ACT

The Association of Corporate Treasurers Ocean House 10-12 Little Trinity Lane London EC4V 2DJ
Tel 020 7213 9728 Fax 020 7248 2591

Andrea Pryde
Assistant Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

E-MAIL: commentletters@iasb.org

22 October 2004

Direct Line: 020 7213 0715
Email: modonovan@treasurers.co.uk

Dear Madam,

ED 7 FINANCIAL INSTRUMENTS: DISCLOSURES

Within companies the Treasurer is normally the manager responsible for transactions in financial instruments. Accordingly the Association of Corporate Treasurers (ACT) is pleased to be able to provide comments on ED 7, and the proposed changes to financial instrument disclosures. Please note, the ACT usually comments from the corporate and not the financial services sector standpoint.

General

In recent years the subject of accounting for financial instruments has received a great deal of coverage and public debate. This has been beneficial, to the extent that this has led to greater disclosures and recognition of the risks, and the valuations, of financial instruments that might otherwise have remained invisible. ED7 is proposing to extend the disclosures both qualitative and quantitative, but we would question whether there has been any very widespread view that the current level of disclosure is inadequate. Extra information is potentially useful but we question whether it is strictly essential in this case.

In reviewing the proposals in ED 7 item by item it is difficult to object in principle to any one extra requirement, (although we do highlight some points of detail below). However taken as a whole they do add up to a significant extra amount of information, which will be burdensome on preparers and may even serve to muddle and confuse the users of the accounts as to what are the really important facts. Focusing on provision of data and analysis for financial items at the expense of attention to underlying business items is a trap for finance persons to guard against. If all the proposals in ED 7 are adopted we are in danger of giving excessive prominence to the risks from financial instruments and perhaps deflecting

attention from the more important performance and risk factors in the main business of the reporting entity.

Disclosures on risks and sensitivities come close to turning into a forward looking statement. Certainly the qualitative disclosures on risks from financial instruments and the policies on capital would fit better in a general commentary format. This could be akin to the OFR (Operating and Financial Review) in the UK or the MD&A (Management Discussion and Analysis) in the USA. Accordingly we believe the IASB should defer consideration of the proposals in ED 7 until such time as it is addressing the wider subject of a standard or guidance for an MD&A. We also have particular specific concerns as regards sensitivities – see below.

Responses to specific questions

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?

Answer 1

(a) ED 7 proposes that the disclosures about financial instruments are broken down between the various categories of financial instruments used in IAS 39. This is an extra breakdown, but seems reasonable, taken alone.

(b) The use of allowance accounts is of more relevance to banks rather than other corporates. Nonetheless the proposals seem reasonable, taken alone.

(c) The sections mentioned repeat existing requirements but using the same breakdown of classifications as in (a) above. We find this acceptable if (a) is adopted.

(d) The disclosure of fees is of more relevance to banks and other financial services industry companies, rather than general corporates. Nonetheless the proposals seem reasonable, taken alone.

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 2

Much of the information to be disclosed in relation to credit risk is aimed at banks and the financial services industry, rather than general corporates. What may be appropriate for a bank could well be excessive and unnecessary for a general corporate. For example para 40 (a) requires an aged analysis of financial assets that are past their contractual due date. A corporate may have standard payment terms of 30 days with its trade debtors, yet many pay later than this and nominal terms are often not the real terms. Is it essential that a reader of the accounts has an aged analysis? It should be sufficient that the company and its auditors have given proper consideration to provisions for bad and doubtful debts.

The materiality override in IAS 1 may be helpful in cases like this, as is the discretion provided in para 8. Para 8 gives an entity the ability to decide how much detail it provides, but presumably this does not extend to deciding to give no detail. In this context further guidance on materiality, detail and relevance would be helpful to most non-financial corporates.

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 3

We are concerned that the sensitivity analysis replaces the disclosures that were in IAS 32.67-75.

Disclosure of the sensitivity of financial instruments to market risk is potentially useful to users of the accounts. However, it is our view that it is better to give information on the raw data, rather than a worked sensitivity analysis which could be calculated off arbitrary changes in the risk variables. For example, we believe the existing IAS 32 interest rate risk information such as amounts of fixed rate financial assets and liabilities, and maturities should be retained. Because the various assets and liabilities will be of different maturities, the time frame of any sensitivity analysis is a major factor. It is better to give the raw exposures (as modified by derivatives) and allow anyone analysing the company to model their own risk scenarios.

It is very unwise to seek to understand sensitivity to financial price risk (interest rates, exchange rates and commodity price risk generally) in relation to one aspect rather than as a whole. Commodity prices are not independent of exchange and interest rates, for example. Traditionally the focus in the financial accounts is on reporting what has happened and where the company is at right now, with a management discussion of the future outlook – including known and unknown unknowns. Sensitivity analysis is a form of assessment as to the future and, if appropriate at all, would sit better in the context of an OFR or MD&A statement where suitable explanations could be added, if need be.

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 4

Paras 46 to 48 are entirely new. One reason given for introducing these rules is "The level of an entity's capital and how it manages capital is an important factor in assessing the risk profile of an entity and its ability to withstand adverse events." As in question 3 above we accept that this information is potentially useful but maintain that this sort of narrative would be far better considered as part of an overall risk commentary in an OFR statement or equivalent.

