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Sir David Tweedie
Chairman
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Email: commentletters@iasb.org

15 December 2008

Dear Sir David,

Re: Exposure Draft, *Improving Disclosures about Financial Instruments* — Proposed amendments to IFRS 7

Deloitte Touche Tohmatsu is pleased to respond to the Exposure Draft, *Improving Disclosures about Financial Instruments,* proposed amendments to IFRS 7 (the "proposed amendment" or the "Exposure Draft").

We support the Board's efforts to enhance the disclosures about financial instruments and to converge the disclosure requirements with Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (Statement 157)*,* issued by the U.S. Financial Accounting Standards Board (FASB). We believe the proposal to converge with the fair value hierarchy disclosures in Statement 157 is appropriate because it provides useful information to users of the financial statements. Specifically, we believe that the proposed amendment will result in more consistent fair value hierarchy disclosures among IFRS preparers and improve comparability with entities using Statement 157. We also support the Board's efforts to clarify the liquidity risk disclosure requirements.

In addition, to meet the goal of improving reporting for financial instruments, we recommend the Board considers incorporating the best practices identified in the Expert Advisory Panel document on measuring and disclosing fair value measurements in inactive markets, which was issued in October 2008. We believe codification of such best practices into IFRS 7 or implementation guidance accompanying IFRS 7, as appropriate in each case and subject to the Board's due process, will enhance its significance and help ensure that users of the financial statements obtain useful information about fair value measurements.

Furthermore, we understand that the FASB is considering adding to its agenda a fair value measurement disclosure project. We encourage the Board to work with the FASB on these issues to further the common goal of convergence.

Our detailed responses to the invitation to comment questions are included in Appendix A and other specific and general comments are included in Appendix B to this letter.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0) 207 007 0907.

Sincerely,

Ken Wild
Global IFRS Leader

Appendix A: Invitation to Comment

Question 1

Do you agree with the proposal in paragraph 27A to require entities to disclose the fair value of financial instruments using a fair value hierarchy? If not, why?

We agree with the proposal in paragraph 27A to require entities to disclose the fair value of financial instruments using a fair value hierarchy. We believe that the use of a fair value hierarchy in IFRS 7 disclosures will improve information available to users of financial statements and facilitate comparisons with fair value hierarchy disclosures provided by U.S. entities under U.S. GAAP. We encourage the Board to consider providing more guidance about how the fair value hierarchy in IFRS 7 relates to the fair value measurement guidance in IAS 39, for example, when an entity uses a valuation technique employing observable and unobservable inputs.

Question 2

Do you agree with the three-level fair value hierarchy as set out in paragraph 27A? If not, why? What would you propose instead, and why?

We generally agree with the three-level fair value hierarchy as set out in paragraph 27A. However, in order to provide additional clarity and promote consistency in application we ask the Board to consider the following:

1. Proposed paragraph 27A states, in part: "To make the disclosures required by paragraphs 27B and 27C an entity shall classify fair value measurements using a fair value hierarchy **that reflects the significance of the inputs used in making the measurements**." (Emphasis added). As currently drafted, this statement is unclear. The fair value hierarchy does not reflect "significance of inputs," but rather is based on the lowest level input that is significant to the fair value measurement of a financial instrument in its entirety. We recommend the Board conform the wording to paragraph 22 of Statement 157. Suggested revisions to the proposed sentence are noted below (changes are indicated in strikethrough or underline):

    > "To make the disclosures required by paragraphs 27B and 27C an entity shall classify fair value measurements using a fair value hierarchy ~~that reflects the significance of the inputs used in making the measurements~~ within which the fair value measurement shall be determined based on the lowest level input that is significant to the fair value measurement in its entirety."

    Further, to ensure consistency in application of the proposed fair value hierarchy disclosures, the Board should provide examples of how financial instruments with quoted rates/prices (for example, interest rate swaps with quoted rates, and NYMEX look alike swaps) will be classified in the fair value hierarchy proposed in paragraph 27A.

