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International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards. These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: 19 September 2008, London

Project: Credit Crisis: Proposed amendments to Disclosure Requirements (supplement to Agenda paper 2C)

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1. At the session to discuss paper 2C on Tuesday, the Board sought clarification as to the extent of the disclosures proposed for what is commonly referred to as 'off-balance sheet' activities. In particular, the Board sought clarification of the *scope* of any such requirements and the requirements themselves.

2. The purpose of this paper is to provide additional information to the Board about both of these matters. To help Board members visualise the type of disclosure anticipated by the staff we have also included some illustrative examples.

3. Our assessment is that our proposals would require the same information as that recently requested by the US SEC. Additionally, we have not identified any requirements in the proposed FIN 46(R) that are not reflected in our proposals. For the Board's information, we have reproduced the requirements proposed in the revision of FIN 46(R) at the back of this paper.

Off-balance sheet relationships within the scope of IFRS 7

4. The first category of entities are unconsolidated entities in which the reporting entity has a continuing interest. As such, that interest is likely to be within the scope of IFRS 7 because of the financial instruments that support their involvement. Such instruments could include guarantees, liquidity support agreements and so on.

5. Even though IFRS 7 requires information about the related risks, we are proposing that entities be required to present summary quantitative information about financial instrument risk in relation to unconsolidated entities.

6. An example of the type of disclosure we are suggesting follows.

At December 2008
Exposure to Losses in Unconsolidated Entities

	Maximum						
Type of asset in unconsolidated entity	**Total**	**Loans, Receivables and Investments**	**Credit Guarantees**	**Liquidity Commitments**	**Repurchase Options and Obligations**	**Subordinated interests and disproportionate exposure to losses**	**Assets held by unconsolidated entities**
	CU Million	**CU Million**	**CU Million**	**CU Million**	**CU Million**	**CU Million**	**CU Million**
Collateralised debt obligations	**x**	x			x	x	x
Real estate, credit-related and other investing	**x**	x	x		x	x	x
Municipal bond securitisations	**x**			x		x	x
Mortgage-backed and other asset-backed	**x**	x			x	x	x
Principal-protected notes	**x**					x	x
Asset repackagings and credit-linked notes	**x**					x	x
Total	**x**	**x**	**x**	**x**	**x**	**x**	**x**

Carrying amount of assets and liabilities in unconsolidated entities recognised in statement of financial position

Type of interest					
Avaliable for sale securities	x	x			
Commitments and guarantees	(x)		(x)	(x)	
Loans and investments	x				x
Total	**x**	**x**	**x**	**x**	**x**

Qualitative

7. The purpose of the disclosures outlined above is to provide users of an entity's financial statements with information about the scale of activities that the entity does not control, but with which it has significant involvement. In addition to the quantitative information, an entity would be required to disclose qualitative information.

8. The type of information would include any concentrations of assets or liability maturities that help users of the financial statements assess the risks to which the entity is exposed as a result of its involvement with these entities.

9. The entity would also disclose the conditions or circumstances related to its significant involvement that could cause it to have control of the entities and whether it has any discretion or ability to avoid obtaining control of the entities.

10. The categories would need to be appropriate to the entity but might include securitisation or investment entities. If the entity has different types of, for example, investment entities that have different economic characteristics those differences should cause the entity to disclose these in separate categories.

11. The entity would be required to meet the disclosure requirements in IFRS 7 in relation to the financial instruments it holds in these unconsolidated entities. Those requirements would include information about credit risk, liquidity risk and market risk.

