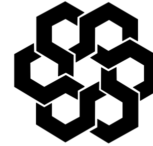

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International Accounting Standards Board

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: **January 2009, London**

Project: **Financial Instruments: Disclosures**
Subject: **Investments in Debt Instruments (Agenda Paper 15)**

BACKGROUND TO ED PROPOSAL

1. In December 2008, the IASB published the exposure draft *Investments in Debt Instruments*, proposed amendments to IFRS 7 (ED). The US Financial Accounting Standards Board (FASB) proposed similar disclosure requirements at the same time (proposed FSP FAS 107-a).

2. The ED proposed additional disclosure requirements for all investments in debt instruments other than those classified as at fair value through profit or loss (FVTPL). The proposals were to require:
   (a) information in tabular format about the effect on pre-tax profit or loss as if these instruments were accounted for (i) at FVTPL and (ii) at amortised cost;
   (b) a summary of the different measurement bases of these instruments in tabular format that sets out (i) the measurement as in the statement of financial position, (ii) fair value and (iii) amortised cost.

3. Appendix A contains the relevant paragraphs from the ED.

OVERVIEW OF COMMENTS RECEIVED ON THE ED

4. The IASB received 70 comment letters by the comment deadline of 15 January 2009. In total, 82 comment letters have been received as of the date of the posting of this paper.

5. Nearly all respondents disagreed with the proposed disclosures (including some users that responded to the ED). While there was a number of different reasons for rejecting the proposals many respondents shared the following reasons:
   (a) the proposed timing is unrealistic;
   (b) the proposed pro-forma profit or loss information may be misleading and/or confusing, and will undermine the focus on the reported profit or loss; and
   (c) the proposed disclosures are not focused on the suggestions made at the three public financial crisis round-table meetings, and go significantly beyond those suggestions. In fact, the information suggested by many participants cannot be identified using the proposed disclosures.

6. Other general comments by respondents include the following:
   (a) There was insufficient due process:
      (i) the comment period was inappropriately short for proposals that many respondents did not view as being 'urgent' in nature (ie these proposals do not warrant changes for 2008 annual reporting periods);
      (ii) backdating the effective date so that it is earlier than the issue date of the amendment denies preparers the required lead-time for implementation (creating many practical problems such as the ability to obtain the information, uncertainty regarding financial statements that are about to be published etc.), as well as for adoption because of the law in some jurisdictions (which does not allow backdating).
   (b) The insufficient due process might have a detrimental effect on the high quality standard setting process, which could ultimately harm the reputation of IFRSs;
   (c) There is no need to mandate disclosures because the disclosure can be made on a voluntary basis where urgent and relevant;
   (d) IFRS 7 should not be amended on a piece-meal basis;
   (e) There is an undue focus on the banking sector that fails to understand the effect and relevance for other sectors;

(f) Disclosure cannot compensate for measurement deficiencies (consistent with IAS 1.18) (some saw the proposed disclosures as an attempt to 'paper over' the inadequacies of existing IFRS and US GAAP measurement and impairment requirements for financial instruments);
(g) Differences in constituencies between IASB and FASB do not always facilitate a joint approach, for example regarding the speed of changes or the use of pro-forma information (some respondents did congratulate the boards on their quick and joint response, however);
(h) The proposed disclosure (in particular pro-forma profit or loss on an 'as if all at FVTPL' basis) is a further step towards a full fair value approach to financial instruments accounting, which is inappropriate in the light of the curtailed due process and the limited scope of this ED;
(i) Some stated that instead of finalising the proposals the boards should move urgently to change existing measurement and/or impairment requirements – either as a short-term change or as part of the project to replace IAS 39.

7. The staff considered these general comments and concerns in its analyses and recommendations for the each of the questions in the ED.

8. Notwithstanding the co-ordination with the FASB in developing the ED some respondents suggested to even further align the ED with the FASB's proposed FSP FAS 107-a regarding the FSP's:
   (a) qualitative disclosures of accounting policies, methodologies used to estimate the key inputs used to measure the incurred loss amount (such as estimated cash flows), including any estimates of costs to sell the financial assets and (to the extent known) a description of the factors causing the differences in measurements for financial assets.
   (b) scope exclusion for short-term receivables.
   (c) exemption regarding the estimate of an allowance for a pool of similar securities under SFAS 5.

