Setting the global standard for investment professionals

15 January 2009

Sir David Tweedie
Chair, International Accounting Standards Board
30 Cannon Street
London EC4M 6Xh
United Kingdom

File Reference: ED Investments in Debt Instruments Proposed amendments to IFRS 7

Dear Sir David,

The CFA Institute Centre for Financial Market Integrity (CFA Institute Centre),[1] in consultation with its Corporate Disclosure Policy Council (CDPC)[2], appreciates the opportunity to comment on *Exposure Draft: Investments in Debt Instruments, Proposed amendments to IFRS 7* (ED) .

CFA Institute represents the views of its investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. Central tenets of the CFA Institute Centre mission are to promote fair and transparent global capital markets, and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality. The CFA Institute Centre also develops, promulgates, and maintains guidelines encouraging the highest ethical standards for the global investment community through standards such as the *CFA Institute Code of Ethics* and *Standards of Professional Conduct.*

[1] The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With offices in Charlottesville, VA, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of 100,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 133 countries, of whom 86,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 57 countries and territories.

[2] The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

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Executive Summary

Proposal Summary

- In this proposed exposure draft, the IASB would amend the existing guidance to add required disclosures for debt instruments not classified as fair value through profit or loss. The proposed disclosures have been developed jointly with the FASB as an interim step to help users of financial statements better understand and compare the effects of different accounting methods used for various financial assets, both under U.S. GAAP and IFRS. The proposals are very similar.

- For all debt instruments of a reporting entity which are not classified as "fair value through profit or loss" instruments, the proposed disclosures would require the disclosure of the carrying amount in the statement of financial position, the fair value, and the amortised cost. The disclosures should be presented so that comparisons of the amounts are possible.

- The proposal would also require disclosure of pre-tax profit or loss from the debt instruments calculated as if the instruments had been classified as fair value through profit or loss instruments, and also on the basis of amortized cost.

Summary of CFA Institute Positions

- CFA Institute does not support requiring disclosure of multiple, alternative measures of performance because it creates the potential to mislead financial statement users. Ordinarily more transparent disclosures are desirable for investors, however in this instance the proposed measures are a component of an increasingly dysfunctional package of financial reporting standards.

- A balance must be struck between providing additional disclosure and the delivery of decision useful information. Presenting different measures of performance, such as amortised cost, may add confusion as companies announce their results of operations. We are concerned that management may choose to emphasize (in earnings releases and earnings calls) one performance measure over another, which may be misleading. We recall the management emphasis and market focus on alternative earnings measures during the dot com era as well as the continued reporting of "pro-forma" results.

- Disclosure of pro forma pre-tax profit or loss is useful to investors on the basis of full fair value reporting.

- CFA Institute supports the decision by the Board to add a joint project with the FASB to address the accounting and reporting for financial instruments. We urge the Board to work expeditiously with the FASB to reduce complexity by requiring fair value accounting for all financial instruments, preferably within the next year.

General Comments

Central to the development of accounting standards addressing recognition, measurement, and disclosure is the fundamental principle that the resulting financial statements present a "true and fair" view of a company's financial position and any changes in that position. To that end, CFA Institute has strongly advocated that the IASB and the FASB require companies to record all financial instruments (both assets and liabilities) at fair value since this method provides the best representation of economic reality[3]. We also believe that changes in fair value should be included in the determination of net income reflected on the face of the income statement.

Currently, financial statements include some items reported at historical cost while others are measured at fair value, the so called mixed-attribute system. Consequently, investors who rely on fair values for decision making must expend considerable effort trying to restate to fair value those decision-relevant financial statement items that are measured at historical cost. Their success depends on the sufficiency of disclosure and on the relative reliability of the measurements in the disclosures. Most, if not all, of this effort would be eliminated if the financial reporting standards were to require that companies record assets and liabilities at fair value at inception with periodic revaluation.[4] A mixed-attribute presentation of financial performance, whether displayed on the face of the financial statements or embedded in the notes, is a second best solution to complete fair value accounting for all financial instruments.

The proposed disclosures have been developed jointly with the FASB as an interim step to help users of financial statements better understand and compare the effects of different accounting methods used for various financial assets, both under IFRS and U.S. GAAP. However, we do not support requiring disclosure of multiple, alternative measures of performance because it creates the potential to mislead financial statement users. Ordinarily more transparent disclosure is desirable for investors as we have argued for in the past. However, in this instance, the proposed measures are a component of an increasingly dysfunctional package of financial reporting standards. We have been generally supportive of dual disclosures (i.e., historical cost presented in notes, etc.) as an interim measure when there is directional consistency towards fair value but this proposal detracts from that goal.

