Implementation Guidance*

*The draft Implementation Guidance accompanying IASB ED 7 suggests possible ways to apply the risk disclosure requirements in paragraphs 32–45 (see paragraphs BC19, BC20 and BC42–BC44).*

*Is the Implementation Guidance sufficient? If not, what additional guidance would you propose?*

Yes, the guidance is sufficient.

#### *IASB Question 9 – Differences from the Exposure Draft of Proposed Statement of Financial Accounting Standards Fair Value Measurements published by the US Financial Accounting Standards Board (FASB).*

*The FASB's Proposed Statement of Financial Accounting Standards Fair Value Measurements, which is open for public comment at the same time as IASB ED 7, proposes guidance on how to measure fair value that would apply broadly to financial and non-financial assets and liabilities that are measured at fair value in accordance with other FASB pronouncements. That Exposure Draft proposes disclosure of information about the use of fair value in measuring assets and liabilities as follows:*

- (a) for assets and liabilities that are remeasured at fair value on a recurring (or ongoing) basis during the period (for example, trading securities):*
  - (i) the fair value amounts at the end of the period, in total and as a percentage of total assets and liabilities;*
  - (ii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used); and*
  - (iii) the effect of the remeasurements on earnings for the period (unrealised gains or losses) relating to those assets and liabilities still held at the reporting date; and*
- (b) for assets and liabilities that are remeasured at fair value on a non-recurring (or periodic) basis during the period (for example, impaired assets), a description of:*
  - (i) the reason for remeasurements;*

- (ii) *the fair value amounts;*
- (iii) *how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used); and*
- (iv) *the effect of the remeasurements on earnings for the period relating to those assets and liabilities still held at the reporting date.*

*Disclosures similar to (a)(ii) above are proposed in paragraph 31 of IASB ED 7 (and are currently required by paragraph 92 of IAS 32) and disclosures similar to (a)(iii) are proposed in paragraph 21(a) of IASB ED 7.*

*Do you agree that the requirements in IASB ED 7 provide adequate disclosure of fair value compared with those proposed in the FASB's Exposure Draft? If not, why not, and what changes to IASB ED 7 would you propose?*

Yes, we agree that the disclosures are adequate.

#### *IASB Question 10 – Other comments*

*Do you have any other comments on IASB ED 7, Implementation Guidance and Illustrative Examples?*

We have no other comments.

## *New Zealand Specific Questions*

### *1. Are the disclosure requirements in NZ IASB ED 7 sufficient for banks and similar financial institutions?*

Although the less prescriptive nature of ED 7 is broadly welcome, it is difficult for us to comment on it in a New Zealand perspective, given recent experience with the ASRB accommodating Reserve Bank of New Zealand's ("RBNZ's") requirement for substantial additional disclosures in the New Zealand version of *IAS 30 Disclosures in the Financial Statements of banks and Similar Financial Institutions* to conform with RBNZ's own disclosure regime. There is additional uncertainty around disclosures required under Basel II. On this basis it is very unclear how much of the reduction in specific disclosures will ultimately be available to New Zealand banks and, conversely, whether further changes will be introduced to the disclosures.

We have strong concerns about the process of adopting a replacement for IAS 30 in New Zealand in terms of the volume of change and how ongoing maintenance of the standard(s) will be managed to ensure overall compliance with both IFRS and the RBNZ's Orders in Council. We note that under IFRS there is likely to be a significant increase in the level of disclosures in our financial statements. If RBNZ continues to require further substantial disclosures, for example its own market risk disclosures in addition to the sensitivity analysis set out in ED 7, the financial statements are likely to become unwieldy and potentially confusing to the reader.

Another issue is that, like many New Zealand banks and other corporates, we also need to comply with the disclosures required by an overseas parent. If the New Zealand version of IFRS continues to develop large numbers of additional New Zealand-specific disclosures it will partly defeat the goal of IFRS to develop standardised global reporting. In this light we recommend that the trans-Tasman accounting advisory group continue its work in converging standards between New Zealand and Australia.

We will be very interested to see the outcome of the Ministry of Economic Development's review of the Financial Reporting Structure, which will determine which entities in New Zealand will need to comply fully with IFRS, and the form of reduced reporting for the proposed tier 2 entities (the replacement for ICANZ's Framework for Differential Reporting). Our comments on ED 7 are likely to differ depending on whether it applies to ASB Bank Limited only or to all members of the ASB Group. Under the existing New Zealand Differential Reporting Framework, for example, closely held subsidiaries of banks are exempt from making full disclosures of financial instruments. The effects of the activities of these subsidiaries are included in the consolidated "banking group" financial statements. Given that there is no separation of ownership and management for these companies or any public accountability requirements, full disclosure would not provide benefits that exceed the cost of providing the information.

2. *Does NZ IASB ED 7 need to be adapted to allow public benefit entities to comply with the requirements?*

We do not have any comment on this issue.

3. *Are there any regulatory issues or other issues arising in the New Zealand environment that may affect the implementation of the proposals in IASB ED 7, particularly any issues relating to:*
- a) public benefit entities;*
  - b) profit-oriented entities; and*
  - c) the Privacy Act 1993?*

See comments under question 1 above, regarding additional disclosure requirements of RBNZ Orders in Council governing disclosures to be made by Registered Banks and the new reporting and differential reporting frameworks.

4. *Would adoption of the proposals in NZ IASB ED 7 be in the best interests of users of general purpose financial reports in New Zealand?*

For the reasons set out in our response to question 1 above we have serious concerns about the ongoing volume of change to accounting standards. We also consider that the proposals are not suitable for all general purpose financial reports, particularly those with no public accountability. This aspect needs to be considered in the review of the reporting framework and differential exemptions.

If you would like any more information concerning our submission please do not hesitate to contact me.

Yours faithfully

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