DGRV
German Cooperative and Raiffeisen Confederation

Schellingstrasse 4
10785 Berlin

Postfach 30 92 62
10760 Berlin
Germany

Tel.: +4930 – 2021 02
Fax: +4930 – 2021 2685

Email: info@dgrv.de

Andrea Pryde
Assistant Project Manager
International Accounting Standard Board
30 Cannon Street
London EC4M 6XH
United Kingdom

eMail: commentletters@iasb.org

22 October 2004

Dear Ms. Pryde,

Comment Letter ED 7 - *Financial Instruments: Disclosures*

The German Cooperative and Raiffeisen Confederation (DGRV) has reviewed the above noted draft and is pleased to set out its comments to you. The DGRV is the national apex organisation of the German co-operative sector. Co-operatives comprise the strongest form of economic organisation in Germany representing some 8,500 co-operatives (including over 1.300 co-operative banks) with more than 20m. members.

We appreciate the opportunity to comment on Exposure Draft 7 – *Financial Instruments: Disclosures*. We hope that you find our comments useful in your deliberations. If you would like any further clarification, please do not hesitate to contact us.

Sincerely

Dr. Carl-Friedrich Leuschner
CEO

Günter Spanier
Member of the Board

ED 7 – Financial Instruments: Disclosures

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 consider all the above mentioned disclosures to be appropriate. Generally we appreciate the boards conclusion to locate in one place all disclosures relating to financial instruments. We also believe that there is a necessity to provide the users of financial statements with information which is reliable and relevant for decision-making. Therefore the users of financial statements need information about an entity's exposure to risks arising from all financial instruments and how those risks are managed. The disclosure requirements contained in ED 7 will generally meet the intended objective.

However we would like to address the following improvement. IAS 30 will be superseded by ED 7. ED 7 does not contain specific disclosure requirements for financial statements of banks (and similar financial institutions) which are as detailed as required by IAS 30 up to now. The general reference in ED 7.8 (deciding in the light of the individual circumstances how much detail an entity provides, how much emphasis it places on different aspects and how it aggregates information) is too abstract compared to the current requirements in IAS 30. Hence, we propose to adopt in ED 7 or in IAS 1 not less than the requirements concerning the income statement (IAS 30.10) and the balance sheet (IAS 30.19) as a separate part exclusive for banks and similar financial institutions. The non-completing enumerations in IAS 30.10 and IAS 30.19 will guarantee a minimum comparability for the users of financial statements of banks and similar financial institutions without being a mere uniformity. Also preparing a balance sheet was greatly facilitated by the non-completing enumeration in IAS 30.19.

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 generally agree with this proposal. However, we doubt whether all entities, especially outside the banking sector, are able to provide the proposed disclosures in detail. The concession in ED 7.39(b) ("unless impracticable") is too undefined. We recommend to add more guidance on the interpretation of "impracticable" in IG 16, which focuses on the aspect of undue cost and effort.

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 support the proposal in ED 7.43(a) and 7.44 as to require a single factor analysis only, while permitting the disclosure of multifactor analysis according to ED 7.44 if management uses such an analysis to manage market risk. Particularly with regard to smaller and medium-sized non-financial institutions the preparation of such a sophisticated multifactor analysis would result in undue cost and efforts. For these kind of entities a single factor analysis in principle may not produce a misleading volatility pattern. Otherwise the general reference in ED 7.8 and ED 7.45 require additional market risk disclosures.

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 believe that the required capital disclosures are not totally appropriate. First of all we are of the opinion that capital targets set internally by management (ED 7.47(b)) should not be required for disclosure. This confidential information may be considered too sensitive for an entity to disclose. If such information is disclosed, how can readers of the financial statement verify these disclosures? In our opinion published capital targets set internally by management wouldn´t be meaningful. Furthermore we do not support ED 7.47(e). On the one hand the objective of regulatory capital requirements established by legislation or other regulation differ from the interests of an investor. Otherwise a disclosure of a non-compliance with externally imposed capital requirements may cause a self-fulfilling prophecy in many cases.

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 proposed requirements. However, we would like to ask the board to consider whether an entity that adopts IFRSs for the first time before **1 January 2007** also should be exempt from requirements to produce comparative information in the first year of application.

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 that the disclosure or risk arising from financial instruments proposed by the draft IFRS should be part of the financial statements! However, when there is a subsequent standard on MD&A we would like to be able to reconsider this question again.

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 do not agree that consequential amendments should be made to IFRS 4 before phase II of the insurance project is finalised. Further changes to disclosure requirements might be burdensome in adjusting systems.

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 believe that the implementation guidance is sufficient. Nevertheless we would appreciate an illustrative example how the fair value of the financial liability that is not attributable to changes in benchmark interest rate can be estimated using the steps as illustrated in ED 7.12 (a) to (d).

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 agree that the requirements in the draft IFRS provide adequate disclosure of fair value compared with those proposed in the FASB´s ED.

Question 10 – Other comments

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

We have three further comments:

ED 7.34 resp. ED 7.35 require qualitative resp. quantitative disclosures for "each risk arising from financial instruments". In our point of view aggregate information about "each *type/category* of risk arising from financial instruments" should be sufficient.

With regard to the active IASB project "Accounting Standards for Small and Medium-Sized Entities" we would like to ask the board to provide special requirements for those entities. In excess of ED 7.8 we would appreciate clear defined exemptions to the disclosure requirements in the future SME-Standard.

IAS 32 par. 18(b) classifies redeemable member share capital as financial liabilities. Due to cooperative law in many countries (like in Germany) members´ shares give holders the right to put the shares back to the co-operative entity. No contractual maturity is arranged nor mandatory redemption. After a defined cancellation period the co-operative entity normally has to repay the paid-in-capital to the retired member on a nominal basis. ED 7.42(a) requires a maturity analysis for financial liabilities that shows the remaining contractual maturities. Therefore co-operative entities are required to disclose such an analysis concerning redeemable member shares.

We maintain that this disclosure is definitely impracticable for prepares, useless and confusing for readers. As we expressed in recent comment letters to ED IAS 32 and IFRIC Draft 8 we strongly disagree with the classification of member shares as liabilities. For example according to capital requirements of the bank supervision ('Basel II') member shares comply with tier 1 capital requirements. Readers of financial statements disclosures will be extremely confused when they notice that cooperative entities meet external capital requirements without showing equity on the face of their balance sheet. If the Board insists on classifying members' shares as financial liabilities we ask the Board to exempt member shares without a contractual maturity from maturity analysis disclosures. Otherwise we would appreciate to have an illustrative example for such an analysis required in ED 7.42(a).