9. The staff notes that these differences were considered before issuance of the ED, and the differences in the proposals reflect:

(a) that IFRSs and US GAAP are different starting points (in other words, existing requirements are different), which means that some disclosures required in one exposure draft may not be required in the other exposure draft in order to arrive at the same requirements after the amendments; and

(b) differences in existing requirements cannot be eliminated in this project because it has a very limited scope and solely addresses disclosures. Therefore, for example, differences in measurement can still result in different disclosures.

ANALYSIS OF RESPONSES TO THE QUESTIONS SET OUT IN THE ED

> Question 1 of the ED
>
> 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?

10. Nearly all respondents disagreed with the proposed pro-forma profit or loss disclosures. They had serious concerns that this information is misleading because:

(a) the scope of the ED is limited to debt instruments that are financial assets, thus it ignores any (often offsetting) impact that would result from applying FVTPL accounting to:

(i) financial liabilities.

(ii) investments in equity instruments.

(iii)non-financial assets and liabilities.

(b) knock-on effects regarding hedge accounting are not taken into account.

(c) for insurance companies the pro-forma information ignores the effect of:

(i) shadow accounting.

(ii) linked liabilities (eg for liabilities with participation features – thus the pro-forma information would create the mismatch that entities avoided by selection of accounting policies available under IFRSs for this purpose).

(d) entities would have made different accounting policy and classification choices if the assumptions of the pro-forma information had really applied. For example, the fair value option might have been used for some financial liabilities if amortised cost would not have been available for investments in debt instruments, and this would have changed the base profit or loss on which the pro-forma disclosures are based.

(e) the pro-forma information would not reflect the basis on which the debt instruments are managed.

11. Respondents were also concerned that:

    (a) the use of pro-forma profit or loss information would call into question the profit or loss determined in accordance with IFRSs in the statement of comprehensive income, and could undermine users' confidence in the appropriateness of existing requirements.

    (b) the cost of providing the pro-forma information would outweigh the benefits (if any).

    (c) disclosure of pro-forma information is generally not a common concept under IFRS (whereas the situation is different for US GAAP).

12. In addition respondents requested the following clarifications if the Board decides to proceed with the proposed pro-forma disclosure:

    (a) define 'investment in debt instrument' (and especially whether short-term receivables, customer loans and other similar items are included).

    (b) whether finance lease receivables are in the scope of the ED.

    (c) whether the scope includes only debt instruments held at the reporting date (or movement within the reporting period such as additions and disposals).

    (d) whether amortised cost include adjustments:

        (i) for impairment on an incurred loss basis (and if so, whether that would include collective provisioning).

        (ii) from fair value hedging.

    (e) whether pre-tax profit or loss relates to the profit or loss of the entity in its entirety or only the debt instruments.

(f) the extent to which consequential effects (knock-ons) are required to be taken into account (eg remuneration of employees under bonus schemes that relate to pre-tax profit).

(g) how to deal with the recognition of day one differences (IAS 39.AG76A).

Staff analysis

13. The staff believes there are three alternatives for the Board regarding the pro-forma profit or loss disclosure:
    (a) finalise the proposed amendments, but provide particular clarifications and set an effective date that provides a realistic lead time for implementation;
    (b) instead of the proposed pro-forma disclosure propose disaggregated disclosure of impairment losses recognised for available-for-sale (AFS) debt instruments as discussed at the round tables – but with an effective date that provides a realistic lead time for implementation; or
    (c) Do nothing at this time.

14. The staff believes that the feedback received provides strong evidence that pro-forma profit or loss information would be confusing. Therefore, the staff thinks that the proposed disclosure would not improve financial reporting. Thus, providing the requested clarifications would not address the problem.

15. Some respondents suggested that disaggregated disclosure about impairment losses on AFS debt instruments would better reflect the request made by some who participated in the round-table meetings (rather than the information proposed in the ED). The impairment losses recognised for AFS debt instruments would be disaggregated into:
    (i) the incurred loss portion – determined in the same way as for debt instruments measured at amortised cost using the incurred loss model; and
    (ii) the remainder of the fair value change.

    (For more information please refer to Paper 6A1 presented at the December IASB meeting, and the IASB staff recommendation).

16. However, the staff notes that based on the responses to the ED:

(a) there appears no urgent demand for this disclosure.

(b) rather, the real issue appears to be the impairment (and measurement) models for financial instruments. Many respondents suggested that issue should be revisited as part of the project on recognition and measurement of financial instruments (rather than in isolation).

