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Ms Andrea Pryde
Assistant Project Manager
International Accounting Standards Board

By Email to: CommentLetters@iasb.org

CC:
Professor David Boymal
Chairman
Australian Accounting Standards Board
Email: dboymal@aasb.com.au

Dear Ms Pryde

Exposure Draft ED 7 *Financial Instruments: Disclosures* ("ED 7")

We are responding to your invitation to comment on the above exposure draft on behalf of the Australian Banking Association ("ABA"), the industry body representing all licensed banking institutions in Australia, including all of the major retail banks. We welcome the Board's decision to revise, enhance and consolidate financial instruments disclosures under International Financial Reporting Standards ("IFRS"). The key points from our response, attached in **Appendix 1**, are summarised as follows:

- We concur with the proposal to consolidate disclosures relating to financial instruments within one standard.

- Appendix A to ED 7 defines "past due" as "…when a counterparty has failed to make a payment when contractually due". ED 7 then proposes specific disclosures for financial assets that are past due. In our strong view, the disclosure of financial assets past due from one to 89 days is meaningless for banking and other financial institutions. For these institutions, the reporting requirements for past due financial assets is determined by local central banking or prudential regulation authorities with internal management reporting, external financial reporting disclosures and prudential and statistical reporting prepared on this basis. For instance, in Australia, the Australian Prudential Regulation Authority (APRA) requires reporting on financial assets past due 90 days or more. Australian accounting standard AASB 1032 "Specific Disclosures by Financial Institutions" is consistent with this approach in asset quality disclosure requirements. We understand this is also consistent with Basel II requirements. The imposition of an alternate reporting requirement for past due financial assets would be inconsistent with the management of the business and other external reporting requirements, would cause considerable complexity in internal processes and systems, and, in our view, would not provide useful information for users of the financial report of a bank or other financial institution. We strongly suggest the IASB reconsider the relevance, usefulness and practicability of reporting assets past due one to 89 days for banks and other financial institutions.

- Within ED 7 it is proposed that the impact of fair value adjustments on earnings or as a percentage of total assets and liabilities requires quantification within the financial report. It is our view these disclosures are not specific to financial instruments and should not be included within a standard specifically attributable to financial instruments. We believe these disclosures are broader than those specifically relating to financial instruments and should be considered as part of the IASB's performance reporting project.

- ED 7 contains a number of new disclosure requirements pertaining to capital management. We do not support disclosure of performance against internal management targets due to the commercial sensitivity of this information.

- We believe an option for relief to the parent entity should be part of the final Standard, whereby when a financial report contains the financial statements of both the parent and the consolidated group, the disclosures required by the final standard need be presented only for the consolidated group.

We thank you for the opportunity to respond to the exposure draft, and hope that you find our feedback helpful and constructive. Please do not hesitate to contact me if you would like to discuss our members' views in more detail.

Yours sincerely

Louise R Thomson
Group Manager, Group Accounting Policy – National Australia Bank Limited
Chairman of the Australia Bankers' Association Accounting Sub-Committee

Appendix 1

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 concur with the planned approach to consolidate financial instruments financial reporting disclosures into one standard. We also agree that the proposed additional disclosure requirements, outlined above, increase the understanding of exposure to financial instruments of both financial and non-financial institutions.

With respect to alternative disclosures in addition to those set out in the draft standard, we believe the following require consideration:

1.1 Income statement and balance sheet line items

We believe guidance should be provided on required high-level income statement and balance sheet line item disclosures for banks and other financial institutions to ensure consistency at a high-level within this industry, similar to that currently contained within IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions.*

1.2 Consolidation of special purpose entities (SPEs)

The application of SIC 12 will often lead to the consolidation of SPEs used in securitisation or other financing transactions. Proposed disclosures appear only to relate to financial assets that fail derecognition and ignore the funding liability that will be recognised from the consolidation of related SPEs. We propose that such financial assets and liabilities should be separately identified together with their relationship.

There appears to be no specific disclosure requirements in relation to financial assets and liabilities that were not originated by the reporting entity but are consolidated by virtue of SIC 12, such as multi-seller securitisation conduits. We propose that such financial assets and liabilities should be separately identified together with their relationship.

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 agree that in theory including the fair value of collateral pledged as security and other credit enhancements improves the disclosure requirements with respect to credit risk, however, we have serious reservations about the practicability of doing this in any large-scale financial services institution.

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?

In principle, we agree with the proposed sensitivity analysis 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 concur broadly with the proposed qualitative and quantitative discloses pertaining to an entity's capital and capital management. We disagree with the requirement for disclosure of an entity's performance against internal capital management targets outlined in Paragraphs 47(d) and (e). We believe such information is often highly confidential and commercially sensitive and not the type of information an entity would share with the market. It is our view that the disclosure of capital management results against internal benchmarks is inappropriate. These disclosures are not required for any other measure, such as an entity's performance against budgeted revenue or profitability, and disclosures purely in relation to capital management may be potentially misleading if not considered in conjunction with an entity's overall performance against other internal benchmarks, budgets or targets.

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 effective date and transition requirements.

