FAR

FAR is the institute for the accountancy profession in Sweden

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International Accounting Standards Board 18 October 2004

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Exposure Draft ED 7 Financial Instruments: Disclosures

FAR, the Institute for the Accountancy Profession in Sweden, is responding to your invitation to comment on the Exposure Draft *ED 7 Financial Instruments: Disclosures.*

General Comments

We agree with the objective of a principle based framework rather than a rule based. However, we fear that the reduction in details of the existing disclosure requirements might have a negative impact on the quality of the financial information. The omission of some of the existing requirements might cause important information for the users of financial statements to be left out.

Question 1

Disclosures relating to the significance of financial instruments to financial position and performance

We agree with the proposal and we believe that the proposed disclosure requirements for financial assets and financial liabilities by classification will provide the users of financial information with a better overview and understanding of the financial information.

At the same time, we find that the retraction of some disclosures previously prescribed by IAS 32 might disguise information which could be potentially important to users of financial statements.

The following retractions raise our particular concern:

Effective Interest Rate - ED 7 Paragraph 18 (old IAS 32 paragraph 94 (d)): This paragraph no longer requires disclosure of effective interest rate on the liability component. Furthermore, we note that the requirement to disclose effective interest rate was deleted for all financial assets and financial liabilities. This requirement was earlier set out in old IAS 32 paragraphs 67-69. The table of concordance indicates that these paragraphs have been substituted by the requirement to disclose a sensitivity analysis. However, we believe that the disclosure of effective interest rate has provided important additional input to users especially for the purpose of forecasting the future debt burden of the entity and also provided an insight as to how the market rates the credit standing of the entity. Therefore, we believe that the requirement to disclose the effective interest should be reinstated for

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financial liabilities including compound instruments with multiple embedded derivatives. We agree, however, that this requirement is not crucial for financial assets.

Impairment Loss - ED 7 Paragraph 22 (old IAS 32 paragraph 94(i)): This paragraph no longer requires disclosure of the nature of the impairment loss. We believe it is important to users of financial statements to know what financial assets were impaired and what the nature of the impairment is.

Accounting Policy - ED 7 Paragraphs 21 and 23: Old IAS 32 paragraph 66 (c) required an entity to disclose "the basis on which income and expenses from financial assets and financial liabilities are recognised and measured." We believe that this information is important to users of financial statements. Therefore, we recommend it to be reinstated in the disclosure of accounting policies set out in paragraph 23 of ED7.

Net Gains and Net Losses - We note that paragraph 21 (b) of ED 7 requires an entity to disclose how net gains and net losses are determined. This requirement appears to be similar but narrower compared with the disclosure requirement in old IAS 32 paragraph 66 (c). If this is the case, we recommend that this requirement should be adjusted to encompass old IAS 32 paragraph 66 (c). We also believe that this paragraph should rather be included in paragraph 23 together with other accounting policies.

Range of Estimates, Fair Value - ED 7 Paragraph 30 (old IAS 32 paragraph 90): This paragraph no longer contains the requirement to disclose ''if possible, the range of estimates within which fair value is highly likely to lie''. We believe that this information is important for users and should be reinstated

Question 2

Disclosure of fair value of collateral and other credit enhancements

We agree with the proposal.

Question 3

Disclosure of sensitivity analysis

According to the Board, the proposed sensitivity analysis will provide more useful information than the following requirements currently in IAS 32, that are intended to satisfy the same user needs; i.e. disclosures of terms and conditions of financial instruments and disclosures about exposure to interest rate risk including contractual repricing or maturity dates.

We do not agree with the proposal to introduce a sensitivity analysis and deleting the above mentioned disclosures. We do not share the view that the proposed sensitivity analysis will satisfy the same user needs, rather we regard the sensitivity information as supplementary. The proposed retraction of information will make it more difficult for the users to assess the amount, timing and uncertainty regarding interest rate exposure. Greater transparency regarding those risks allows users to make more informed judgements about risk and return.

The disclosure of terms and conditions of financial instruments might prove to be onerous. We consider the disclosures about exposure to interest rate risk, including contractual repricing or maturity dates, to be highly relevant and therefore should remain as a disclosure requirement.

Question 4

Capital disclosure

We do not agree that the externally imposed capital requirements should be treated differently than the internally imposed capital requirements. This is relevant information for users of financial information, in order to assess the financial position of the entity correctly. We see no reason to distinguish between externally and internally imposed requirements as they are both of importance to the users of financial information. The externally imposed capital requirements may affect its ability to conduct business and should therefore be disclosed. This is also consistent with the aim of greater transparency.