Summary of responses to the FASB proposals

17. The staff's understanding from the discussion with FASB staff is that the FASB received similar feedback on its proposed FSP FAS 107-a and that the FASB staff will propose not proceeding with that proposal.

Staff recommendation

18. The staff recommends that the Board not proceed with any amendments at this time. This is because:

(a) the disclosure proposed in the ED would not improve financial reporting;

(b) most respondents do not perceive the disclosure of the disaggregated impairment loss for AFS debt instruments to be an urgent amendment. In particular the staff notes that:

(i) an entity can provide this disclosure on a voluntary basis if it is considered useful;

(ii) this disclosure could not be required for 2008 annual reporting periods because it would not allow any lead time; and

(iii) addressing the issue as part of the Board's project on recognition and measurement of financial instruments would provide a more consistent and qualitatively better solution, allow an appropriate due process, and allow a more appropriate and efficient allocation of board and staff resources.

Question to the Board

19. Does the Board agree with the staff recommendation to not further pursue the proposed pro-forma information but instead focus on the project on recognition and measurement of financial instruments to address the root cause of recognition and measurement of impairment? If not, why? What does the Board propose instead, and why?

If the Board agrees with the staff recommendation, there is no need to address the issues raised in the rest of this paper.

Question 2 of the ED

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?

20. Since nearly all respondents disagreed with the proposed pro-forma profit or loss information the reconciliation was consequently not applicable. Notwithstanding that, the majority of respondents explicitly objected to a reconciliation in general. They either questioned its usefulness or objected because the costs of preparing it would outweigh the benefits, if any.

21. However, some of those who disagreed with the proposed disclosure of pro-forma profit or loss would support a reconciliation (or some form of limited quantitative or qualitative reconciliation) if the Board decides to finalise the amendments. They thought a reconciliation might be useful, as did most of the handful of respondents who supported the pro-forma information.

Staff analysis

22. The staff notes that if the Board agrees with the staff recommendation on Question 1 the reconciliation is not applicable.

23. Even if the Board decides to require the proposed disclosure of pro-forma profit or loss the staff notes that preparing this reconciliation would be so complex that preparers could not implement it in the short term. This is clear from examples of the likely reconciling items that some respondents included in their letters, eg changes in liquidity spreads (the round table discussions indicated this was difficult or impossible to do and that there was no consensus on what eg liquidity spreads were and how to determine them).

24. The staff also believes that this reconciliation relates to the issue of disaggregating changes of fair value, which should be more appropriately addressed in the Board's projects on recognition and measurement of financial instruments and financial statement presentation.

Staff recommendation

25. The staff recommends not requiring a reconciliation for the reasons set out in the staff analysis above.

Question to the Board

26. Does the Board agree with the staff recommendation to not require reconciliations between profit or loss and pro-forma information? If not, why? What does the Board propose instead, and why?

Question 3 of the ED 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) 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?

27. Nearly all respondents disagreed with the proposed disclosures. Almost all of the respondents who disagreed with the pro-forma profit or loss disclosure also disagreed with disclosing different measurement bases. This reflects that the two proposed disclosures were overwhelmingly considered to be linked. The main reasons for rejecting the proposed disclosures were:
    (a) the proposed timing is completely unrealistic (see earlier comments); and.
    (b) the proposed information is largely redundant because of existing IFRS 7 (and other IFRS) requirements.

28. Respondents also pointed out that IFRS requirements should remain principles based. They were concerned that the proposed disclosures were not consistent with a principles based approach because, for example, the ED:
    (a) prescribes a tabular disclosure format;
    (b) is inconsistent with the 'through the eyes of management' approach in IFRS 7; and
    (c) would require duplication of information that is already required in accordance with IFRSs.

29. In addition respondents requested the following clarifications should the Board decide to proceed with the proposed disclosure of different measurement bases (most of these clarifications also relate to the pro-forma profit or loss information as these disclosures are linked):
    (a) scoping issues, including defining 'investment in debt instrument'; and
    (b) whether amortised cost include adjustments:

(i) for impairment on an incurred loss basis (and if so, whether that would include collective provisioning).
(ii) from fair value hedging.

Staff analysis

30. The staff believes there are two alternatives that the Board could consider regarding the disclosure of different measurement bases:
    (a) proceed with the proposals but provide clarifications and set an effective date that provides a realistic lead time for implementation; or.
    (b) do nothing at this time.

