16 January 2009

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Dear Sir / Madam

Re: Exposure Draft of Proposed Amendments to IFRS 7

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Exposure Draft of proposed amendments to IFRS 7 *Financial Instruments: Disclosures* "Investments in Debt Instruments" (the ED). This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive interpretations/amendments on the issues.

The ED proposes additional disclosure requirements for all investments in debt instruments (other than those classified as at fair value through profit or loss). We understand that the purpose of the proposed disclosures is to enhance comparability between investments in debt instruments held within and by different entities, by providing the information needed to adjust results on to a more consistent basis regardless of how the debts instruments are classified. The proposals will enable companies to disclose the profit or loss that would have been recorded if all financial assets (other than those categorised at fair value through profit or loss) had been measured using amortised cost (ie using an incurred cost model) or all had been measured using fair value. The ED also proposes that the disclosures shall be applied as early as annual periods ending on 15 December 2008. The ED was issued on 23 December 2008, with a 23 day comment period—much of which is a holiday period in the northern hemisphere. FASB is proposing similar changes to US GAAP.

EFRAG's overall position regarding the proposals in this ED is that:

- We do not believe the proposed disclosures are as urgently needed as the timetable implies.
- We believe the issues underlying the proposals are complex. As a result, it is questionable whether it is possible to enhance comparability between investments in debt instruments held within a single entity and also by different entities through what is essentially a 'patch' of existing IFRS. We are therefore not convinced that the stated objective of the proposals has been met. We also do not believe that providing more than one measure of the pre-tax profit arising from financial instruments as proposed

enhances usefulness of the reported information. We believe the IASB should undertake further analysis and consideration of the issues involved. Without such a comprehensive analysis it is in our view premature to bring forward any proposals in this area or to reach any decisions on future amendments.

- Should the IASB decide to proceed with the amendments in one way or the other we recommend that they are not made mandatory for implementation in 2008 financial statements. We understand that it could be problematic for some entities to gather and analyse the information necessary to implement the proposed new disclosures in 2008 financial statements. Furthermore, backdating an effective date is problematic for jurisdictions that require legal endorsement of any changes to IFRS before they can be applied.

On this occasion, we have not responded to the questions asked in the ED directly but explained our position in more detail in the Appendix addressing three issues: whether it is appropriate to rush through these changes, backdating the effective date and impairment of debt securities classified as available for sale.

If you wish to discuss our comments further, please do not hesitate to contact Paul Ebling, Svetlana Boysen or me.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix – general comments on the proposals in the ED

Is it appropriate to rush through these changes?

1 EFRAG recognises that, because of the current financial crisis, it might be necessary for the IASB to make some amendments to existing IFRS at very short notice. We further recognise that this might make it necessary to issue proposals for change with very short comment periods (for example 23 days) even though a holiday season might be involved and to backdate their application. However, the key word here is 'necessary'; the amendments and circumstances involved must be such that it is <u>necessary</u> to short-cut the normal due process and to backdate their application.

2 EFRAG therefore started its evaluation of the ED by considering whether the amendments proposed warranted being 'rushed through' in this way, bearing in mind market conditions currently and in the near-future. Its tentative conclusion is that they do not.

(a) We understand that a number of preparers have asked for urgent changes to be made to the way in which impairments of debt instruments classified as available-for-sale (AFS) are accounted for, and that aspects of the disclosures being proposed in the ED might be considered by some to be an alternative to the requested changes. We also understand that a number of users have said that, although they would not support the accounting changes requested, they would find it useful if the disclosures provided about impaired debt instruments classified as AFS could be enhanced urgently; and we understand that aspects of the disclosures being proposed in the ED might be considered by some to satisfy that request. For those reasons we think a case could perhaps be made to move quickly on disclosures about impairments of debt instruments classified as AFS. However, the disclosures proposed are much more extensive than that.

(b) The only reason we can think of for trying to 'rush through' the changes proposed is if disclosures that would meet the urgent needs of preparers and users will 'not work' unless they are placed in the context of the disclosures proposed in the ED. However, we have heard or read nothing that suggests that that is the case.