We accept that the management of a firm's capital is a fundamental responsibility of management so that information on polices (para 47 (a)) is a good idea as is disclosure of any externally imposed capital requirements. However paras 47 (b) to (e) go on to cover internally set capital targets. We consider that compulsory disclosure of such information, which may be commercially sensitive, is not appropriate, and in any case management of capital targets will be just one of many financial targets that management consider – and the priority given to these various targets will vary from time to time. Many of these targets will be interdependent, so looking at capital in isolation could be misleading. We further believe that requiring information to be "based on the information provided internally to the entity's key management personal" is not a good yardstick by which to set standards.

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 5

We appreciate that the start date proposed is set a good way into the future which should provide time for a wider public airing of the overall aims and benefits of this standard. However as explained earlier the ACT feels that the standard as a whole should be deferred and taken as part of a wider consideration of an OFR /MD&A style of risk commentary.

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 6

As already stated we strongly believe that the sorts of disclosures proposed should form part of the information provided by management outside the financial statements. However since the IASB has no mechanism at present to require additional material outside the financial statements, the idea that information be included in the accompanying material and be cross referenced from the financial statements, would be a good solution.

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 7

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, C20 and BC42-BC44).

Is the Implementation Guidance sufficient? If not, what additional guidance would you propose?

Answer 8

The guidance appears generally helpful. We have no suggestions for additional guidance other that that already mentioned (see answer 2) in the context of para 8 and the discretion over what level of detail to provide.

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 9

We agree that the requirements of the ED are adequate as compared to the FASB proposals.

Question 10 – Other comments

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

Answer 10

Para 30 (d) Fair values: Where fair value is not disclosed because it can not be measured reliably, information about the market for the instrument must be provided. This is the same as in IAS 32. However in addition information is needed on whether and how the entity

intends to dispose of the financial instruments. This requirement appears an excessive level of detail.

Conversely IAS 32 para 90 previously required, if possible, a range of estimates within which the fair value is highly likely to lie, and this has been removed. We believe it would be better to retain this, so as to provide an indication of the reliability of the information.

Para 35 states;
"Quantitative disclosures.For each risk arising from financial instruments, an entity shall disclose:
(a) summary quantitative data about the extent to which it is exposed to that risk as at the reporting date. This disclosure shall be based on the information provided internally to the entity's key management personnel (as defined in IAS 24 *Related Party Disclosures* (as revised in 2003)), for example the entity's board of directors and chief executive officer."

Basing the requirements on "information provided to management" is not an objective benchmark with which to set standards. This paragraph is unnecessary given that paragraph 8 already provides a discretion as to the level of detail and the form in which the information is displayed.

Paras 36: Extra disclosures are being required if the data provided at the reporting date is unrepresentative of the entity's exposure to risk during the period. This is a new requirement and while apparently reasonable is not confined to making a qualitative statement but seems to require a quantitative additional data. Repeating the point made in the general section earlier it appears that excessive importance is being allocated to these disclosures. By comparison if the period end balance sheet is not representative of the balance sheet during the year there is no obligation to restate it, so why single out the financial risk disclosures for special treatment? That the balance sheet as a whole is *not* typical throughout the year, and how it normally changes, should be dealt with in the OFR or MD&A. Singling out one sub-topic is potentially misleading.

Para 37: This is a new requirement so that if an entity uses several risk management methodologies disclosures should be based on the most relevant and reliable. We fully support this type of approach.

We note that IAS 32 paras 1 to 50 remain unchanged. Nonetheless we would like to take this opportunity to reopen consideration of para 42 of IAS 32 regarding the conditions under which an entity can offset an asset and liability and show the net. To be able to offset there must be (a) a legal right of set off and (b) an intent to settle on a net basis. An entity may have a full right of set off as a credit protection, (on two substantially equal and opposite interest rate swaps for example) but for settlement convenience the cash flows are expected to occur normally over the remaining life of the contracts i.e. gross. It would be helpful if in such a case the entity could still net off the position. Over time if net settlement becomes customary this will be less of a problem – but tax and other authorities often prefer to see gross payments and the facility should be retained without accounting disadvantage.

The ACT makes its comments from the perspective of non financial-services companies. However in this example of set off we understand that the ability to offset is important for banks in the calculation of regulatory capital required. The simple example here is the right to set off positive and negative balances on bank accounts, where legal right of set off exists, but where there is no intention to settle net since in the ordinary course of business the bank balances will just continue in existence.

These comments are on the record and may be freely quoted and made available for public inspection.

We hope these responses are helpful for your deliberations and if you need any further information or clarifications please contact any of the people listed below.

Yours faithfully,

Martin O'Donovan
Technical Officer

****

The Association of Corporate Treasurers

The Association of Corporate Treasurers was formed in 1979 to encourage and promote the study and practice of corporate finance and treasury management and to educate those involved in the field. Today, it is an organisation of professionals in corporate finance, risk and cash management operating internationally. A professional body and not a trade association, it has over 3,300 Fellows, Members and Associate Members. With more than 1,200 students in more than 40 countries, its education and examination syllabuses are recognised as the global standard setters for treasury education. Members of the Association work in many fields. The majority of Fellows work in large UK public companies, responsible for the treasury and corporate finance functions.

Contacts:	
Richard Raeburn, Chief Executive (020 7213 0734; rraeburn@treasurers.co.uk) John Grout, Technical Director (020 7213 0712; jgrout@treasurers.co.uk) Martin O'Donovan, Technical Officer (020 7213 0715; modonovan@treasurers.co.uk)	The Association of Corporate Treasurers Ocean House 10/12 Little Trinity Lane London EC4V 2DJ Telephone: 020 7213 0728 Fax: 020 7248 2591 Website: http://www.treasurers.org

The Association of Corporate Treasurers is a company limited by guarantee in England under No. 1445322 at the above address