31. Consistent with the responses received, the staff believes that the pro-forma profit or loss disclosure and the disclosure of the different measurement bases are linked.

32. Moreover, as many respondents pointed out, the existing IFRSs already require most of the proposed disclosures. The only additional disclosure would be the amortised cost amount for AFS debt instruments. However, the staff notes that the AFS reserve in equity allows users to approximate the amortised cost of AFS debt instruments unless there is a material effect of:
    (a) AFS equity instruments (and no separate analysis is provided for AFS debt and equity instruments); or
    (b) impairment losses (which result in transfers of impairment losses from other comprehensive income to profit or loss measured on a fair value basis).

Staff recommendation

33. If the Board agrees with the staff recommendation on Question 1 the staff does not believe that the incremental information resulting from disclosure of the different measurement bases would justify an amendment to IFRS 7 in isolation.

34. However, should the Board decide to proceed with the pro-forma profit or loss disclosures (refer to Question 1) as proposed in the ED the staff thinks the proposed disclosure of the different measurement bases would be appropriate complementary information. In this case the staff recommends to better integrate the proposed disclosure into the structure of IFRS 7 in order to avoid duplication of information.

Question to the Board

35. Does the Board agree with the staff recommendation to not further pursue the proposed disclosure of the different measurement bases? If not, why? What does the Board propose instead, and why?

Question 4 of the ED

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?

36. Nearly all respondents agreed with excluding debt instruments classified as at FVTPL from the scope of the proposed disclosures. Generally, those who agreed with this scoping also rejected the pro-forma profit or loss disclosure and disagreed with disclosing different measurement bases.

37. The main reason cited by respondents for this view was that currently there is no need to maintain amortised cost based information for debt instruments classified as at FVTPL in order to comply with IFRSs. Thus, the significant cost and effort that would be required to generate such information would be excessive compared to the benefits of that information to users. In particular, generating this information in the short term would be impossible.

38. A few respondents supported including either debt instruments designated as at FVTPL or all such instruments classified as FVTPL (ie including those held for trading). Their rationale was that extending the scope to FVTPL would further enhance comparability of financial instruments.

Staff analysis

39. The staff believes that the responses confirm the view in paragraph BC6 of the ED that disclosures that would require entities to determine new amortised cost information that is not needed under existing IFRS requirements would be excessively burdensome. The feedback also revealed that there was no significant demand for this disclosure. Thus, the staff is convinced that the costs associated with such a requirement would outweigh any benefits that might result from it.

Staff recommendation

40. Should the Board decide to go ahead with any of the proposed disclosures, the staff recommends a scope that excludes investments in debt instruments classified as FVTPL for the reasons set out in the staff analysis above.

Question to the Board

41. Does the Board agree with the staff recommendation to exclude investments in debt instruments classified as FVTPL? If not, why? What does the Board propose instead, and why?

Question 5 of the ED

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

42. Nearly all respondents objected to the proposed effective date of annual periods ending on or after 15 December 2008. Those respondents who objected to the proposed effective date also objected to the pro-forma profit or loss disclosure and disclosing different measurement bases. This reflects that respondents had concerns about the practicability of the proposed disclosures given the absence of lead time.

43. The reasons for objecting to the proposed effective date included that:
    (a) the proposed timing is completely unrealistic; it would not allow preparers sufficient lead time to make the necessary changes to processes and systems (in particular as many entities with a calendar year reporting cycle are already in the process of finalising their 2008 financial statements);
    (b) an effective date before the date of issuing the final amendment creates problems for jurisdictions that adopt IFRSs as law because that would violate legal due process and constraints;
    (c) 'backdating' is generally inappropriate for standard setting; and
    (d) the changes are not sufficient urgent to justify such an accelerated effective date.

44. Very few respondents thought that the proposed disclosures were sufficiently urgent to warrant the effective date as proposed.

Staff analysis

45. Based on the feedback received, the staff believes that any amendment to IFRS 7 with an effective date of annual periods ending on or after 15 December 2008 would not be practicable for a many IFRS preparers in the light of the advanced stage of their financial reporting season. Imposing such an effective date would unduly disadvantage preparers (with calendar financial year-ends) that have a very timely reporting schedule.

