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International Accounting Standards Board
30 Cannon Street,
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**Exposure Draft 7 Financial Instruments: Disclosures**

Dear Ms. Pryde,

The World Bank appreciates the opportunity to respond to the International Accounting Standards Board's (the "Board") Exposure Draft, *Financial Instruments: Disclosures* (the "Proposed Standard").

Overall, we endorse the Proposed Standard's introduction of enhanced financial information and discussion of risks from the perspective of management (e.g. Para 44, Para 47). However, certain approaches outlined in the proposed requirements serve to highlight the continuing problematic nature of the mixed attribute financial reporting model which currently persists in the accounting standards. In some cases, these disclosures may perpetuate the misunderstandings about the risks related to financial instruments.

To illustrate this, we offer two examples:

(1) A financial institution uses $100m of its short term deposits to finance a fixed-rate twenty-year loan. Both the short term liabilities (for which carrying value approximates fair value) and the loans and receivables are not generally recorded at fair value under IAS 39; however, the institution faces a significant interest rate risk if there is a sudden significant increase in market rates. The sensitivity analysis proposed in Para 43 would have produced immaterial effects to both profit and loss, and equity, and the proposed disclosures would not have properly illustrated the risk.

(2) A financial institution issues a ten-year floating-rate bond in the amount of $100m. It converts this into a ten-year fixed-rate liability using an interest-rate swap, and applies cash-flow hedge accounting as allowed under IAS 39. This is in turn used to fund a ten-year fixed-rate loan of the same amount. The financial institution is not economically exposed to interest rate risk. The floating-rate bond and the fixed rate loans are normally not recorded at fair value under IAS 39, while the interest-rate swap would be, with changes to fair value posted to other comprehensive income. However, applying Para 43 would result in a disclosure which suggests that the entity's equity is significantly affected by changes in interest rates. It would again be difficult for readers to interpret this, and may lead to misinformed conclusions. Given that one objective is to better inform readers of the risks associated with the use of financial instruments, the disclosure outcomes from these fairly realistic examples seem to create an unhelpful result.

We understand that the fundamental difficulties of the mixed attribute system are unlikely to be resolved until IAS39 is revised. However, we strongly recommend that the Board allow risk disclosures (and in particular sensitivity analysis) on a full fair value basis as financial institutions already manage their financial instrument positions this way. For instance, the World Bank performs sensitivity analysis on its financial assets and liabilities, and closely monitors the net impact fair value adjustments have on its equity. It would be more transparent and meaningful for us to share such information as part of our disclosures.

It would however, be counter-productive, and an inefficient use of resources to perform a similar exercise on the current mixed attribute basis of accounting. We recommend that the Board state clearly that reporting entities are encouraged to disclose sensitivity analysis information that are used internally by management, provided adequate explanations on any differences/ adjustments are clearly disclosed; with this approach, readers could better understand the risk management and monitoring process that the reporting entity employs.

We also believe that this objective will best be served if the final standard allows an entity to present its disclosures based on the categorization they employ to manage market risks in the entity. For example, if interest rate risks are managed on the basis of various financial instrument portfolios the required disclosures could be prepared on the basis of those groupings.

***Location of Disclosures*** Given the broad, global application of International Financial Reporting Standards in various capital markets, where preparers are subject to a variety of regulatory frameworks, we appreciate the difficulty the Board may face in determining the location of certain types of disclosures. That is, the Board must strike a balance in the information it requires in the financial statements, versus information provided by management that may accompany those statements, but be presented outside of the body of the financial statements.

We recognize that at present there is no requirement in IFRS for material accompanying the financial statements, such as management commentary (e.g. management discussion and analysis) and so the Board has no other mechanism for ensuring that the necessary information is provided elsewhere. However, in light of the fact that many of these proposed disclosures (e.g. discussion of risk management practices) are already required to be presented in accompanying management commentary under the rules of various securities regulators, a Board requirement to include it in the body of the financial statements may lead to unnecessary duplication and redundancy for preparers subject to such requirements. Therefore we strongly support the flexibility described in the Basis for Conclusions, BC41, which would allow such disclosures to be included in accompanying material and cross-referenced in the financial statements. We believe the provision of such flexibility to be absolutely necessary given the varying jurisdictions in which IFRS preparers may reside, and accordingly would like to support the Board's conclusions in this matter and request that the Board make this flexibility more explicit by including it in the body of the final standard. We have addressed the Board's specific questions on the Proposed Standard in the Appendix attached to this letter.

We appreciate the opportunity to express our views. If you have any questions regarding our comments we would be happy to discuss them with you.

Sincerely,

Fayezul Choudhury
Vice President and Controller
International Bank for Reconstruction and Development

*Appendix 1*
**World Bank Comment Letter**

**Exposure Draft 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 support the Board's proposal to incorporate all disclosure requirements associated with financial instruments into one standard.

*(a) financial assets and financial liabilities by classification (see paragraphs 10 and BC13).*
To the extent that the reporting entity manages and monitors certain risks by business activities (e.g. loans portfolio, investment portfolio, debt portfolio etc), the Proposed Standard should allow the entity to further sub-group the above mentioned categories into the respective portfolios for the purposes of compliance. For example, IBRD (International Bank for Reconstruction and Development) monitors the interest rate risk of its trading investment portfolio separately, but monitors credit risk on our derivatives on an aggregate basis. In this example, it would therefore be more meaningful to present information relating to market risk (Para 43-45) on the entire investment portfolio (i.e. including the derivatives associated only with our investment business), while disclosing credit risk information (Para 39-41) on the entire holding of derivatives (with clear delineation of the individual balance sheet components to facilitate reconciliation). We believe this approach is in keeping with the spirit of the objective to present information in the way that management views and manages such risks. Further explicit guidance could be provided in the proposed standard to support this view explicitly A separate but related issue brings us back to the fact that IAS39 is a work-in-progress, promotes a mixed attribute basis of accounting, and will be re-drafted in due course. The World Bank has continued to support a full fair value basis of accounting for all financial assets and liabilities. We believe that any resulting volatilities in income should be explained via disclosures (like those proposed in this Exposure Draft), through better presentation (e.g. the Reporting Comprehensive Income) and through other regular means of communications between the reporting entities and investors plus other stakeholders. This will lead to transparency, enhance communications between management and stakeholders, while at the same time, promote better understanding of management's use of financial instruments.