12. We anticipate requiring that an entity disclose the following information in relation to those unconsolidated entities included in the quantitative summary:

    a. In relation to the assets the unconsolidated entities hold:

        i. their categories and rating;

        ii. weighted-average life; and

        iii. material write-downs or downgrades.

    b. In relation to funding and loss exposure:

        i. the forms of funding (commercial paper, medium-term notes, etc) and weighted-average life of the funding the unconsolidated entities hold;

ii. any difficulties the unconsolidated entities have experienced in financing their activities during the period; and

iii. maximum limit of the losses to be borne by any first loss note holders.

c. types of instrument held in, and the types of returns the entity receives from, the unconsolidated entities

d. detailed disclosures regarding obligations under the liquidity facilities. For example:-

i. whether there are triggers associated with obligations to fund

ii. whether there are any terms that would limit the obligation to perform

iii. any obligations under the facilities (eg to purchase assets from or commercial paper the unconsolidated entities issued), and their material terms

iv. whether there are any other liquidity providers, and if so, how the obligation ranks with other liquidity providers

e. In relation to support that has been provided by the entity to unconsolidated entities:

i. whether any commercial paper or other securities issued by the unconsolidated entities has been purchased by the reporting entity, and whether any agreement required the reporting entity to make these purchases. If not, why these purchases were made;

ii. whether any other assistance was provided to the off-balance sheet entity in obtaining any other type of support, or whether there are any current intentions to do so; and

iii. the potential effect on debt covenants, capital ratios, credit ratings, or dividends should the reporting entity be required to consolidate or incur significant losses associated with the entity.

13. There will also be a requirement for the entity to report any other factors related to its setting up, sponsoring and managing unconsolidated entities that are important in assessing the risk the reporting entity faces in relation to those entities.

Off-balance sheet relationships outside the scope of IFRS 7

14. The other class of entities of interest is those investment or financing vehicles with which an entity has had some significant involvement but:

    a. has no current involvement; or

    b. if there is some current involvement, the entity does not have an associated financial instrument that would cause the reporting entity to fall within the scope of IFRS 7.

15. There can be risks for the reporting entity if investors in those vehicles perceive that the reporting entity is providing implicit support for the investment vehicle. During the credit crisis entities that sponsored investment vehicles (set them up or arranged their financing, or both) took steps to support the investment vehicles even though they had no contractual obligation to do so.

16. Such actions are viewed by some as being related to the reporting entity taking control of the vehicles to protect its (ie the reporting entity's) credibility or reputation. The extent to which a reporting entity has been involved in transactions that expose them to such risks is widely perceived as being information that improves transparency.

Access to information

17. The difficulty, of course, is that after the initial establishment of these vehicles it can be difficult for the sponsor to get information about the assets and liabilities of the vehicles.

18. The approach we are recommending is to require an entity to disclose information about the vehicles it has sponsored or set up. This provides an indication of the scale of such activities using information that will be available to the reporting entity. The reporting entity would also disclose the extent to which it has provided support to such entities, despite the absence of a contractual obligation to do so. Additional information would be required for those circumstances in which the support provided resulted in the reporting entity controlling the vehicle.

19. Such disclosures should be made for the current period and the preceding two periods. An example of a table that provides this type of information follows. It

demonstrates the minimum quantitative information for which we are developing additional qualitative requirements.

Sponsored vehicles where there is significant involvement but no ownership interest or contractual guarantee

Asset type	2008 Sponsored Entity Assets CU Million	2007 Sponsored Entity Assets CU Million	2006 Sponsored Entity Assets CU Million
Collateralised debt obligations	5,000	15,000	10,000
Real estate, credit-related and other investing	37,500	20,000	20,000
Municipal bond securitisations	10,000	5,000	5,000
Mortgage-backed and other asset-backed	15,000	15,000	10,000
Principal-protected notes	10,000	10,000	5,000
Asset repackagings and credit-linked notes	10,000	10,000	10,000
Total	**$87,500**	**$75,000**	**$60,000**

Subsequent non-contracual support provided			
Short term liquidity support			3
Messanine notes			
Investments and loans	17,500		
Guarantees and commitments			

Explanation of non-contractual support provided

In February this year, due to disruption in the supply of CP funding, the reporting entity provided CU17.5B of funding in the form of CP purchases to Entity X. As a consequence, the reporting entity concluded that the provision of the funding caused the reporting entity to control Entity X. The financial effect of consolidating Entity X resulted in CU20B of BBB rated mortgage receivables being recognised in the group financial statements.