46. The staff further notes that the responses do not convey an urgency that would be sufficient justification for the unusual step of setting an effective date before the date of issuing the final amendment.

Staff recommendation

47. The staff recommends that if the Board decides to make any amendment to IFRS 7 the effective date should allow a lead time commensurate with the implementation effort that the amendment entails. In any case, the effective date should not be earlier than the date of issuing the final amendment, for the reasons set out in the staff analysis.

Question to the Board

48. Does the Board agree with the staff recommendation not to use an effective date before the date of issuing a final amendment? If not, why? What does the Board propose instead, and why?

Question 6 of the ED

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

49. There was broad consensus among respondents that no comparative information should be required in the year of initial adoption (with some respondents differentiating between alternative appropriate effective dates for different proposed disclosures). The main reason was the same as that regarding the effective date (Question 5): that the proposed timing was impracticable. Consequently, relief from comparatives was considered a mitigating factor (although not sufficient).

Staff analysis

50. The staff believes that relief from comparative information is only justified as a mitigating factor when the effective date provides only a short lead time in relation to the implementation effort required.

51. Because of its analysis and recommendation regarding the proposed effective date (Question 5) relief from comparative information should be reconsidered in the light of any decision on a delayed effective date. Depending on the extent of the delay in effective date relief from comparatives may no longer be required.

Staff recommendation

52. The staff recommends reconsidering the relief from comparative disclosure because the decision is inextricably linked to setting the effective date, as explained in the staff analysis above.

Question to the Board

53. Does the Board agree with the staff recommendation to reconsider the relief from comparative information in conjunction with a decision on a revised effective date? If not, why? What does the Board propose instead, and why?

Appendix A

Proposed amendments to International Financial Reporting Standard 7 *Financial Instruments: Disclosures*

After paragraph 30 a new heading and paragraphs 30A and 44G are added.

Significance of financial instruments for financial position and performance

Other disclosures

Investments in debt instruments

30A An entity shall disclose the following for all investments in debt instruments other than those classified as at fair value through profit or loss:

(a) pre-tax profit or loss as though the instruments had been:

(i) classified as at fair value through profit or loss; and

(ii) accounted for at amortised cost.

(b) the following amounts in a way that permits comparison of:

(i) the carrying amount in the statement of financial position;

(ii) fair value; and

(iii) amortised cost.

An entity shall provide the information required by this paragraph in tabular format.

Effective date and transition

44G An entity shall apply paragraph 30A for annual periods ending on or after [15 December 2008]. However, comparative information relating to periods before the date of initial adoption is not required.

Appendix A

Guidance on implementing IFRS 7 *Financial Instruments: Disclosures*

After paragraph IG6 a heading is amended (new text is underlined). After paragraph IG14 a heading and paragraph IG14A are added.

Significance of financial instruments for financial position and performance (paragraphs 7–30A, B4 and B5)

Investments in debt instruments (paragraph 30A)

IG14A IFRS 7 requires disclosures about all investments in debt instruments other than those classified as at fair value through profit or loss. A tabular format is required. An entity might disclose the following for those investments to comply with paragraph 30A. (Comparative information is not included in the following example.)

Investments in debt instruments (other than those classified as at fair value through profit or loss)

	20X1
	Pre-tax profit or loss in each scenario CU million
If all investments in debt instruments had been classified as financial assets at fair value through profit or loss	X
If all investments in debt instruments (other than those classified as at fair value through profit or loss) had been accounted for at amortised cost	X

	31 Dec 20X1		
Investments in debt instruments classified as:	Carrying amount in the statement of financial position CU million	Fair value CU million	Amortised cost CU million
Loans and receivables	X	X	X
Held-to-maturity investments	X	X	X

Appendix A

Available-for-sale financial assets	X	X	X
Total	X	X	X

Appendix B

Respondents (by type)	Number
Academics	2
Accounting firms	7
Banks	17
Individuals	1
Industry/sector organisations	13
Insurers	3
Preparers	9
Professional associations	13
Regulators	3
Standard setters	14
Total	82

Respondents (by geographical region)	Number
Africa	3
Asia Pacific (excluding Australia/New Zealand)	7
Australia/ New Zealand	8
Europe	50
International/Multi-regional[1]	11
Latin America	2
North America	1
Total	82

[1] Multi-regional comprises of respondents representing multiple regions, such as the joint international responses from each of the Big 4 Accounting Firms, and international professional organisations.