Date

9 November 2004

Le Président

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Dear Sir David,

Re: IASB Exposure Draft 7 Financial Instruments: Disclosures

FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) is pleased to submit its comments on the IASB Exposure Draft 7 on Financial Instruments Disclosures. FEE as a founding organisation of EFRAG has also contributed to the EFRAG consultation process by submitting our views on their preliminary comments. We refer to the EFRAG preliminary comments (draft letter of 15 September 2004) where we are in agreement with their comments; where we are in disagreement our own views are put forward. However, we have not considered the final EFRAG submission to IASB for our own response.

We agree with EFRAG in supporting the objective of the IASB to revise and enhance the disclosures in existing IASs by applying more principle based disclosure requirements on financial instruments. We welcome IASB proposal to reduce the requirements and to locate in one place all disclosures relating to financial instruments.

We agree that the scope of the ED includes all types of entities. However, the minimum disclosure necessary as well as the level of disclosure may differ from entity to entity. The IASB should clarify in paragraph 8 that the level of detail and extent of the disclosure is to be tailored on the basis of the significance of a particular financial risk exposure for an entity.

The proposal furthermore appears to attempt consistency between disclosure in the financial statements and Basel II Pillar 3 requirements applicable to banks. Transposing the requirements of a particular industry to all entities raises concerns as entities may have difficulties to understand the requirements that are particularly relevant for that industry. The entities that are not operating under a regulatory regime should not be obliged to provide disclosures that are aimed at meeting regulatory reporting requirements, but are not relevant to these particular entities, given their exposure to risks. Furthermore, supervisors have other information tools at their disposal more suited to their needs. The IASB should therefore consider carefully which disclosures are necessary to understand general purpose financial statements for all entities and remove those that are required only for compliance with Pillar 3 reporting requirements and not relevant for other entities. While it might be reasonable to allow many of these to be included in the financial statements, some Pillar 3 disclosures should not be imported into accounting standards and thereby mandated for all entities.

We have the following comments on the questions raised in the exposure draft.

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? Do you agree with the proposals in this Exposure Draft? If not, why not? What changes do you propose and why?

We support the IASB proposals. We favour a principles based approach to disclosures and we support the approach developed in this proposed standard.

However, we agree with the EFRAG draft proposal to reinstate the requirement to disclose effective interest rate of financial liabilities previously included in old IAS 32.67-69. The information provided is useful for users to forecast future cash flow and brings added value to the financial statements that a sensitivity analysis would not necessarily provide, especially in an environment of fixed interest rates. We suggest that the disclosure of the effective interest rate be the minimum requirement and the sensitivity analysis be provided additionally, if this analysis is prepared already for internal management purposes. Therefore, the old IAS 32.67-69 should be reinstated in respect of financial liabilities.

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?

Overall, we support the objective of disclosing information on the entity's credit risk. We agree with the proposed description of collateral pledged as security (39(b)) but are concerned about the disclosure of their fair value for the following reasons:

- We are not convinced that the disclosure of the fair value of collateral pledged as security for all types of financial instruments adds value to the financial statements. A balance should be stuck between the significant costs of requiring such level of information and its benefits and relevance for the users. It will often be impracticable to provide fair value information on collateral in a way that will be meaningful for the users to assess the losses an entity expects to incur in the event of default of debtors. The disclosure requirement should be restricted to collateral for which fair values are readily available and therefore reliably measurable, for example comprising traded securities or other assets which are traded on a liquid market.

- The value of collateral is relevant only when there are problems in a loan portfolio. It may even be misleading to disclose the value of collateral of other financial instruments in other circumstances.

- The disclosure of the fair value of collateral pledged as security as required in the paragraphs 39 and 40 of the ED is only relevant up to the amount of the maximum exposure. Limiting the disclosure to at maximum the amount of the maximum exposure would increase the possibility of compliance with the requirement and may achieve a better cost-benefit balance.

- Providing information on a portfolio of items including fair values that exceed the maximum exposure on an individual basis may mislead users. The excess on one particular item is not an offset on another particular item.

- The disclosures on the entity's credit risk are simplistic and meaningless unless provided in greater detail than is proposed. Aggregate disclosure would not, for example, highlight any under-collateralised problem loans. To properly understand collateral, it would be necessary to break down a portfolio which would result in extensive, onerous disclosures. We suggest that IASB considers those concerns.

- The IASB should – if the IASB decides to retain this requirement - also clarify the meaning of fair value in the context of collaterals. Disclosure of the fair value of the assets held as security would not of itself provide useful information, since it ignores the fact that collateral can have different standards of enforceability. The enforceability of collateral can have a significant impact upon its value. Even ignoring this significant point, the fair value of underlying assets held as collateral for the long term would be difficult to reliably measure. For example the fair valuation of a mortgage book can be several years out of date and updates using property indices are unlikely to take account of local variations or the current condition of the property. Providing a reliable estimate of the value of property held as collateral would require significant additional work, including periodic inspections. It would be even more difficult to reliably measure the fair value of a floating charge held over a corporate loan.