3 We understand that the purpose of the proposed disclosures is to enhance comparability between investments in debt instruments held within a single entity and also by different entities. The proposal is that this should be done by requiring disclosures that provide the information users need to adjust the numbers included in the primary financial statements to a more consistent basis. However, bearing in mind that there are some fairly fundamental issues involved, it is questionable whether it is possible to achieve this objective through what is essentially a 'patch' of existing IFRS; the risk is that the result will be that an illusion of greater comparability is created while in reality little has changed.

4 As the responses to the Discussion Paper *Reducing Complexity in Reporting Financial Instruments* highlighted, it is still not clear what makes reporting financial instruments more comparable. For example, is it the use of a single measurement basis—in which case, which measurement basis would that be—or is it the use of measurement bases in ways that reflect the business model? Furthermore, does comparability require the approach adopted for assets to also be applied when reporting financial liabilities? For these—and other reasons—it is not clear to us whether comparing only some financial

assets on the basis of two measurement alternatives—fair value and amortised cost—will enhance the usefulness of reporting financial instruments greatly, if at all.

5 In addition, we are concerned that one result of the proposed disclosures is that, in addition to the gains and losses arising from financial instruments that are recognised in the primary financial statements, the proposed new disclosures will result in pro forma profit and loss disclosures on a different basis. We do not think this is appropriate. The role of note disclosures is to support the numbers in the primary financial statements. That can sometimes involve portraying transactions and events from another perspective, but presenting them on an alternative basis undermines the credibility of the accounting adopted. It might also be confusing for users.

6 We are also concerned that, as with any rushed through amendment (and the recent October 2008 amendment was a good example), there is a risk of significant omissions or unintended consequences in proceeding at the pace proposed in the ED. For example:

(a) this ED refers to debt instruments. However the term 'debt instruments' is not defined under IFRS and therefore there might be confusion in some instances as to which instruments are in the scope of this amendment and which are not. IAS 39 refers to non-derivative financial assets with fixed or determinable payments and fixed maturity in the definition of loans and receivables or held-to-maturity investments, but it is not clear whether these are the type of financial assets that the ED intends to cover when it refers to 'debt instruments'.

(b) it is not clear how the proposed new disclosures focusing only on some financial assets could be meaningful in those situations where financial assets are linked to and managed together with financial liabilities (for example, in the case when policyholder liabilities of an insurance company are linked to available-for-sale financial assets the proposed disclosures might distort the usefulness of the information rather than enhance it).

(c) it is not clear how to apply the proposed disclosure requirements to instruments that are part of hedge relationships to which hedge accounting is applied.

7 For the above reasons, EFRAG's view is that the proposals in the ED are not sufficiently urgent to justify abandoning the normal due process and sensible implementation regime.

8 Although we have not yet had time to analyse the proposals in detail, we note that paragraph IG 14A of ED proposes to require entities to follow the prescribed tabular format for the proposed disclosures. Generally, we do not think that it is a good idea to prescribe a particular format for disclosure requirements. A particular format may be the best way to present information in some cases; however, it might be misleading in others.

Backdating the effective date

9 Quite apart from our concerns about rushing through the proposed changes, we also believe that the proposal that the requirements be implemented for annual periods ending on or 15 December 2008 could result in practical difficulties.

(a) By the time the final amendment is issued, some entities will have already largely completed their annual financial reports. Issuing the amendments in late January with such an effective date would therefore require such entities to gather in a rushed way the necessary information and prepare additional disclosures.

(b) We understand that in backdating the effective date the IASB assumed that no additional information to that already required by IFRS 7 needs to be gathered to provide the disclosures, but we are not convinced that that assumption is correct. For example, the amendments seem to require keeping parallel measurement (including impairment) schedules for financial instruments in the scope of this amendment taking into account purchases and sales of debt instruments during the year, foreign exchange movements, interest accruals, principal repayments and other cash flows, hedge accounting, and transaction costs. Entities might not have been doing this in 2008 or before. Even if new disclosures are largely based on the information already required in IFRS 7, our understanding is that for some entities it will still for various reasons (e.g. the way their information systems are designed) be burdensome to gather and analyse the information needed to meet the new requirements.

