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SERVING THE PUBLIC INTEREST

Our Ref: 3455-05

Andrea Pryde
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22 OCT 2004

Dear Madam

INTERNATIONAL ACCOUNTING STANDARDS BOARD (IASB) EXPOSURE DRAFT ED 7 "FINANCIAL INSTRUMENTS: DISCLOSURES"

Members of the Australasian Council of Auditors-General (ACAG) have been canvassed and, subject to the comments contained in the attachment, the following are supportive of the proposals contained in the Exposure Draft.

- Auditor-General of New South Wales;
- Auditor-General of Queensland;
- Auditor General for Western Australia; and
- Auditor-General of Tasmania.

The non-inclusion of an ACAG member in the submission does not necessarily mean they disagree with the submission.

The opportunity to provide comment is appreciated and I trust you will find the attached comments useful.

Yours faithfully

D D R PEARSON
AUDITOR GENERAL
October 21, 2004

ATTACHMENT

RESPONSE TO INTERNATIONAL ACCOUNTING STANDARDS BOARD EXPOSURE DRAFT ED 7 "FINANCIAL INSTRUMENTS: DISCLOSURES"

<u>Specific Matters for Comment</u>

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

The draft IFRS 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).
(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?

We agree that the disclosure proposals are appropriate as they would assist users in evaluating financial performance and position.

Question 2 Disclosures of the fair value of collateral and other credit enhancements

For an entity's exposure to credit risk, the draft IFRS 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?

The disclosure of the fair value of collateral pledged as security and other credit enhancements unless impracticable, is considered to be appropriate.

We would prefer, however, the inclusion of additional guidance to better understand the definition and criterion to deem the condition as "impracticable."

Question 3 Disclosures of a sensitivity analysis

For an entity that has an exposure to market risk arising from financial instruments, the draft IFRS 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?

The proposed disclosure of a sensitivity analysis at a minimum level is appropriate for all entities as it provides a good business practice for entities to manage market risks.

We consider that guidance on the methodology to be used in preparing the sensitivity analysis would be useful, as it would enable a consistent approach to be adopted and allow comparisons of financial information across similar entities.

Question 4 Capital disclosures

The draft IFRS 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 agree with the capital disclosure requirements as capital management information is useful for assessing an entity's performance.

We do not consider that it is appropriate for the disclosures to be limited to externally imposed capital requirements as total capital management should include internally set capital targets.

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 the draft IFRS for the first time before 1 January 2006 would be exempt from providing comparative disclosures for the draft IFRS 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?

It is our view that the proposed effective date of 1 January 2007 is appropriate considering the timeframes that may be required for the transition.

The non disclosure of comparatives for adoptions before 1 January 2006 is considered reasonable to encourage early implementation.

Question 6 Location of disclosures of risks arising from financial instruments

The disclosure of risks arising from financial instruments proposed by the draft IFRS would be part of the financial statements prepared in accordance with International Financial Reporting Standards (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 the draft IFRS should be part of the financial statements? If not, why not?

We are in favour of the disclosures about risks arising from financial instruments being part of the financial statements.

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 the draft IFRS. The requirements in IFRS 4 were based on disclosure requirements in IAS 32 that would be amended by the draft IFRS. The Board'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 the draft IFRS? If not, why not and what amendments would you make pending the outcome of phase II of the Board's Insurance project?

We disagree that the risk disclosures in IFRS 4 should be amended to be consistent with the proposals in the draft IFRS, as phase II of the Insurance project is likely to introduce further changes to insurance disclosures.

It is our view that insurance risk disclosures need to be reviewed as a whole in the phase II project before the IFRSs are amended.

Question 8 Implementation Guidance

The draft Implementation Guidance accompanying the draft IFRS 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?

We consider that the Implementation Guidance is adequate.

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 this Exposure

Draft, 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.

(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 the draft IFRS (and are currently required by paragraph 92 of IAS 32) and disclosures similar to (a)(iii) are proposed in paragraph 21(a).

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

We consider the disclosure of fair value in the draft IFRS is appropriate.

Question 10 Other comments

Do you have any other comments on the draft IFRS, Implementation Guidance and Illustrative Examples?

No.