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 agree that a sensitivity analysis is a relevant disclosure to explain an entity's exposure to market risk. However, providing these analyses would often require significant work. When sophisticated treasury risk management systems allow preparing such analysis for management purposes, the disclosure should be based on the internal information available. However, not all entities use sensitivity analysis and not for all types of risks. Therefore not all entities are able to prepare such complex analysis or only for certain types of risk. When entities prepare sensitivity analyses it is often for trading risks, for which these are best suited. For other risks, many entities consider these of lesser relevance and therefore do not use sensitivity analyses in their management reporting. In our view these entities should not be forced to prepare sensitivity information for all financial risks.

We propose that the IASB should allow disclosures on the basis of other types of analyses of the market risk exposures than sensitivity analyses and amends the paragraphs 43-45 accordingly. For example, some entities may provide interest rate risk or foreign exchange risk gap analysis. We note that sensitivity analyses of different entities would not be comparable anyway, because each entity will have a different view of a reasonable possible change in the relevant risk variable, as required in proposed paragraph 43 (a).

We furthermore note that sensitivity analyses are only required for market risks, while for many entities other risks, such as operating risk, pension scheme risk, may be more important. We recommend that the IASB considers the balance of the risk disclosure in a further project, for example as part of the project on the management discussion & 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?

We agree with EFRAG draft response that it is not appropriate to require the disclosure of internal capital targets in the financial statements, at least not for all companies. For regulated industries, we agree that some additional disclosure of capital as defined for regulatory purposes is appropriate. However, for unregulated companies, the existing disclosures of the components of equity and their movements in the year, as required by IAS 1, should be sufficient. There is little benefit to users to provide all the proposed disclosures.

We are concerned that for the regulated industries, the disclosure of external capital targets may reveal the regulators' capital targets and could result in entities breaching legal requirements. The confidentiality and the communication between an entity and its supervisory authority could be hampered due to the requirement to disclose non-compliance with external capital targets. We share the arguments against requiring disclosure of externally imposed capital requirements listed in BC 52. Additionally, although we agree that the information on non-compliance with capital requirements might provide useful information, we are concerned that disclosures of minor breaches could have a disproportionate effect upon capital markets.

We are not convinced that the new requirements on the disclosures of information regarding externally imposed capital requirements have yet been fully digested. All the more since some information could be given outside of the financial statements it could be considered to postpone the whole proposal pending a discussion on information provided outside the financial statements, such as Management Discussion and Analysis or equivalent. We also would like to point out to IASB that the definition of capital target is not clear in the exposure draft (para. 47(b)).

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 EFRAG draft response and with the IASB proposed requirements. We also agree that entities applying the draft IFRS for the first time before 1 January 2006 should be exempt from providing comparative disclosures for the draft IFRS in the first year.

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?

Although some disclosures about risk should not be mandated to be included in the financial statements because this information goes beyond the portray of the financial effects of past events, we agree that they continue to be part of the financial statements as long as there are no specific requirements for the presentation of management commentary outside the financial statements. We consider that paragraphs 32 – 45 in particular should not be made mandatory. The disclosures are required to comply with Basel II and Solvency II disclosure requirements, but are not necessary to understand general purpose financial statements. While we do not consider that entities in regulated industries or other entities should be prevented from providing these disclosures in the financial statements, they should not be required to do so.

However, there is a risk that financial statements may be unbalanced with extensive disclosures on risk arising from financial instruments, without disclosure of risks arising from other assets and liabilities and activities. As also stated in our response to question 4, we propose that the IASB includes on its agenda a broader consideration of risk disclosures.

The discussion on location of risks reporting may be the opportunity for IASB to start working on financial information outside the financial statements. We encourage IASB to start a discussion on guidance on MD&A by developing criteria to distinguish between information to be included in the financial statements or outside them. Such information could include disclosures which are not directly related to items of the balance sheet or income statement such as qualitative disclosure. The minimum disclosures required in the financial statements should be limited to those necessary for an understanding of the current financial position and performance of the entity.

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 understand the concerns of insurance companies which will prefer not to change disclosures requirements before Phase 2 of the Insurance Project as they are dedicating extensive resources in the implementation of IFRS 4. In principle we agree that the risk disclosures in IFRS 4 should be amended to make them consistent with this ED, for the same reasons they were aligned with IAS 32 when implemented. However, insurance companies should not be required to disclosure certain information in 2005 and 2006 which will not be necessary again in 2007 when ED 7 is implemented and IFRS 4 is amended.

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 are concerned that the implementation guidance is not sufficient for non-financial services entities and is drafted in terms of more relevance to financial services entities. The guidance and the examples included in the guidance are more or less repetition from the standard rather than adding value. Further illustrative examples would be helpful.

Question 9 - Differences from the ED 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*
- *(i) 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 fair value disclosures as proposed in ED 7 are adequate compared to those in the FASB's exposure draft.

Question 10 – Other comments
Do you have any other comments on the draft IFRS, Implementation Guidance and Illustrative Examples?

We suggest that some exclusion is proposed for wholly owned subsidiaries from providing disclosures on an individual basis when consolidated disclosures are publicly available. Such information is likely to be incomplete and misleading for the individual entity. While the IASB has not in the past allowed group exemptions, the level of disclosures proposed under ED 7 are such that an exemption would be justified in this case on cost-benefit grounds.

We would be pleased to discuss any aspect of this letter you may wish to raise with us.

Yours sincerely,

David Devlin
President