INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

COMMENTS ON ED 7 - FINANCIAL INSTRUMENTS: DISCLOSURES

CL 4

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?

Answer:

We agree that all disclosures relating to financial instruments should be located in one standard. We also agree with the additional disclosure requirements being added through this exposure draft.

However, guidance as to how these additional disclosures will be linked with the existing requirements of IAS 1 (based on liquidity criteria) needs to be included in the standard as from the exposure draft, it is not clear where and how such information will be disclosed. For instance paragraph 10 of the exposure draft does not clarify whether the proposed additional minimum disclosures will be disclosed on the face of the balance sheet or through a separate note.

Also, the disclosures specific to financial sector (as was included in IAS 30) are not included in ED 7. One way of retaining such disclosures is to amend IAS 1 in order to give all disclosures pertaining to the balance sheet/ income statement etc. at one place.

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?

Answer

Though in principle, we agree with the proposal that the fair value of collateral and other credit enhancements should be disclosed however, considering the fact that Pakistan has not yet developed an infrastructure to collect the information regarding:

- land price indices for short, medium and long term (to estimate the fair value of collateral at a particular point of time)
- inflation factors for short, medium and long term (to estimate the fair value of collateral other than land at a particular point of time)

In view of above, the cost/benefit of proposed requirements cannot be established for the developing countries i.e. the process of valuation would not be cost effective and yet it would necessitate excessive use of judgement that may lead to misleading figures being disclosed in the financial statements.

Therefore, we believe that the above disclosures appear to be onerous for the entities especially when the requirements are located under the heading “Minimum Disclosures” without defining the conditions in which assessing the fair values of collaterals etc. would be considered as impractical.

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?

Answer

The proposed disclosure of a sensitivity analysis would not be practicable for most of the entities. Sensitivity analysis is believed to be a management tool and is always based on certain parameters that not only need to be defined but also should be appropriately understood to get the substance from the analysis.

We are of the view that the requirement would involve subjectivity and would rather result in preparation of lengthy financial statements with information that is not useful and comprehensible for most of the users.

Still if the Board decides to continue with the disclosure, then the standard should provide elaboration relating to the parameters for instance whether the analysis should be based on practical maturity or contractual maturity etc. Otherwise the requirements would lead to incomparable disclosures of the sensitivity 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?

Answer

Agreed that the 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 externally imposed capital requirements; and if it has not complied, the consequences of such non-compliance should be disclosed.

However, disclosing whether the entity complied with any capital targets set by management may not be desirable as many entities might consider it confidential information that may not be shared with the market. Therefore, the proposed disclosure relating to internal capital targets should be deleted.

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?

Answer.

The proposed effective date and transition requirements appear to be appropriate.

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?

Answer

We do not agree that the disclosures relating to risks proposed by the draft IFRS should be part of the financial statements.

However, if the Board decides to continue with the requirement of sensitivity analysis, then it should be made part of the information provided by management outside the financial statements.

Also see our response to Question 3.

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?

Answer

All amendments to IFRS 4 should wait for the proposals of Phase II of the Insurance Project.

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?

Answer.

Illustrative disclosures should also be made part of the implementation guidance

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?

Answer

No comment offered

Question 10 – Other comments

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

Answer.

The Draft IFRS proposes to withdraw IAS 30 which in our opinion should not be withdrawn as it provides industry specific disclosures that could not be relocated to this draft IFRS.

However, if the Board finally decides to withdraw IAS 30 then it is proposed that the disclosures particularly relevant to the financial sector should be re-issued in the form of implementation guidelines or an appendix to IAS 1.

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