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Sir David Tweedie
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Our ref MT/288
Contact Mary Tokar

15 January 2009

Dear Sir David

Comment letter on Exposure Draft *Investments in Debt Instruments – Proposed amendments to IFRS 7*

We appreciate the opportunity to comment on the International Accounting Standards Board's (IASB or Board) Exposure Draft *Investments in Debt Instruments – Proposed amendments to IFRS 7* (ED). This letter expresses the views of the international network of KPMG member firms.

We support the Board's efforts to respond to the financial reporting issues that result from the difficulties encountered by entities due to the current economic environment and to issues raised by participants at the recent joint IASB and US Financial Accounting Standards Board (FASB) round table meetings. We support, in principle, the Board's proposal to use additional disclosures as an interim response to issues raised by participants at the round table meetings with respect to differences between the measurements of different categories of investments in debt instruments.

However, we believe that the proposed disclosure requirements do not address, in the clearest and most efficient manner, the requests by participants at the round table meetings for disaggregated disclosures of impairment losses on available-for-sale (AFS) debt instruments split between "incurred losses" and other fair value changes. Moreover, the proposed disclosure requirements go beyond providing this requested information. We believe that the proposed disclosure requirements may pose an undue burden on entities, particularly given the additional effort required by entities to implement the requirements in a short timeframe. We do not think it is appropriate for the Board to enact new disclosure requirements, with immediate retrospective effect, that go beyond the disaggregated impairment loss information for AFS debt instruments that users requested.

Although we support co-ordinated efforts between the IASB and the FASB to achieve consistent high-quality global standards, in this case we believe that the more diverse environment in which IFRSs are applicable requires the IASB to move at a more cautious pace. The IASB should ensure that the costs and benefits of additional financial instrument disclosures beyond disaggregated loss information for impaired AFS debt instruments are addressed in a more holistic and extensive manner, but still as a matter of priority, following consultation with the Financial Crisis Advisory Group during early 2009 and as part of the Boards' comprehensive examination of possible enhancements to financial reporting arising from recent market conditions.

Therefore, in our view, the Board should amend the proposed disclosure requirements to require only disaggregated impairment information for AFS debt instruments as at the proposed date of adoption and for future periods but not for the period of adoption. We believe that the Board should defer consideration of any further disclosure requirements until later in 2009.

Our principal comments are as follows:

- To meet requests for disaggregated information for impairment losses on AFS debt instruments, disclosures of profit or loss impacts should be focused on disclosing impairment losses recorded on AFS debt instruments and the amounts that would have been recorded if those instruments had been accounted for at amortised cost.

- The proposed disclosures of overall *pro forma* pre-tax profit or loss amounts do not provide this disaggregated impairment loss information in the most efficient manner. Disclosure of overall *pro forma* pre-tax profit or loss figures as if all debt instruments had been accounted for at fair value through profit or loss go beyond reported user requests. Although such a disclosure may be responsive to the Boards' objective of enhancing comparability across reporting entities, we believe that it is not appropriate to make such changes with such short notice given entities will be required to apply the proposed changes immediately.

- The proposed balance sheet disclosures are largely duplicative of current IFRS 7 *Financial Instruments: Disclosures* requirements. The only proposed incremental disclosure requirement relates to the amortised cost of AFS debt instruments. The proposed requirement to disclose the amortised cost of AFS debt instruments should be amended to require disclosure of what the amortised cost would have been if these instruments had been *accounted for* at amortised cost.

- The Board should clarify that the "as-if at amortised cost" disclosures for AFS debt instruments should not include a collective impairment loss allowance.

- Amounts for AFS debt instruments as if they had been accounted for at amortised cost could be different from those based on the actual amortised cost of those debt instruments as defined in IAS 39. Entities therefore will be required to undertake additional efforts to produce the proposed disclosures and the Board should not require disclosure of profit or loss impacts for the annual period of adoption.

Appendix 1 contains our detailed responses to the specific questions raised in the ED and other drafting comments.

Please contact Mary Tokar or Chris Spall at +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

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Appendix 1

Question 1: The exposure draft proposes in paragraph 30A(a) to require entities to disclose the pre-tax profit or loss as though all investments in debt instruments (other than those classified as at fair value through profit or loss) had been (i) classified as at fair value through profit or loss and (ii) accounted for at amortised cost.

Do you agree with that proposal? If not, why? What would you propose instead, and why?

