EFRAG

European Financial Reporting Advisory Group

Jörgen Holmquist
Director General
European Commission
Directorate General for the Internal Market
1049 Brussels

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Dear Mr Holmquist

Adoption of the Amendment to IFRS 7 *Improving Disclosures about Financial Instruments*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on the adoption of the Amendment to IFRS 7 *Improving Disclosures about Financial Instruments* (the Amendment), which was published by the IASB in March 2009. It was issued as an Exposure Draft in October 2008 and EFRAG commented on that draft.

The Amendment is intended to improve disclosures about fair value measurements and liquidity risk management associated with financial instruments.

EFRAG has carried out an evaluation of the Amendment. As part of that process, EFRAG issued an initial evaluation of the Amendment against the EU endorsement criteria for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports the Amendment and has concluded that it meets the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards that:

- it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

- it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt the Amendment and, accordingly, EFRAG recommends its adoption. EFRAG's reasoning is explained in the attached Appendix.

On behalf of the members of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix
Basis for conclusion

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Amendment to IFRS 7 Improving Disclosures about Financial Instruments *(the Amendment).*

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

Introduction

1 When evaluating the merits of the Amendment, EFRAG considered whether the accounting that results from its application meet the criteria for EU endorsement.

2 Having formed tentative views on the issues and prepared a draft assessment, EFRAG issued that draft assessment on 3 April 2009 and asked for comments on it by 15 May 2009. EFRAG has considered all the comments received in response, and the main comments received are dealt with in the discussion in this appendix.

Does the accounting that results from the application of the Amendment meet the criteria for EU endorsement?

Relevance

3 According to the IASB's Framework, information has the quality of relevance when it influences the economic decisions of users by helping them to evaluate past, present or future events or confirming, or correcting, their past evaluations. EFRAG considered whether the Amendment would result in the provision of relevant information—information that has predictive value, confirmatory value or both—and whether it might result in the omission of any information that is relevant.

4 EFRAG's assessment is that the additional and amended fair value measurement disclosures for financial instruments that the Amendment requires will help users to understand better the uncertainties surrounding fair value measures used in the financial statements.

5 Regarding liquidity risk disclosures, EFRAG notes that the effect of the Amendment is to allow management greater flexibility to provide maturity analyses for derivative financial liabilities in a way that management believes meets the overall objective (of providing disclosures that enable users to evaluate the nature and extent of the entity's exposure to risks and how it is managing those risks). The focus is still though on the provision of relevant information. EFRAG's assessment is that the Amendment will help entities to meet the objective more effectively.

6 As a result, EFRAG believes that the information that will result from applying the Amendment will meet the EU endorsement criteria of relevance.

Reliability

7 The Framework explains that information has the quality of reliability when it is free from material error and bias, can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost. EFRAG has considered whether information resulting from the application of the Amendment exhibits those qualities.

8 Regarding the fair value measurement disclosures, the Amendment requires disclosure of the components (input from each category) of numbers that are already required to be disclosed by the current standard. As a result, EFRAG's assessment is that the Amendment does not require additional calculations and therefore has no additional reliability implications.

9 Regarding disclosures about the liquidity risk an entity is exposed to, the Amendment requires that the maturity analysis an entity provides in respect to derivative financial liabilities only include the remaining contractual maturities if the latter is essential for an understanding of the timing of the cash flows. Presently, IFRS 7 requires that the remaining contractual maturities be provided for all financial liabilities. EFRAG considered whether allowing management to use a different approach in some cases would create reliability concerns. EFRAG concluded that it would not, because entities would need to disclose information about the remaining contractual maturities if such information was essential to the understanding of the cash flows.

10 EFRAG has therefore concluded that the information that results from the application of the disclosures in the Amendment meets the reliability criterion.

Comparability

11 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

12 The Amendment requires a new three-level fair value measurement hierarchy to be used for the purpose of disclosure. EFRAG considered whether the introduction of a new fair value hierarchy in the Amendment might result in diversity in practice (because of the subjectivity of certain notions used in the definitions of the hierarchy). EFRAG also considered whether there would be divergent application of the fair value measurement hierarchy described in the Amendment and the one used in the existing IAS 39 *Financial Instruments: Recognition and Measurement* and, if so, whether such divergence may create a comparability concern. Judgement is required when categorising financial instruments under the Amendment and under the requirements in IAS 39. However, EFRAG believes that the potential comparability issues in this case are no more significant than those in other IFRS literature that involve the application of judgment.

13 As previously explained, the Amendment requires that information about the remaining contractual maturities arising from derivative financial liabilities be provided only if such information is essential for an understanding of the timing of cash flows. EFRAG believes that, although permitting some management discretion in this way might result in a wider range of numbers being disclosed for similar instruments, this would not involve a decrease in comparability; rather, it would reflect the diversity of liquidity risk management.

14 EFRAG has therefore concluded that the information that results from the application of the disclosures in the Amendment meets the comparability criterion.

Understandability

15 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

16 Although there are a number of aspects to the notion of 'understandability', EFRAG believes that most aspects are covered by the discussion above about relevance, reliability and comparability (because, for example, information that represents something as similar when it is in fact dissimilar is not comparable, and that lack of comparability will mean it is also not understandable). As a result, EFRAG believes that the main additional issue it needs to consider in assessing whether the information resulting from the application of the Amendment is understandable is whether that information will be unduly complex.

17 Regarding fair value measurement disclosures, EFRAG understands that some entities already provide some of the disclosures required by the Amendment on a voluntary basis in their IFRS financial statements. Other disclosures are new, but do not seem overly complex. As a result, EFRAG's assessment is that the information that will result from the application of the fair value measurement disclosures in the Amendment will be understood by users.

18 EFRAG's assessment is that the changes made by the Amendment to the liquidity risk disclosures will better reflect the manner in which entities manage liquidity risk relating to their derivative financial liabilities and therefore provide users with information that is more meaningful and understandable.

19 Having considered the above reasoning, EFRAG believes that the information that will result from the application of the Amendment will meet the understandability characteristic.

True and Fair

20 Having concluded that the information that results from the application of the Amendment will meet the criteria of relevance, reliability, comparability and understandability and being unaware of any other reason to be concerned about the accounting effect of the Amendment, EFRAG sees no reason to believe that the Amendment is inconsistent with the true and fair view requirement.

European Interest

21 EFRAG has considered whether the benefits of implementing the Amendment in the EU exceed the costs of doing so. Its assessment is that, although implementation of the Amendment would involve some costs, they are likely to be outweighed by the benefits.

Conclusion

22 EFRAG's overall conclusion is that the Amendment satisfies the criteria for EU endorsement and EFRAG should therefore recommend its endorsement.