The information about externally imposed capital requirements is of interest as it illustrates what the authorities consider to be the requirement in order to ensure financial stability. The externally imposed capital requirements might also limit the business and growth opportunities of the entity and should therefore be disclosed. They, in addition to the internally imposed capital requirements, are clearly relevant as they affect the entity and how it manages, and hence, determines the adequacy of its capital resources.

We do not agree with the concerns raised in the Basis for Conclusions, e.g. the argument that the disclosure of entity specific capital requirements imposed by a regulator might undermine the regulator's ability of impose the requirements, etc. It is in the best interest of the depositors that there is full transparency of the capital requirements and the risk assessments from the regulators, as the regulator aims to protect them. In the Basis for Conclusions there is also expressed some concern that the regulator's risk assessment might have a different focus (e.g. the protection of depositors or policyholders). We agree that the supervisor's risk assessment is not a substitute for independent analysis or other risk assessments, but it should be underlined that it is relevant supplementary information. However, our opinion is that the arguments in the Basis for Conclusions do not provide justifiable argument to exclude disclosure about externally imposed capital requirements, i.e. that this information would cause unnecessary detriment to the business of the entity. We do believe that this information is beneficial to the users of financial information and can be provided without prejudice to the entity.

There are some areas where there is a need for elaboration. We would appreciate further clarification as to what is considered as externally imposed capital requirements, if it only applies to capital requirements imposed by authorities or if it also includes external agreements (e.g. listing agreements, finance agreements with financial covenants, etc.). We believe it should be further elaborated in the Basis for Conclusion what is considered as capital, but not financial instruments as it reads in the scope of the draft IFRS – "Capital may include items other than financial instruments". An entity should disclose information about the nature of the externally imposed capital requirements. What is the scope of "nature", would it for instance include financial covenants?

We can see no convincing reasons for disclosing internally imposed capital requirements, but not the externally imposed capital requirements. Information about externally imposed capital requirements would enable users of financial information to evaluate the complete picture of capital requirements for the entity and these are significant for the entity's financial position and performance.

Question 5

Effective date and transition

We agree with the proposal. However, we recommend that the rules for early application and comparative information be clarified. It is proposed that an entity that adopts and applies the IFRS for the first time before 1 January 2006 should be exempt from providing comparative information in the first year of adoption. If you adopt and apply the IFRS on or after 1 January 2006 but before 1 January 2007, are you then obliged to present comparative information? We believe that entities would be more motivated to adopt the IFRS earlier, before the effective date, if comparative information is not required.

Question 6

Location of disclosures of risks arising from financial instruments

We agree with the proposal that the disclosures should be part of the financial statements as these otherwise would be incomplete. The disclosures of risks arising from financial instruments are imperative in order for users of financial information to properly assess the financial performance and position of an entity. The managing and measuring of exposure to risk is critical and therefore the information should be presented in the financial statements.

Question 7

Consequential amendments to IFRS 4

We agree with the proposal to amend IRFS 4 to be fully consistent with the IFRS.

Question 8

Implementation Guidance

We agree with the requirements in the draft IFRS, but we would appreciate further clarification regarding recognised and unrecognised financial instruments. Unrecognised financial instruments include some financial instruments that, although outside the scope of IAS 39, are within the scope of the draft IFRS, e.g. loan commitments. We believe that it should be further clarified what qualifies as an unrecognised financial instrument.

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)

We agree with that fair value disclosures as proposed in the draft are adequate compared with those proposed in the FASB's exposure draft.

Question 10

Other comments

Paragraphs 9-10 – Headlines may be misrepresentative for the contents

The headline of paragraph 9 is "Minimum disclosures" but the following sub-headline is "Balance sheet". Paragraph 10 regulates disclosures, but from the headlines you cannot tell whether the disclosures should be presented on the face of the balance sheet or if disclosure in the notes would also be allowed.

Paragraph 13 – Reclassification

If the entity has reclassified a financial asset as one measured at cost or amortised cost rather than at fair value, it shall disclose the reason for the reclassification. In our opinion also information regarding the impact on financial statements arising from the reclassification is of interest. If the entity has reclassified a financial asset as one measured at cost, or amortised cost rather than at fair value, it should disclose the reason for that reclassification. From the perspective of the user of financial information it is also relevant to understand what the financial result/implications from the reclassifications are. Therefore the information of reasons for the reclassification should be accompanied by quantitative information. This is also in accordance with IAS 8 paragraph 39.

Appendix B Amendments to other IFRSs, B4 – amendments to IAS 14

We do not see the rationale for amending IAS 14 due to ED 7 and would welcome an explanation in the Basis for Conclusions.

Yours sincerely,

Jan Buisman
Chairman Accounting Practices Committee

Dan Brännström
Secretary General