It is our view that it is important to enable entities to early adopt the proposed standard if this enables the transition to reporting under IFRS more manageable. Rather than financial institutions reporting under IAS 30 in their first year of transition and then changing the reporting framework to comply with these new additional disclosures in a subsequent period, it may be more efficient for entities to early adopt. Such an approach would also minimise confusion for users of the financial report arising from change.

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 disclosures proposed in ED 7 should be part of the financial statements. An understanding of the risks an entity is exposed to through financial assets and liabilities and how these are managed is considered important to the understanding of the financial report.

Additionally, the inclusion of these disclosures within the financial report and being subject to audit enhances the reliability of this information.

Question 7 - Consequential amendments to IFRS 4

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 agree that the risk disclosures in IFRS 4 should be amended to make them consistent with the requirements of this proposed IFRS.

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 consider that the Implementation Guidance would be improved by the addition of illustrative examples of qualitative and quantitative disclosures, and the application of the minimum disclosures proposed in the draft standard. For instance, if the Board considered additional disclosures were appropriate based on our response to Question 1 on consolidation of SPEs, illustrative examples of a linked-presentation style would be helpful.

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 with the -proposed FASB disclosure requirements, except for the disclosures proposed in (a)(i), (a)(iii) and (b)(iv). We question the relevance of this specific information for organisations with significant levels of activity in these areas, such as banks and other financial institutions.

Whilst movements in the fair values in financial assets and liabilities undeniably impact earnings and balance sheet values, numerous other variables also impact earnings and balance sheet values that are not attributable to financial assets and liabilities. We therefore question the relevance of this information in isolation.

It is our view that it would be more appropriate to defer the additional disclosures and to consider them as part of the IASB's performance reporting project. Through the inclusion of these disclosures as part of the broader performance reporting project, this would promote consistency in the nature of disclosures required with respect to the impacts upon earnings and balance sheet carrying values of both financial and non-financial assets and also the dates when these disclosures are effective.

Question 10 - Other comments

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

10.1 Definition of items that are "past due"

Appendix A to ED 7 defines "past due" as "…when a counterparty has failed to make a payment when contractually due". ED 7 then proposes specific disclosures for financial assets that are past due. It is our strong view that the disclosure of financial assets past due from one to 89 days is meaningless for banking and other financial institutions. For these institutions, the reporting requirements for past due financial assets is determined by local central banking or prudential regulation authorities with internal management reporting, external financial reporting disclosures and prudential and statistical reporting all prepared on this basis. For instance, in Australia, the Australian Prudential Regulation Authority (APRA) requires reporting on financial assets past due 90 days or more. Australian accounting standard AASB 1032 "Specific Disclosures by Financial Institutions" is consistent with this approach in asset quality disclosure requirements. We understand this is also consistent with Basel II requirements.

The imposition of an alternate reporting requirement for past due financial assets would be inconsistent with the management of the business and other external reporting requirements, would cause considerable complexity in internal processes and systems, and, in our view, would not provide useful information for users of the financial report of a bank or other financial institution. We strongly suggest the IASB reconsider the relevance, usefulness and practicability of reporting assets past due one to 89 days for banks and other financial institutions. This is necessary to ensure that the users of financial reports of banks and other financial institution are provided with information to assist them in further understanding the business "through the eyes of management" and in line with how the prudential regulator reviews asset quality and related risks. In our view, information on financial assets past due one to 89 days is not useful information for this industry.

We therefore ask the IASB to reconsider the appropriateness and/or applicability of all disclosure requirements in ED 7 in relation to “past due” for banks and other financial institutions.

10.2 Collateral - Paragraph 16

We believe clarity is required in relation to this disclosure requirement and question the relevance for banking and other financial institutions in the absence of context.

10.3 Fair value and assumptions – Paragraph 31(c)

Because of the stringent requirements relating to classifying investment securities as held-to-maturity financial assets, entities, particularly financial institutions, are likely to classify such securities as available-for-sale financial assets. A consequence of this is that the disclosure load associated with explaining valuation assumptions and variants for a wide range of debt and equity securities – the changes in fair value of which are recognised in equity and not profit or loss until realised – will be extremely onerous and costly in relation to benefits to users. We ask that the IASB reconsider this requirement specifically in relation to available-for-sale financial assets.

10.4 Removal of a banking and other financial institutions specific standard

The removal of the guidance within IAS 30 specifying the format of the income statement and balance sheet for banks and other financial institution will potentially lead to a decrease in consistency and comparability in financial reporting between like institutions. As commented in our response to Question 1, we support the retention of the disclosure requirements specifying at a high level the format of the income statement and balance sheet as per IAS 30.

If specific disclosures for banks and other financial institutions are contemplated, we encourage the Board to consider the Basel II Pillar III requirements, to promote consistency between these reporting regimes. However, we would not support the imposition of all Basel II Pillar III disclosure requirements in IFRS financial reports as some information is best reported in other forms or locations.

10.5 Carve out for parent entity accounts

We believe an option for relief to the parent entity be part of the final Standard, whereby when a financial report contains the financial statements of both the parent and the consolidated group, the disclosures required by the final Standard need be presented only for the consolidated group.