We do not agree with the proposal. This proposed amendment is described by the Board as a response to comments from constituents who participated in the joint IASB and FASB round table meetings. As described in paragraph BC4 of the ED, most of the constituents taking part in the round table discussions agreed that disaggregated information about impairment losses recognised for available-for-sale (AFS) debt instruments would be useful. The constituents suggested that the impairment loss information for AFS debt instruments be disaggregated between incurred losses and the remaining fair value changes. In our view, the proposed disclosures do not respond in the clearest and most efficient manner to the requests from most constituents taking part in the round table discussions for disaggregated information about impairment losses recognised for AFS debt instruments. The proposed disclosures will require additional efforts by preparers within a short timeframe. Therefore, at present, we support more focused disclosures in relation only to AFS debt instruments and encourage the Board to defer any conclusion requiring any further disclosures or changes to the presentation of impairment losses.

In response to the user requests reported by the Board, we believe that paragraph 30A(a) should be replaced with a requirement for entities to disclose:

- the impairment losses recorded in pre-tax profit or loss on AFS debt instruments (as required by IFRS 7.20(e));

- the impairment losses that would have been recorded in pre-tax profit or loss on AFS debt instruments had they been accounted for at amortised cost; and

- any adjustments in respect of reversals of impairment losses, interest income and foreign exchange gains/(losses) that would have been recorded in pre-tax profit or loss on AFS debt instruments if they had been accounted for at amortised cost.

Given the current measurement requirements for AFS debt instruments, we believe that this disclosure would most closely be responsive to requests by users for disaggregated loss information. We also believe that this disclosure would have the following other advantages over what is proposed in the ED:

- The current proposals do not provide any visibility into or analysis of the differences between recorded profit or loss and the amounts that would have been recorded had the AFS debt instruments been accounted for on an amortised cost basis.

- The current proposals are effectively a requirement to disclose overall *pro forma* pre-tax profit or loss information for the entity. Disclosure of pro forma information is less common under IFRSs than under US GAAP. We believe that given the compressed timeframe for entities to comply with the proposed requirements and the fact that the *pro forma* disclosures go beyond the requests of most constituents at the round table discussions, it would be more appropriate at this time for entities to be required to provide specific disclosures only with respect to AFS debt instruments and their impact on overall profit or loss.

- A requirement to disclose overall *pro forma* pre-tax profit or loss information as if AFS debt instruments had been accounted for at amortised cost may be interpreted to mean that other consequential adjustments are required to be made to arrive at the disclosed *pro forma* profit or loss. Also, it may not be clear to users of financial statements whether such consequential adjustments have been made. For example, an entity may have a profit sharing scheme whereby a percentage of profits is allocated to employees; in this situation, it may be unclear whether compensation expense should be or has been adjusted in arriving at the *pro forma* pre-tax profit or loss required by the proposals. In contrast, our suggested disclosures above would clearly be limited to the different amounts that would be recorded in respect of the measurement and presentation of gains and losses on AFS debt instruments but not on any other items. Under our suggestions, no potential confusion or complications should arise as to possible consequential adjustments to other items.

- The current proposals include a requirement for information as if all debt instruments had been accounted for at fair value through profit or loss (FVTPL).

    - Entities would likely have the data available to comply with such a disclosure requirement, but we expect that there would be an additional cost and effort involved in order to compute the adjustments required to pre-tax profit or loss in order to disclose the impact as if all debt instruments had been accounted for at FVTPL because of the likely more extensive nature of both direct and consequential adjustments. For example, if an entity had designated a debt instrument in a cash flow hedge relationship, it would be required to adjust pre-tax profit or loss for any amounts recognised in other comprehensive income in relation to the effective portion of the hedge. This goes beyond the requests by users reported from the round table meetings. We do not see a convincing basis for proposing such a change in the short time frame required by the ED.

    - We understand how disclosure of a *pro forma* pre-tax profit or loss amount may be helpful; however, limiting the disclosure so as to adjust to a FVTPL basis only investments in debt instruments, but not other financial instruments (i.e. AFS equity investments and liabilities), may not be the most helpful form of disclosure.

- There would be added implementation complexities for insurance entities. These complexities could increase the time and cost associated with the preparation of the disclosures or render the disclosures less meaningful and less comparable. If an insurance entity were to account for all its investments in debt instruments on a FVTPL basis, then it would be precluded from applying "shadow accounting" through other comprehensive income for insurance contracts related to AFS debt instruments pursuant to IFRS 4.30. Also, if an insurance entity were to change the accounting for all its investments in debt instruments to a FVTPL basis, it may have the ability to elect to change its accounting policies for insurance contracts pursuant to IFRS 4.22. In each case there are possible impacts on pre-tax profit or loss. The ED does not address these complexities.

As highlighted by the above points, we believe the proposal for fair value-based profit or loss information should be the subject of more extensive debate and due process and would be better considered after consultation with the Financial Crisis Advisory Group and as part of the longer term project on reducing complexity in the accounting for financial instruments rather than enacting new disclosure requirements in haste now.