We recognize that standard setters frequently hear users asking for more transparency in the disclosures existing today and that often preparers cite information overload as well as adverse cost-benefit arguments. However, a balance must be struck between providing additional disclosure and the delivery of decision useful information. We feel that presenting different measures of performance in the notes will add confusion as companies announce their results of operations. In the current economic environment, company management may choose to

[3] See CFA Institute website regarding response to the current global financial crisis. http://www.cfainstitute.org/centre/news/turmoil.html?intCamp=centre_box_news_market_turmoil

[4] CFA Institute *A Comprehensive Business Reporting Model: Financial Reporting for Investors* July 2007.

emphasize one performance measure over another, which may be misleading. The expanded disclosure, while intended to be an interim measure simply adds further confusion to the already substandard mixed-attribute system by introducing further subjectivity in the determination of reported values, and reduces comparability. Introducing alternative measures of performance in the disclosures will only further complicate an already complex set of recognition and measurement standards. Fair value accounting for all financial instruments would reduce complexity and would eliminate the recent impairment debates.[5]

In the event that the IASB proceeds with issuing the standard and requires disclosure of incurred loss values despite our opposition, we urge the Board to require an additional disclosure. This disclosure would require a definition of incurred loss as determined by the IASB. Furthermore, this disclosure should describe the elements that incurred loss measures ignore but fair value measures include. This disclosure would be required to be presented each time the information is provided in order to draw attention to the deficiencies in the measure and reduce the ability for management to present it as a comprehensive valuation technique.

Finally, we strongly support the decision by the Board to add a joint project with the FASB to address the accounting and reporting for financial instruments. We urge the Board to work expeditiously with the FASB to reduce complexity by requiring fair value accounting for all financial instruments, preferably within the next year.

Comments on Specific Questions

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 believe that disclosures of pre-tax profit or loss is useful to investors only on the basis of full fair value reporting. Presenting multiple alternative measures of performance could mislead users and depending upon the economic circumstances, be used by management to emphasize one performance measure over another.

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?

We support a reconciliation of pre-tax profit or loss only on the basis of fair value. This reconciliation when accompanied by transparent qualitative disclosures will provide users with

[5] CFA Institute Comment Letter to IASB *Reducing Complexity on Reporting Financial Instruments* *https://www.cfainstitute.org/centre/topics/comment/2008/pdf/080919.pdf*

information not captured by the reported amounts. Amortised cost reconciliations are of little use to users and may be misleading or over emphasized by management in their periodic earnings releases.

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 believe that presenting the "Carrying amount in the statement of financial position" and the "fair value" amounts provide information that would be considered useful to users. These amounts should be accompanied by transparent qualitative disclosures regarding methodologies used to estimate the key inputs and factors that cause differences in measurements for each financial asset.

However, despite our misgivings with presenting the amortised cost amounts in the table, we suggest that in addition, impairments recognized as of the financial reporting date should be prominently disclosed and/or cross referenced to disclosures required by IAS 36, *Impairment of Assets.*

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?

The disclosures should include financial assets measured at fair value in the statement of financial position given that this is the most relevant measurement basis for users. However, for reasons cited above, we feel that the amortised cost disclosures will only add confusion and is not useful to users.

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

We believe that the fair value disclosures should be required as soon as possible and urge that they be presented on a comparative basis in both interim and annual reports. Comparative information is necessary given that investors analyze companies across periods and therefore, enhances comparability.

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

We urge that the disclosures be required for periods presented prior to the initial adoption date since investors analyze companies across periods and therefore, this would enhance comparability.

If you, other Board members or your staff have questions or seek further elaboration of our views, please contact either Matthew Waldron, CPA, by phone at +1.434-951-5321, or by e-mail at matthew.waldron@cfainstitute.org, or Patrick Finnegan, CFA, by phone at +1.212.754.8350, or by e-mail at patrick.finnegan@cfainstitute.org.

Sincerely,

/s/ Kurt N. Schacht

Kurt N. Schacht, CFA
Managing Director

/s/ Gerald I. White

Gerald I. White, CFA
Chair, Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council