In May 2006, the reporting entity was approached by the administrators of the fund, Entity Y to provide liquidity support because of difficulties of obtaining short-term funding from other sources. The reporting entity provided CU3M of short term liquidity support to Entity Y. The short-term support was repaid within fourteen days of the funding being advanced and no additional support has been provided since this date.

US GAAP – disclosures proposed in the revised FIN 46(R)

20. On Tuesday 16 September (BST) the FASB published proposed revisions to FIN 46(R). Included in the revisions are new disclosure requirements. Many of those requirements are qualitatively similar to those presented to the Board in paper 2C, in this paper and in IFRS 7. We do not intend to discuss these requirements in the Board session on Friday morning, but provide them for the information of the Board.

21. The proposed disclosure requirements are:

> 22A. The principal objectives of the disclosures required by paragraphs 22B–26 are to provide users of financial statements with an understanding of:
>
> a. The judgments and assumptions made by the enterprise in determining whether the enterprise must consolidate a variable interest entity and/or disclose information about its involvement in a variable interest entity
>
> b. The nature of restrictions on a consolidated variable interest entity's assets reported in an enterprise's statement of financial position, including the carrying amounts of such assets
>
> c. The nature of, and changes in, the risks associated with the enterprise's involvement with the variable interest entity
>
> d. The current and potential financial effects from an enterprise's involvement with a variable interest entity on the enterprise's financial position, financial performance, and cash flows.
>
> An enterprise shall consider these overall objectives in providing the disclosures required by this Interpretation. To achieve these objectives, an enterprise may need to supplement the disclosures required by paragraphs 22B–26, depending on the facts and circumstances surrounding the variable interest entity and the enterprise's interest in that entity. Accordingly, if the enterprise's economic relationship with the variable interest entity or exposure to risk is not addressed by any of the disclosures provided in paragraphs 22B–26, the enterprise shall provide further information, as needed.
>
> 22B. Disclosures about variable interest entities may be reported in the aggregate for similar entities if separate reporting would not provide useful incremental information to financial statement users. An enterprise shall disclose how similar entities are aggregated and shall distinguish between:

a. Variable interest entities that are not consolidated because the enterprise is not the primary beneficiary but is either the sponsor or has a significant variable interest

b. Variable interest entities that are consolidated.

In determining whether to aggregate variable interest entities, the enterprise shall consider quantitative and qualitative information about the different risk and reward characteristics of each variable interest entity and the significance of each variable interest entity to the enterprise.

22C. An enterprise that is a primary beneficiary in a variable interest entity, holds a significant variable interest in a variable interest entity but is not the primary beneficiary, or is a sponsor that holds a variable interest in a variable interest entity (irrespective of the significance of the variable interest) shall disclose:

a. Its methodology for determining whether the enterprise is (or is not) the primary beneficiary of a variable interest entity, including, but not limited to:

22. (1) Significant factors considered.

23. (2) Significant assumptions and judgments made and whether a different assumption or judgment could have reasonably been made that would result in a different conclusion.

b. If the consolidation determination is different for a variable interest entity in the current financial statements from the determination in the most recent financial statements (for example, the variable interest entity was previously consolidated and is not currently consolidated), the primary factors that cause the change, and the effect on the enterprise's financial statements.

c. Whether the enterprise has provided financial or other support to the variable interest entity that it was not contractually required to provide during the periods presented, including:

(1) The type and amount of financial support, including situations where the enterprise assisted the variable interest entity in obtaining another type of support.

(2) The primary reasons for providing the noncontractual support.

d. Qualitative and quantitative information about the enterprise's involvement (giving consideration to both explicit and implicit arrangements) with the variable interest entity, including:

(1) The nature, purpose, size, and activities of the variable interest entity, including how the entity is financed.

(2) Information to allow users to understand the significant risks of the variable interest entity, including those created and passed through to the variable interest holder's assets. Such risks may include concentrations of assets and/or activities, credit risk, interest rate risk (including prepayment risk), foreign currency exchange risk, commodity price risk, equity price risk, and operational risk. In providing this information, the disclosures required by other standards shall be considered (for example, AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, and FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*).

