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Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

Re: Exposure Draft, Investments in Debt Instruments - proposed amendments to IFRS 7

Sir David,

Deloitte Touche Tohmatsu is pleased to respond to the exposure draft, *Investments in Debt Instruments,* proposed amendment to IFRS 7 (the "ED").

While we support the efforts of the Board to work closely with the Financial Accounting Standards Board (FASB) and other standard setters to simplify and improve the accounting standards for the reporting of financial instruments, we do not support issuance of the ED as currently drafted. We are not supportive of the ED for a number of reasons:

- We do not consider the proposals have a clear objective and therefore cannot determine whether the objective is met. The proposals do not illustrate the profit or loss effect and carrying values of *all* financial assets had they been classified differently, nor do they show the effect on impairment losses of applying different impairment loss models. Without a clearly identified objective that responds to an identified demand from users for specific information we cannot support the proposals as drafted.

- The proposals show alternative measurement bases even though the entity may have been prevented from measuring on that basis. In addition, had the entity been able to measure financial assets differently it may have made different classifications decisions for financial liabilities, e.g. applying the fair value option. The disclosures may as a result be confusing or be misunderstood.

- The discussions at the roundtable discussions on the credit crisis in November and December 2008 that led to the issue of the ED focused on determining the most appropriate impairment model for AFS debt instruments. We believe consideration of this remains a priority and that the proposed "as if" disclosures do not fill this gap nor provide information to users that is most meaningful.

- We believe there is insufficient time for many entities, particularly those with calendar year-ends, to provide the proposed disclosures as required by the effective date. The amount of work needed to provide the disclosures is significant, particularly when determining the amortised cost for AFS debt instruments that have previously been subject to impairment losses. This applies to all entities in all sectors.

Our detailed responses to the invitation to comment questions are included in Appendix A.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0) 207 007 0907 or Andrew Spooner in London at +44 (0) 207 007 0204.

Sincerely,

Ken Wild
Global IFRS Leader

Appendix A: Invitation to Comment

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 proposals as we are not clear what the objective of the proposals is, how that objective is met, and how the proposals meet the immediate information needs of users.

The ED originated from the roundtable discussions on the credit crisis on what is the most appropriate model for recognising impairment losses on AFS debt instruments. The debate focused on whether impairment losses should be determined based on a fair value basis as currently required by IAS 39 or based on an incurred loss model as applied for debt instruments measured at amortised cost. If the objective of the ED was to respond to this concern we believe the Board's time would be better served by addressing this issue as a priority. If the Board consider that an intermediate disclosure, rather than a measurement, solution is preferable, we question why the ED's scope is extended to *all* debt instruments other than those classified as at FVTPL, as opposed to just AFS debt instruments. The latter are those assets that paragraph BC4 cite as being most relevant to decision making.

If the Board's objective is to illustrate how the profit or loss and carrying amounts would have differed had the entity applied different measurement decisions it has not met this objective. The proposals do not, for example, show the impact had an entity chosen to designate a debt instrument that met the definition of a loan and receivable as an available for sale asset. The ED is only concerned with the impact had an asset been measured at amortised cost or FVTPL. Therefore, the ED does not provide a complete picture of the impact of alternative measurement decisions. In addition, by requiring disclosure of the income statement impact of all financial assets as at FVTPL, but not requiring disclosure of the impact of alternative measurement bases for those assets measured as at FVTPL the proposals could be seen as assuming that FVTPL is the most relevant basis. We note that this question remains outstanding as part of the project on *Reducing Complexity in Reporting Financial Instruments*.

The proposals present an incomplete picture of the profit or loss impact of applying different measurement bases. For example, had the entity been able to measure financial assets differently it may have made different classifications decisions for financial liabilities, e.g. applying the fair value option. The entity may have made different decisions regarding compensation plans or applied different hedge accounting policies. We are concerned that the disclosures may be confusing or be misunderstood.

The roundtable discussions as well as this document have served to highlight that the Board should consider the wider issue of what an impairment loss is intended to represent. When this question has been answered the basis for calculating impairment losses should flow from this conclusion, i.e. whether impairment losses are calculating using an original effective interest rate or based on a current market interest rate for the asset. Such a discussion may lead to the alignment of the impairment models which may make the ED redundant.

Should the Board press ahead with its proposals we believe it should be clearer what a "debt instrument" is. It is a term that is used sparingly in IAS 39 but it is not a defined term. We believe it is the Board's intention that a debt instrument in the context of the ED is a recognised financial asset in the scope of IAS 39 other than a derivative or investment in an equity instrument. This view would be consistent with the identification of a debt host contract in IAS 39.AG27. Yet, we note in IAS 39.AG26 the following (emphasis added):

> Any non-derivative financial asset with fixed or determinable payments (including loan assets, trade receivables, ***investments in debt instruments*** and deposits held in banks) could potentially meet the definition of loans and receivables.

