INVITATION TO COMMENT ON THE EFRAG'S ASSESSMENTS OF AMENDMENTS TO IFRS 7 'IMPROVING DISCLOSURES ABOUT FINANCIAL INSTRUMENTS'

Comments should be sent to commentletter@efrag.org or uploaded via our website by 15 May 2009

EFRAG has been asked by the European Commission to provide it with advice and supporting material on Amendments to IFRS 7 *Improving Disclosures about Financial Instruments* (IFRS 7 Amendments). In order to do that, EFRAG has been carrying out a technical assessment of IFRS 7 Amendments against the criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from their implementation in the EU.

A summary of IFRS 7 Amendments is set out in Appendix 1.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

1 Please provide the following details about yourself:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

German Accounting Standards Board (GASB)

(b) Are you/Is your organisation or company a:

☐ Preparer ☐ User ☒ Other (please specify)

National Standard-setter

(c) Please provide a short description of your activity/ the general activity of your organisation or company:

(d) Country where you/your organisation or company is located:

Germany

(e) Contact details including e-mail address:

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2 EFRAG's initial assessment of IFRS 7 Amendments is that they meet the technical criteria for endorsement. In other words, they are not contrary to the true and fair principle and they meet the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of IFRS 7 Amendments? If there are, what are those issues and why do you believe they are relevant to the evaluation?

There are no other issues.

3 EFRAG is also assessing the costs that will arise for preparers and for users to implement IFRS 7 Amendments, both in year one and in subsequent years. The results of the initial assessment are set out in Appendix 3. To summarise, EFRAG's initial assessment (see paragraphs 1-4 of Appendix 3) is that IFRS 7 Amendments are:

(a) likely to involve preparers in some additional year one and ongoing costs. For some preparers those costs will be insignificant, but for some others they will be greater than that; and

(b) likely to involve users in no year one or ongoing incremental costs.

Do you agree with this assessment?

☐ Yes ☐ No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

As a national standard-setter, we are not in a position to answer this question.

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4 EFRAG's initial assessment is that IFRS 7 Amendments are likely to result in improvements in the information provided. Furthermore, those benefits are likely to exceed the costs involved. (See Appendix 3, paragraphs 5 - 7).

Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

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5 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on IFRS 7 Amendments.

Do you agree that there are no other factors?

☒ Yes ☐ No

If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

APPENDIX 1
A SUMMARY OF IFRS 7 AMENDMENTS

1 The objective of IFRS 7 *Financial Instruments: Disclosures* is to require entities to provide disclosures in their financial statements that enable users to evaluate:

(a) the significance of financial instruments for the entity's financial position and performance; and

(b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

2 IFRS 7 Amendments amend and add to the existing disclosure requirements. They do so in response to the demand from users for enhanced disclosures on financial instruments, primarily in the light the current market conditions. These enhanced disclosures cover two topics:

(a) fair value measurement; and

(b) liquidity risk.

Fair value measurement

3 The existing IFRS 7 already requires entities to provide some information about their use of fair value measures, but IFRS 7 Amendments require entities to classify the fair value measures they use into three levels (fair value hierarchy) and to provide additional information on each measure used depending on its level.

4 The levels of the fair value hierarchy depend on the type of input used for the valuation of those instruments. There are three levels:

(a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);

(b) inputs other than quoted prices included under Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and

(c) inputs for the asset or liability that are not based on observable market data (unobservable input) (Level 3).

This hierarchy is similar to the one used for similar purposes in US GAAP.

5 The additional disclosures to be provided are:

(a) an analysis of the fair value amounts used by level;

(b) any significant transfers between Level 1 and Level 2, and the reasons for those transfers;

(c) for level 3 valuations, an analysis of the movement between the opening and closing balances disclosing separately various prescribed items (such as total gains and losses recognised in profit or loss, total gains and losses recognised in other comprehensive income, transfers into and out of level 3, etc); and

(d) for Level 3 valuations, certain information about the sensitivity of the fair value amounts.

Liquidity risk

6 Existing IFRS 7 requires disclosure of a maturity analysis of all financial liabilities by reference to the contractual cash flows. IFRS 7 Amendments changes the requirement for derivative financial liabilities by allowing management to use a different approach unless the contractual maturities are essential for the understanding of the timing of the cash flows associated with those instruments.

APPENDIX 2
EFRAG'S TECHNICAL ASSESSMENT OF IFRS 7 AMENDMENTS AGAINST THE ENDORSEMENT CRITERIA

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.

1 When evaluating the merits of IFRS 7 Amendments, EFRAG considered whether the accounting that results from the application of IFRS 7 Amendments meet the criteria for EU endorsement.

DOES THE ACCOUNTING THAT RESULTS FROM THE APPLICATION OF IFRS 7 AMENDMENTS MEET THE CRITERIA FOR EU ENDORSEMENT?

Relevance

2 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 IFRS 7 Amendments 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.

3 EFRAG's initial assessment is that the additional and amended fair value measurement disclosures for financial instruments that the IFRS 7 Amendments require, will help users to understand better the uncertainties surrounding fair value measures used in the financial statements.

4 Regarding liquidity risk disclosures, EFRAG notes that the effect of IFRS 7 Amendments is to allow management greater flexibility to provide maturity analyses for derivative financial liabilities in a way that they believe 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 firmly on the provision of relevant information. EFRAG's initial assessment is that this amendment will help entities to meet the objective more effectively.

5 As a result, EFRAG believes that the information that will result from applying IFRS 7 Amendments will meet the EU endorsement criteria of relevance.

