International Accounting Standards Board
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United Kingdom

CL 93

**Attention: Andrea Pryde**
Assistant Project Manager

21 October 2004

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Dear Sirs,

**Exposure Draft 7 *Financial Instruments: Disclosures***

We are writing in response to the invitation to comment on Exposure Draft (ED) 7 *Financial Instruments: Disclosures*. This response is made on behalf of the Institute of Certified Public Accountants of Cyprus.

Overall we welcome the proposals by the International Accounting Standards Board for developing a single International Financial Reporting Standard that deals with the disclosures for financial instruments, exposure to risks arising from financial instruments and capital. We set out below our comments on each of the questions raised by ED 7.

**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?**

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**Answer**

We consider the above proposals appropriate except in relation to the following matter:

<u>Disclosure of income statement amounts by classification</u>

We propose that ED 7 paragraphs 21 (a) and (b) are amended to require separate disclosure of:
- (i) net gain or loss arising from disposal (net realized gains or losses);
- (ii) net gain or loss arising from remeasurement at fair value (net unrealized gain or loss);
- (iii) net interest income or expense;
- (iv) dividend income; and
- (v) any other source of income.

for each of the financial assets and financial liabilities listed in ED 7 paragraph 21 (a) where applicable.

The above proposed disclosure requirement has the following benefits:
- (a) ensures consistency in the presentation of information and hence facilitates comparison between different entities;
- (b) better enables users of financial instruments to understand the financial performance of an entity's financial instruments as they will have information by classification of financial assets and financial liabilities as to which items included in the income statement are recurring (for example interest income and expense) and which are not recurring (for example gains or losses from disposal of financial assets); and
- (c) ensures compliance with FASB's Proposed Statement of Financial Accounting Standards *Fair Value Measurements* with respect to the disclosure of the effect of the remeasurements on earnings for the period.

**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**

We consider that the proposal for the disclosure of the fair value of collateral pledged as security is appropriate. However, this disclosure would be more useful to the users of the financial statements if the fair value of the collateral is analysed by loan type and credit quality. For example if the loan portfolio is analysed by industry sector of counterparties and/or geographical distribution of counterparties then the fair value of collateral pledged should also be analysed in the same manner. Such an analysis will illustrate for example whether there is adequate collateral for risks in specific areas where there is a concentration of credit risk.

**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**

We agree with the proposal that entities should disclose a sensitivity analysis to explain their exposure to market risk.

However, we would like to draw attention to a situation where risk management is carried out at the group level but disclosures will be required on risk management in the individual entity financial statements of subsidiary entities. Such disclosures will be quite onerous for subsidiary entities that need to prepare individual entity financial statements in accordance with International Financial Reporting Standards for local statutory purposes. Hence we propose that such entities are exempt from the above 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?**

**Answer**

We consider that the proposal for capital disclosures should be limited only to externally imposed capital requirements subject to our further comments below.

It is our position that it is more appropriate that disclosures with respect to internally imposed capital requirements are part of the information provided by management outside the financial statements in other sections of the annual report. Given that the IASB cannot at this stage enforce such disclosure we suggest that the IASB recommends that the disclosures in ED 7 paragraph 47 with respect to internally imposed capital requirements are provided by management outside the financial statements in other sections of the annual report.

With respect to the disclosures regarding externally imposed capital requirements in paragraphs 47 (d) and (e) we would like to point out our position that regulators may not favour the proposed disclosures. We consider that the proposed disclosures relate to sensitive information for both the entities concerned and the regulators. Hence we recommend that the proposed disclosures regarding externally imposed capital requirements in paragraphs 47 (d) and (e) should only be required in specifically defined circumstances, for example where:

- the regulator has imposed a penalty on the entity for the non-compliance; or
- the non-compliance with the externally imposed capital requirements has not been rectified by the year end or by the date of approval of the financial statements by the Board of Directors; or
- the regulator has withdrawn any license granted to the entity.

Hence the proposed disclosures regarding externally imposed capital requirements in paragraphs 47 (d) and (e) will not be required where the non-compliance was only temporary during the year, has been rectified by the year end and there were no repercussions on the entity.

**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**

We agree with the proposed effective date and transition requirements.

**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 agree with the position that the disclosures proposed by the draft IFRS should be part of the audited financial statements.

**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**

We agree with the position that the risk disclosures in IFRS 4 should be amended to make them consistent with the requirements proposed in the draft 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?**

**Answer**

With respect to example IE1 in the implementation guidance we consider that this example is a useful guidance for entities with simple capital structure and capital management and we consider its inclusion in the implementation guidance appropriate after removing the disclosures with respect to capital requirements set internally, following our comments to question 4.

We recommend that a more complex and comprehensive example is developed by the IASB for inclusion in the implementation guidance of IFRS X *Financial Instruments: Disclosures*. This example should be more applicable for a financial institution with a complex capital structure and capital management and with externally imposed capital restrictions.

Regarding the guidance in ED 7 paragraph IG 14 we suggest that a requirement is included to disclose a numerical reconciliation of the maximum exposure to credit risk and the corresponding carrying amounts on the balance sheet. This reconciliation would include for example the amounts for the items referred to in ED 7 paragraph IG 14 (a), (b).

**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**

We agree that the requirements in the draft IFRS provide adequate disclosure of fair value compared with those proposed in the FASB's Exposure Draft subject to our comment in question 1 in relation to the disclosures of the effect of the remeasurements on earnings.

**Question 10 - Other comments**

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

<u>(a) Accounting policies</u>

We recommend that the accounting policy requirements included in IAS 32.66 (c) are reinstated as part of the draft IFRS paragraph 23 since we consider that this information is useful for the users of the financial statements.

<u>(b) ED 7 Paragraph 18 (IAS 32.94 (d)) and disclosure of effective interest rates</u>

We recommend that the requirement for the disclosure of the effective interest rate on the liability component should be reinstated and included in the final version of IFRS X *Financial Instruments: Disclosures* for the reasons described below.

With respect to the disclosure of effective interest rates as required by IAS 32 paragraph 67 (b) we believe that this requirement should be reinstated and included in the final version of IFRS X *Financial Instruments: Disclosures* for both interest bearing financial assets and financial liabilities. We consider that this disclosure is useful for the users of financial statements because it assists them in:

(i) analysing how a financial institution generates its net interest income and its net interest margin;
(ii) forecasting future interest expense of an entity; and
(iii) understanding how the market rates the credit standing of the entity.

Please contact Stelios Constantinou (00357 25 555000) if you would like to discuss any of the matters raised above.

Yours faithfully

Stelios Constantinou
President
Accounting and Auditing Standards Committee
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