Both the ED and our suggestion above are focused on the amounts that would have been recorded in respect of AFS debt instruments "as though the instruments had been … accounted for at amortised cost." IAS 39.63-64 and .AG84-AG92 provide guidance on the measurement of impairment of financial assets measured at amortised cost and indicate that, in addition to recording impairment losses on individual assets, a collective impairment loss is recorded, when applicable, for groups of assets with similar credit risk characteristics. Conversely, pursuant to IAS 39.67, impairment losses on AFS debt instruments may be recorded only in respect of the impairment of individual assets. The drafting of the amendment implies that entities might be required to perform a new collective impairment calculation for AFS debt instruments in order to calculate the profit or loss that would have been recorded if those instruments had been measured at amortised cost. A requirement to measure at "true" amortised cost (ie with a collective impairment loss) would facilitate more accurate comparison with assets actually measured at amortised cost. However, this would be likely to require significant additional costs to entities, particularly in light of the short timeframe to comply with the additional disclosure requirements, and it has not been demonstrated that it would be justified on cost-benefit grounds. We also draw the Board's attention to the fact that, in paragraph A1.a.15F of the parallel proposals in Proposed FASB Staff Position FAS 107-a *Disclosures about Certain Financial Assets: An Amendment of FASB Statement No. 107*, the FASB indicated that entities would not estimate a collective impairment allowance for a pool of similar debt securities. Based on the above, we suggest that the Board clarify that entities would not be required to estimate collective impairment losses in calculating amounts that would have been recognised if AFS debt instruments had been accounted for at amortised cost.

We note that, under IAS 39.AG84, as a practical expedient, a creditor may measure impairment of a financial asset carried at amortised cost on the basis of an instrument's fair value using an observable market price. The ED does not state whether this expedient would also be available in calculating the amounts that would have been recorded in respect of AFS debt instruments had they been accounted for at amortised cost. The Board should make clear its intended meaning on this point in any final amendment.

Also, to the extent the Board requires *pro forma* pre-tax profit or loss disclosures, it should provide clarification as to whether and how insurance entities that have applied shadow accounting through other comprehensive income for insurance contracts related to AFS debt instruments should compute and disclose the effect of any adjustments to their accounting for those contracts and whether any other consequential adjustments are required or permitted in respect of any other items.

Question 2: The exposure draft proposes to require disclosing the pre-tax profit or loss amount that would have resulted under two alternative classification assumptions.

Should reconciliations be required between profit or loss and the profit or loss that would have resulted under the two scenarios? If so, why and what level of detail should be required for such reconciliations?

As described in our response to Question 1 above, we believe that in order to meet requests for disaggregated information for impairment losses on available-for-sale (AFS) debt instruments, disclosures of profit or loss impacts should be focused on disclosing impairment losses recorded on AFS debt instruments and the amounts that would have been recorded if those instruments had been accounted for at amortised cost. Therefore, we believe that requiring disclosure of pre-tax profit or loss amounts that would have resulted under two alternative classification assumptions goes beyond the requests of the constituents at the round table discussions and would likely pose significant difficulties for entities to comply with given the compressed timeframe for implementation.

Question 3: The exposure draft proposes in paragraph 30A(b) to require entities to disclose for all investments in debt instruments (other than those classified as at fair value through profit or loss) a summary of the different measurement bases of these instruments that sets out (i) the measurement as in the statement of financial position, (ii) fair value and (iii) amortised cost.

Do you agree with that proposal? If not, why? What would you propose instead, and why?

We do not agree with the proposal.

IFRS 7.25 already requires the disclosure, for each class of financial assets and financial liabilities, of the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount. Therefore we believe that requiring entities to disclose the carrying amount, fair value and amortised cost for loans and receivables and held-to-maturity debt instruments or the carrying amount and fair value of AFS debt instruments does not provide any useful additional information to readers of the financial statements since it is duplicative of current requirements.

The only incremental disclosure that would be required as a result of the ED's proposal is disclosure of the "amortised cost" of AFS debt instruments. As drafted, we believe that this requirement would not provide useful additional information to readers without further clarification or guidance from the Board as to how the "amortised cost" should be calculated and could lead to diversity in practice. Thus, if the Board were to require entities to disclose the amortised cost of AFS debt instruments, then it should amend the wording in paragraph 30A(b)(iii) to state that for AFS debt instruments, the amount disclosed for amortised cost is an amount as though the instruments had been *accounted for* at amortised cost (excluding collective impairment losses).

Further explanation of these potential issues is as follows:

- IAS 39.9 defines amortised cost of a financial asset or financial liability as "the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility." The definition does not specify that a reduction for impairment is measured using an incurred loss model. Based on this definition of amortised cost, we believe that the fair value/carrying amount of an AFS debt instrument at the date that an impairment loss is recognised on that instrument also could represent its amortised cost at that date. Unless the practical expedient allowed by IAS 39.AG84 noted above were applied, this recorded amortised cost would be different from the amortised cost amount that would have been recorded if the AFS debt instrument had been *accounted for* at amortised cost since the reduction for impairment that would have been recorded would have been the incurred loss.