To achieve that end, World Bank prepares a set of financial statements with full fair value accounting, and this is included in the Management Discussion and Analysis section of our filed documents. We strongly recommend that the Proposed Standard allow reporting entities the options to present information in a way consistent with how management uses the information, provided that these are properly reconciled to the financial statements.

In addition, we also believe that certain disclosures are very useful for readers when presented on an aggregate basis, rather than merely separately under each IAS 39 defined category. For example, the aggregate impact of a 100bps shifts in interest rates in profit and loss, when applied to all the financial instruments of the reporting entity, is useful and informative. Rather than requiring readers to sum up the income impact that might appear on various pages of the financial statements, we thought the Proposed Standard, where appropriate, could encourage disclosures of aggregated quantitative information.

(b) *information about any allowance account (see paragraphs 17 and BC14).*
We support this disclosure.

(c) *income statement amounts by classification (see paragraphs 21(a), BC15 and BC16*
We generally agree with this disclosure. However, we recommend that the Board provide more guidance for cases where a hybrid (combination of a bond and an embedded derivative) instrument issued by the reporting entity, is bought back. Under the current proposed language, it is our interpretation that any gains/losses (i.e. the difference between the buyback costs and the carrying value) have to be separately identified and presented for derivatives held at fair value and for financial liabilities held at amortized cost. This is operationally onerous and potentially costly . It is not clear to us that the resulting information, given the additional costs associated with this, is justified by the marginal benefits that readers may derive. We recommend that the Proposed Standard modify the language to that effect to provide clarity.

(d) *fee income and expense (see paragraphs 21(d) and BC17).*
We support this disclosure.

**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 with the proposal.

**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 generally support disclosing a form of sensitivity analysis. However, as stated above, we believe that reporting entities should have the option to report sensitivity analysis on a full fair value basis, provided that the entities are already managing their balance sheet and equity on that basis. We believe this approach will be in line with the Board's conclusion that preparers should retain the flexibility of determining the type of sensitivity analysis that is most appropriate and which addresses the preparer's unique circumstances.

We also welcome the Board's attempt to introduce more management information into the disclosures, where appropriate. For example, BC37 recognizes that certain information (e.g. VAR and other outputs generated from risk modeling system etc) does provide more informative data, and permit its disclosure when used by management. However, it is unclear what the scope of work would entail for external auditors with regard to this additional information, bearing in mind much of the information would most likely be generated from highly complex risk models which are proprietary to each financial institution. We recommend the Board consider the audit ability (and corresponding costs) of these requirements.

**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 support the Board's decision to require disclosure about whether the entity complied with any internal capital target requirements and, if not, the consequences of non-compliance.

**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 the proposed effective date should allow sufficient lead-time for entities to be ready. We also support the view that early adopters would not need to include comparatives.

**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?*

Given the potential broad global application of International Financial Reporting Standards in various capital markets, subject to a variety of regulatory frameworks we appreciate the difficulty the Board may face in determining the location of disclosures. That is, the Board must strike a balance in the information it requires in the financial statements, versus information provided by management that may accompany those statements, but be presented outside of the body of the financial statements.

We recognize that at present there is no requirement in IFRS for material accompanying the financial statements, such as management commentary ( e.g. management discussion and analysis) and so the Board has no other mechanism for ensuring that the necessary information is provided elsewhere. However, in light of the fact that many of these proposed disclosures (e.g. discussion of risk management practices) are already required to be presented in accompanying management commentary under the rules of various securities regulators a Board requirement to include it in the body of the financial statements may lead to unnecessary duplication and redundancy for preparers subject to such requirements. Therefore we strongly support the flexibility described in the Basis for Conclusions, BC41, which would allow such disclosures to be included in accompanying material and cross-referenced in the financial statements. We believe the provision of such flexibility to be absolutely necessary given the varying jurisdictions in which IFRS preparers may reside, and accordingly would like to support the Board's conclusions in this matter and request that the Board consider making this flexibility more explicit by including its conclusion in the body of the final standard.

**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?*

No comments.

**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?*

None other than those highlighted above.

**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) (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) (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 believe the existing draft with regards to Fair Value is adequate. However, we also believe that the FASB proposed requirement described in *(a) iii* above is an incomplete and non-useful number for entities which frequently turn over their portfolios.

We note that Para 21(a) does not mention separately the need to disclose unrealized gains/losses from realized gains/losses; first, we do not believe the split is necessary. Second, if the intention of the paragraph is to separately identify unrealized gains/losses, this is not clear. We recommend that the Board not require reporting entities to separate realized gains/losses from unrealized gains/losses. We believe the split is not useful, and is often misleading. For example, it gives no indication how much of the realized gains/losses were earned/expensed in this reporting period, and the unrealized gains/losses figure, is really a balancing figure. This effectively represents the movements in the unrealized gains/losses in the balance sheet, which is not a very useful concept for readers. We recommend that the Board state clearly in the Implementation Guidance that the split is not necessary.

**Question 10 – Other comments**

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

None