Reliability

6 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 IFRS 7 Amendments exhibits those qualities.

7 Regarding fair value measurements disclosures, IFRS 7 Amendments require 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 initial assessment is that IFRS 7 Amendments do not require additional calculations and therefore have no additional reliability implications.

8 Regarding disclosures about the liquidity risk an entity is exposed to, the IFRS 7 Amendments require 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, as entities would need to disclose information about the remaining contractual maturities if such information was essential to the understanding of the cash flows.

9 EFRAG has therefore tentatively concluded that the information that results from the application of the disclosures in IFRS 7 Amendments meets the reliability criterion.

Comparability

10 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.

11 IFRS 7 Amendments require 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 IFRS 7 Amendments may create diversity in practice by virtue of the inherent 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 Amendments 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. EFRAG noted that judgement is required when assessing which financial instruments will be categorised into which level when an entity applies the requirements in IFRS 7 Amendments and in IAS 39, which affects comparability of information. 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.

12 As previously explained, IFRS 7 Amendments require 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 acknowledges that permitting such use of management discretion may result in a wider range of numbers being disclosed for similar instruments. However, EFRAG believes that this would not result in a decrease in comparability, but, rather, would reflect the diversity of liquidity risk management.

13 As a result, EFRAG believes that IFRS 7 Amendments will not create significant comparability issues in practise.

Understandability

14 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.

15 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 IFRS 7 Amendments is understandable is whether that information will be very complex.

16 Regarding fair value measurement disclosures, EFRAG understands that some entities already provide some of the disclosures required by the IFRS 7 Amendments on a voluntary basis in their IFRS financial statements. Other disclosures are new, but do not seem overly complex. As a result, EFRAG's initial assessment is that the information that will result from the application of the fair value measurement disclosures in IFRS 7 Amendments will be understood by users.

17 EFRAG's initial assessment is that the changes made by IFRS 7 Amendments 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.

18 Having considered the above reasoning, EFRAG believes that IFRS 7 Amendments meet the understandability characteristic.

True and Fair

19 Having concluded that the information that results from the application of IFRS 7 Amendments 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 Amendments, EFRAG sees no reason to believe that the IFRS 7 Amendments are inconsistent with the true and fair view requirement.

European Interest

20 EFRAG has considered whether the benefits of implementing the IFRS 7 Amendments in the EU exceed the costs of doing so. Its initial assessment (as explained more fully in Appendix 3) is that, although implementation of the Amendments would involve some costs, they are likely to be outweighed by the benefits.

Conclusion

EFRAG's overall conclusion is that the IFRS 7 Amendments satisfy the criteria for EU endorsement and EFRAG should therefore recommend their endorsement.

APPENDIX 3
EVALUATION OF THE COSTS AND BENEFITS OF IFRS 7 AMENDMENTS

Cost for preparers

Fair value measurement disclosures

1 EFRAG's initial assessment is that the IFRS 7 Amendments could involve preparers in additional costs in two areas.

(a) Breaking down the fair value measurement disclosures into the three levels — EFRAG's initial assessment is however that the information necessary to meet these requirements already exists and therefore the cost of meeting the new requirements — which would be an ongoing cost — is essentially that of collecting existing information, which is likely to be insignificant in most cases, because it can be collected through existing reporting systems.

(b) Preparation of the reconciliation from the opening balance to the closing balance of Level 3 fair value measurements and disclosure of specific information on the movements in the period — EFRAG understands that implementing these reconciliation requirements could require preparers to be able to monitor a large quantity of additional information, such as the purchases and sales of assets measured using Level 3 techniques within a specific book of business. When the number of corresponding books of business is large and spread among various subsidiaries, this ongoing cost would not be insignificant.

Liquidity risk disclosures

2 The existing requirements concerning liquidity risks disclosures require entities to provide specific disclosures on liquidity risk for all financial liabilities. As previously explained, under IFRS 7 Amendments an entity is no longer required to provide a maturity analysis on liquidity risk that includes the remaining contractual maturities for derivative financial liabilities, unless such information is essential to the understanding of the cash flows associated with the instruments. Therefore, EFRAG's initial assessment is that this part of IFRS 7 Amendments will not have any cost implications.

Overall assessment

3 EFRAG's overall initial assessment is that, for some preparers, the additional year one and ongoing costs of implementing IFRS 7 Amendments is likely to be insignificant, but for some other preparers the ongoing costs are likely to be greater than that mainly because of the costs involved in disclosing a reconciliation of the opening to closing balance Level 3 fair value measures.

Costs for users

4 EFRAG is not aware of any aspect of IFRS 7 Amendments that will increase the costs users will incur in analysing the financial statements as a result of its adoption.

Benefits of the IFRS 7 Amendments

5 In issuing these amendments, the IASB is responding to a strong and urgent call from users for better disclosures about the use of, and uncertainties arising from, fair value measures of financial instruments and about the liquidity risk to which the entity is exposed and how it is managing that risk. The value of some of the fair value measurement disclosures is highlighted by the fact that some entities already provide

some of the information required by the IFRS 7 Amendments on a voluntary basis in their IFRS financial statements.

6 EFRAG's initial assessment is that the amendments will overall improve the quality of the information provided in two areas where such improvements are much needed. The benefits arising from the implementation of IFRS 7 Amendments are therefore likely to be significant.

Conclusion

7 To summarise, EFRAG believes that for some entities implementation of IFRS 7 Amendments will result in some not insignificant ongoing costs. On the other hand, the benefits are likely to be significant, and therefore are likely to exceed the costs involved.