FINANCIAL REPORTING COUNCIL

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Dear Sir

Joint Comments of the Financial Reporting Council (FRC) and the IFRS Issues Committee at the Institute of Professional Accountants of Russia (IFRS Committee) on ED 7 'Financial Instruments: Disclosures'.

Please find below the joint comments of Financial Reporting Council (FRC) and the IFRS Issues Committee at the Institute of Professional Accountants of Russia (IFRS Committee) on ED 7 'Financial Instruments: Disclosures'.

Yours sincerely,

Larissa Gorbatova

Chair

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 with these proposals.

Question 2 – Disclosure 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?

- We agree with this proposal.

Question 3 – Disclosure 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?

- We do not support the proposed disclosure of a sensitivity analysis for several reasons.

1. We do not agree that a sensitivity analysis fits in the information to be presented in financial statements:

a. in our opinion there exists a possibility that different preparers will use different methodology for calculating a sensitivity analysis and, correspondingly, will not arrive at comparative information.

b. a sensitivity analysis involves a high degree of subjectivity, thus impugning verifiability of corresponding disclosures presented in the financial statements.

2. We consider a sensitivity analysis to be rather a part of MD&A than that of financial statements subject to audit.
3. We are quite comfortable with the disclosures required by the existing IAS 32 of terms and conditions of financial instruments and about risk exposure to interest rate risk. These disclosures provide users with objective information which may be audited using existing audit techniques, and serve as a basis for further financial analysis.

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?

- It is not clear from the Exposure Draft what is meant by the term 'capital' – capital contributed by owners, equity, or equity together with borrowed funds, or everything related to funding the entity's activities, etc. - and, correspondingly, it is not clear which disclosures are proposed. Disclosures proposed are clear with respect to the externally imposed capital requirements, but those dealing with the capital targets set by management and policies for managing capital etc. look very uncertain and *more appropriate for MD&A* rather than for financial statements subject to audit.

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?

- We agree with the proposals concerning the effective date and transition.

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 agree with those who believe that disclosures about risks should not be a part of the financial statements due to the high degree of subjectivity of the information to be disclosed. Financial statements are audited, and the auditor's opinion as of those statements need to be explicit with respect to the reliability and faithfulness of the financial data presented. We doubt that this explicitness could be reached in a case when an entity presents its own analysis of some financial and non-financial data (e.g. market forecasts, etc.) using its unique model. We also doubt that this information will be comparable through different entities.

Our opinion is that this information should be included in MD&A since it does not fit in criteria of financial statements, i.e. comparability (unique methods), faithfulness (not applicable), completeness (not applicable). In case some additional verification of this information presented is needed for external users' purposes, auditors may check this information as for how this information reconciles to, or is consistent with, the data in the financial statements presented, but not for its faithfulness. Otherwise, once this information is included in financial statements, both a reporting entity and its auditor will encounter serous difficulties arguing which approach to perform and present the information required is more reliable and more faithful.

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 agree with the reasons of the Board to amend IFRS 4 on insurance contracts to put it in line with the revised disclosure requirements about financial instruments.