One may expect that the quality of the disclosures prepared in such a rushed manner may suffer.

10 It should also be noted that backdating the effective date of an amendment to IFRS is problematic for jurisdictions that require legal endorsement of any changes to IFRS before they can be applied.

11 For these reasons, we strongly recommend that, should the IASB decide to proceed with the disclosures, it adopts an effective date that gives entities sufficient lead time to prepare for the change with earlier implementation permitted for those entities that wish to do so and are sufficiently prepared to be able to do so.

Impairment of debt securities classified as AFS

12 Above we have argued that the proposals set out in the ED should not be rushed. In the paragraphs below we consider whether, were the scope of the proposed new disclosures limited just to debt securities classified as AFS and treated under IAS 39 as impaired, the disclosures would be sufficiently useful to justify a short comment period and backdated implementation.

<u>The call for changes to the accounting treatment of AFS debt securities</u>

13 It is our understanding that that a number of preparers have expressed concerns about the fact that impairments of debt instruments classified as AFS are measured differently from impairments of debt instruments classified as loans and receivables (LAR) or held-to-maturity (HTM).[1] One of the concerns seems to be simply that similar instruments that are managed on the same basis are subject to different measurements of impairment depending on their classification. Another concern is that the impairment rules applying to AFS debt instruments overstate the losses incurred on

---

[1] AFS debt instruments are carried at fair value and impairment losses are measured as the difference between amortised cost and the lower fair value. LAR and HTM debt instruments are carried at amortised cost and impairment losses are measured as the difference between amortised cost and the present value of estimated future cash flows, calculated using the original effective interest rate or – for variable interest rate instruments – the current effective interest rate ('incurred loss model').

such instruments, primarily because they take changes in credit spreads into account in addition to changes in expectations about future cash flows.

14 As a result, the preparers involved have been suggesting that it would be useful to 'disaggregate' the impairment loss recognised for AFS debt instruments into:

(a) the incurred loss, determined in the same way as for debt instruments measured at amortised cost using the incurred loss model. This loss would continue to be presented in the income statement; and

(b) the remainder (ie the fair value change other than (a) above). This loss would be presented in OCI.

15 However, we also understand a number of users have told the IASB that, although they think it would be useful to understand how much of an AFS debt instrument is made up of (a) and how much of (b), they would prefer the information to be provided either via note disclosure or by separate presentation within the income statement.

16 Our understanding is that, having had an initial discussion of this issue, the IASB has concluded that, although the issues involved are worthy of further consideration, that will take time even if treated as an urgent issue. EFRAG agrees with this assessment. It is not just that the impairment requirements in IFRS for AFS debt instruments are different from those for LAR and HTM debt instruments, there are also differences between IFRS and US GAAP and there are aspects of both the AFS requirements and the LAR/HTM requirements that would benefit from re-examination. Indeed, as we pointed out in our response to the Discussion Paper *Reducing Complexity in Reporting Financial Instruments*, the existing IAS 39 requirements for the recognition and measurement of impairment losses is one of the areas in reporting financial instruments many consider to be flawed. These are complex issues that need to be considered carefully.

<u>Limiting the scope of the ED's proposed disclosures just to debt securities classified as AFS and treated under IAS 39 as impaired</u>

17 Our concern is that there are quite a number of issues to be addressed to ensure that the recognition and measurement of impairments is appropriate, so it is doubtful that it is possible to improve the quality of the information provided through disclosures. We therefore believe that the IASB should undertake further analysis and consideration before bringing forward even disclosure proposals in this area.

18 In addition, it does not seem right to keep adding disclosure requirements in the hope that the disclosures will be useful to someone; we should be sure the disclosures will really shed new insights or enhance the usefulness of the other information provided.

19 However, should the IASB decide to go ahead with the limited scope of the additional disclosures, we strongly recommend that the effective date and transitional provisions allow entities sufficient time to prepare for providing such disclosures—which means the disclosures could not be mandatory for 2008.