(3) Terms of arrangements that could require the enterprise to provide financial support (for example, liquidity commitments and obligations to purchase assets) to the variable interest entity, including events or circumstances that could expose the enterprise to a loss.

23. The primary beneficiary of a variable interest entity that is a business shall provide the disclosures required by Statement 141(R). The primary beneficiary of a variable interest entity that is not a business shall disclose the amount of gain or loss, if any, recognized on initial consolidation of the variable interest entity. In addition to disclosures required by other standards, the primary beneficiary of a variable interest entity shall disclose the following[17]

a. The carrying amount and classification of the consolidated variable interest entity's assets and liabilities in the statement of financial position that are consolidated pursuant to this Interpretation
b. If the variable interest entity's assets can only be used to settle obligations of the variable interest entity:
   (1) The carrying amount and classification of the consolidated variable interest entity's assets and associated liabilities
   (2) Qualitative information about the nature of the restrictions on those assets.

[17] A variable interest entity may issue voting equity interests, and the enterprise that holds a majority voting interest also may be the primary beneficiary of the entity. If so, and if the entity meets the definition of a business in Statement 141 (R) and the entity's assets can be used for purposes other than the settlement of the entity's obligations, the disclosures in paragraphs 22C, 23, and 27 are not required.

c. Lack of recourse if creditors (or beneficial interest holders) of a consolidated variable interest entity have no recourse to the general credit of the primary beneficiary~~.~~

d. Quantitative and qualitative information about liquidity facilities, guarantees, and other commitments to the variable interest entity provided by third parties

e. The fair value of the consolidated variable interest entity's financial assets and financial liabilities (separately from those disclosed pursuant to Statement 107.

24. In addition to disclosures required by other standards, an enterprise that holds a significant variable interest or is a sponsor that holds a variable interest in a variable interest entity (irrespective of the significance of the variable interest), but is not the entity's primary beneficiary, shall disclose:

a. The enterprise's maximum exposure to loss as a result of its involvement with the variable interest entity, including how the maximum exposure is determined and the significant sources of the enterprise's exposure to the variable interest entity. If the enterprise's maximum exposure to loss as a result of its involvement with the variable interest entity cannot be quantified, that fact shall be disclosed.
b. The enterprise's estimated exposure to loss or range of that loss if it believes that the amount of the maximum exposure to loss is not representative of its estimated exposure to loss. If this disclosure is made, the enterprise shall disclose the methodology used to determine the estimated loss exposure. This description shall include qualitative and quantitative information, such as:
   (1) Significant factors considered, assumptions made, and primary risks of the variable interest entity

   (2) Liquidity, guarantees, and other commitments to the variable interest entity by third parties.

c. The carrying amount and classification in the enterprise's statement of financial position of the enterprise's variable interest in the variable interest entity.

25A. The disclosures required by this Interpretation may be provided in more than one note to the financial statements, as long as the objectives in paragraph 22A are met. If the disclosures are provided in more than one note to the financial statements, the enterprise shall provide a cross reference to the other notes to the financial statements that provide the disclosures prescribed in this Interpretation for similar entities.

26. An enterprise that does not apply this Interpretation to one or more variable interest entities or potential variable interest entities because of the condition described in paragraph 4(g) shall disclose the following information:

a. The number of entities to which this Interpretation is not being applied and the reason why the information required to apply this Interpretation is not available
b. The nature, purpose, size (if available), and activities of the entity(ies) and the nature of the enterprise's involvement with the entity(ies)
c. The reporting enterprise's maximum exposure to loss because of its involvement with the entity(ies)
d. The amount of income, expense, purchases, sales, or other measure of activity between the reporting enterprise and the entity(ies) for all periods presented. However, if it is not practicable to present that information for prior periods that are presented in the first set of financial statements for which this requirement applies, the information for those prior periods is not required.

Note: Paragraph 4g is a scope exception that relates to potential variable interest entities created before December 31, 2003 for which, after making an exhaustive effort, the reporting entity is unable to obtain the information necessary to apply FIN 46(R).