- As discussed under Question 1, the amortised cost of AFS debt instruments may not include any collective impairment allowance while, under the proposed disclosure of paragraph 30A(a)(ii) as currently drafted, a collective impairment allowance would be required, when applicable, in determining the amounts that would have been recorded if AFS debt investments "had been … accounted for at amortised cost."

- These differences may also impact the amounts recorded as interest income on impaired assets and in respect of reversals of impairment.

Subject to our comments in response to Question 1 with respect to collective impairment losses, we believe that any proposed disclosure of the amortised cost of AFS debt instruments should be calculated as though the instruments had been *accounted for* at amortised cost so as to meet the user request for amounts determined in the same manner as for instruments measured at amortised cost and so as to be consistent with disclosures in respect of the profit or loss impacts discussed under Question 1.

Question 4: The exposure draft proposes a scope that excludes investments in debt instruments classified as at fair value through profit or loss.

Do you agree with that proposal? If not, would you propose including investments in debt instruments designated as at fair value through profit or loss or those classified as held for trading or both, and if so, why?

We agree with the exclusion of items classified at FVTPL from the proposal. We believe that if entities were required to disclose the amortised cost of debt instruments classified at fair value through profit or loss, then this requirement would be too onerous for entities to comply with in light of the short timeframe for implementation because we expect that few entities collect the information necessary to meet the proposed amortised cost disclosure requirements for these debt instruments. Furthermore, we are not aware of urgent demands from users for such additional information.

Question 5: Do you agree with the proposed effective date? If not, why? What would you propose instead, and why?

Dealt with below under Question 6.

Question 6: Are the transition requirements appropriate? If not, why? What would you propose instead, and why?

We do not believe the proposed effective date and transition requirements are appropriate.

As detailed above in our responses to Questions 1 and 3, given users' requests for disaggregated information about impairment losses on AFS debt instruments and the current significance of this issue to the financial position and results of many entities, we support currently limiting paragraph 30A to require disclosure only of: (i) certain profit or loss information for each annual reporting period as if AFS debt instruments had been accounted for at amortised cost; and (ii) amortised cost balance sheet information for AFS debt instruments at the reporting date as if they had been accounted for at amortised cost.

We would support an effective date for disclosure of this "as-if" amortised cost balance sheet information for AFS debt instruments at the reporting date for annual financial statements for periods ending on or after 15 December 2008 if authorised for issue after the publication date of the final amendment.

However, as discussed in our responses to Questions 1 and 3, although entities' accounting records should include amortised cost amounts for AFS debt instruments at each balance sheet date, these amortised cost amounts for impaired AFS debt instruments would be different from the amortised cost amounts that would have been recorded had those instruments been *accounted for* at amortised cost. As it is the latter amounts that we believe are intended to form the basis for the proposed disclosures, preparing the disclosure information may require entities to undertake extensive recomputation and data collation exercises. Although it may be reasonable to request entities to perform this exercise in respect of the end of the annual period in which the amendments are adopted, we expect that requesting entities to produce information so as to compute the amounts that would have been recorded in profit or loss on an amortised cost basis for impaired AFS debt instruments for the annual period in which the amendments are adopted would involve a significant additional time and cost burden. As currently drafted, the proposed disclosure effectively would require as-if amortised cost balances to be calculated as of the previous annual period end. We therefore suggest that the Board amend the proposed transition requirements so as not to require disclosure of any profit or loss information for the period of adoption.

We support the Board's proposal not to require comparative information for periods before the date of adoption.

There is a possibility that some entities will finalise their annual financial statements for 2008 prior to the publication of any final amendment to IFRS 7. Our belief is that if such a situation should arise, an entity would be required to comply only with the IFRS 7 disclosure requirements as enacted by the IASB at the date the financial statements are authorised for issue. Further, an entity would not be required to amend and reissue its 2008 annual financial statements subsequent to the publication of any amendment to IFRS 7 that was stated to be effective for 2008. If the Board publishes a final amendment with an effective date prior to the date of publication of the final amendment, we suggest that the Board make clear that the amendment would only be applicable to financial statements authorised for issue after that date of publication.

Other comments

The scope of the amendments relates to "all investments in debt instruments other than those classified as at fair value through profit or loss" but neither the amendments, IFRS 7, IAS 32 or IAS 39 define the term "investments in debt instruments." We suggest that the Board clarify the scope of the amendments to make clear whether it encompasses all AFS financial assets other than investments in equity instruments and all assets classified as loans and receivables or held-to-maturity investments or whether and which of any such assets are excluded (e.g. short-term receivables with no stated interest rate).