IAS 39.AG26 could imply that investments in debt instruments excludes loan assets and trade receivables which we do not believe was the Board's intention. In addition, the Board should clarify whether finance lease receivables are part of the scope of ED. Finance lease receivables are in the scope of IFRS 7 but they are not fully in the scope of IAS 39. For example, it is not possible to designate a finance lease receivable as at FVTPL as it is only the impairment and derecognition provisions of IAS 39 that apply[1].

In the case of financial assets where embedded derivatives are separated the Board should make clear whether the disclosures only relate to the debt host contract or the hybrid financial instrument in its entirety. We presume it is the debt host contract only as the embedded derivative is already classified as at fair value through profit or loss (unless it is designated as an effective hedging instrument).

Given the choice of a pre or post tax impact we are supportive of the proposals to disclose the pre tax impact of alternative measurement bases in the interests of practicability. We note, however, that in the illustrative example of market risk disclosures in IFRS 7.IG36 the disclosure is based on a post-tax basis.

We note that the ED proposes requiring the disclosures described in paragraph 30A in a tabular form. We agree that requiring tables has the advantage of forcing consistent application across entities and should ensure users are able to locate and understand the information more easily when compared to disclosures being scattered across many notes to the financial instruments. We note, however, that the use of tables was voluntary in the recently issued ED to IFRS 7, *Improving Disclosures about Financial Instruments*. The Board may want to consider to what extent financial instruments disclosures in future should be *required* to be in tabular format.

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?

We are not supportive at this stage of requiring reconciliations between alternative classification assumptions. In order to provide a meaningful reconciliation an entity would need to disaggregate the fair value gains/losses. Further work would be needed by the IASB before mandating such an approach. Before requiring a reconciliation the Board would need

[1] The inability to designate a financial instrument outside the scope of IAS 39 was clarified by the Board in its exposure draft, *Improvements to IFRSs*, issued in August 2008.

to decide to what degree, and on what basis, should fair value gains/losses be disaggregated. For example, whether and how the fair value gains/losses should be disaggregated between movements in the risk-free interest rate, movements in credit spreads, liquidity spreads etc. An understanding of the different techniques used in practice for management purposes in disaggregating fair values would be required as well as a better understanding of the information needs of users.

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 are not supportive of the proposals. Our response to question 1 equally applies to our response to this question.

We note that the amendment is not clear whether an entity would be able to apply the practical expedient described in IAS 39.AG84 where a creditor may measure impairment of a financial asset carried at amortised cost on the basis of its fair value using an observable market price. Applying the practical expedient to AFS debt instruments would make the ED partly redundant as the impairment loss that would be incorporated into the amortised cost for disclosure purposes would be determined on the same basis as the AFS debt instrument is already measured.

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?

In order to respond to this question it must be clear what is the objective of the ED and how the ED responds to the information needs of users. As stated in our response to question 1 we do not believe the objective of the ED is clear.

If the IASB's objective was to illustrate how profit or loss and the carrying values would have differed had *all* financial assets been measured as at FVTPL or amortised cost it fails to meet this objective. If this was the objective the ED would require disclosure of the effect of measuring at amortised cost for all assets that are FVTPL, whether designated under the fair value option or held for trading. We believe such an approach is misleading as it would show the impact of measuring assets on a different measurement basis even though the entity had no ability to measure them on that basis.

If the IASB's objective was to illustrate how profit or loss and carrying values would have differed had the entity made different classification decisions from the classifications choices available to the entity then excluding those assets designated as at FVTPL under the fair value option is inconsistent with this objective. In addition, the ED requires an entity to disclose the effect of a measurement basis even though the alternative classification decision was not available to the entity. For example, a non-trading loan and receivable not listed in an active market could not be measured as at FVTPL unless it met the criteria of the fair value option, which in many cases it will not. Equally, unless the entity had the intent and ability to hold a non-trading debt instrument listed in an active market until its maturity it could not have measured the asset at amortised cost. Providing information on the effect of measuring financial assets on a different basis when they could not have been measured on that basis is potentially misleading and confusing.

Question 5

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

We are not supportive of the proposed effective date. We believe the effective date will result in insufficient time for many entities, particularly those with calendar year-ends, to provide the necessary disclosures. The amount of work needed to provide the disclosures is significant, particularly when determining the amortised cost for AFS debt instruments that have previously been subject to impairment losses. Such an exercise would require an entity to look back into prior periods for impairment trigger events in order to determine the expected recoverable cash flows at the start of the reporting period so the profit or loss effect in the current period required by paragraph 30A(a) can be calculated. The difficulty in providing this information is exacerbated as a significant proportion of entities are currently in their post-year end reporting cycle and many have large portfolios of AFS debt instruments.

We note paragraph BC7 justifies the proposed effective date because of the "urgent need for disclosures". We participated in all three of the roundtable discussions on the credit crisis and we were not convinced that users fully supported the proposed disclosure and felt the need for this information to be mandated in such a short time frame.

Should the IASB choose to finalise the ED we believe at a minimum the effective date should be deferred.

Question 6

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

Should the IASB finalise the ED we would agree with the transition requirements to not require comparative information in the period of initial application.