2. Proposed paragraphs 27A(a)-(b) refer to active markets and observable market data in determination of inputs used in fair value measurements. Given the recent events in the global financial markets, we encourage the Board to provide additional interpretive guidance on what characteristics an entity may consider in determining what constitutes an active (or inactive) market and the criteria or characteristics to consider in determining which observable transactions are relevant in measuring fair value. We believe it would be highly beneficial to preparers and users of financial statements if the discussion points highlighted in the Expert Advisory Panel document on measuring and disclosing the fair

value of financial instruments in inactive markets were incorporated in the final amendment. The Board should consider its due process requirements in making any such changes.

Question 3

Do you agree with the proposal in:

(a) Paragraph 27B to require expanded disclosures about the fair value measurement recognised in the statement of financial position? If not, why? What would you propose instead, and why?

(b) Paragraph 27C to require entities to classify, by level of the fair value hierarchy, the disclosures about the fair value of the financial instruments that are not measured at fair value? If not, why? What would you propose instead, and why?

We generally agree with the expanded disclosure requirements in paragraphs 27B and 27C. However, it is unclear whether the proposed disclosures of fair value measurements recognised in the financial statements applies solely to recurring fair value measurements or also to other fair value measurements recognised during the reporting period or at initial recognition. Refer to specific comments below for detail.

1. <u>Proposed paragraph 27B</u> states, in part, "For fair value measurements recognised in the statement of financial position an entity shall disclose for each class of financial instruments [...]." It is unclear from the proposed sentence whether the disclosure requirements apply to just recurring fair value measurements or include financial instruments recognised at fair value upon initial recognition, such as investments in held-to-maturity financial instruments or financial liabilities for which the fair value option has not been elected.

   Further, it is unclear from the proposed sentence, whether the disclosure requirements apply to instruments reclassified from "fair value through profit or loss" (FVTPL) and "available-for-sale" (AFS) categories, as permitted by the recent amendment to IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39). One of the new disclosure requirements in IFRS 7.12A requires that the carrying amounts and fair values of all financial assets reclassified must be disclosed. In light of these new disclosure requirements, we believe that it will be useful information for users of financial statements if the disclosure requirements in proposed paragraphs 27A and 27B applied to such instruments.

   In addition, it is not clear from the proposed sentence whether each class of financial instrument must be disclosed separately. Suggested revisions to clarify the proposed sentence are noted below (changes are indicated in strikethrough or underline):

   > "For fair value measurements recognised in the statement of financial position an entity shall disclose <u>separately</u> for each class of financial instruments."

2. <u>Proposed paragraph 27B(a)</u> states, in part, "the level in the fair value hierarchy into which the fair value measurements are categorised in their entirety." Although there is nothing incorrect with the proposed sentence, we recommend the Board conforms the wording to paragraph 32(b) of Statement 157 to clarify that fair value measurements must be categorised in their entirety in one of the three levels of the fair value hierarchy (i.e., a single fair value measurement cannot be broken down into different levels based on the levels of the inputs used). Suggested revisions to the proposed sentence are noted below (changes are indicated in strikethrough or underline):

> "the levels in the fair value hierarchy into which the fair value measurements are categorised in their entirety, <u>segregating fair value measurements using quoted prices in active markets for same instrument (Level 1), quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data (Level 2), and valuation techniques for which any significant input is not based on observable market data (Level 3)</u>."

3. <u>Proposed paragraphs 27B(b) and 27B(c)</u> require entities to provide a reconciliation of Level 3 balances (proposed paragraph 27B(b)) and the total amount of unrealised gains or losses (proposed paragraph 27B(c)) for the period included in profit or loss for those assets and liabilities still held at the end of the reporting period. These disclosure requirements are consistent with Statement 157, which has been applied in the U.S. since 2007 (for early adopters). Such disclosures have resulted in implementation issues and diversity in application in the U.S. which potentially diminishes the comparability and usefulness of these disclosures. Application issues identified in the U.S. include, for example, (a) when are transfers assumed to occur between categories (for example, is the transfer from Level 2 to Level 3 (or vice versa) assumed to occur at the beginning of period, end of period, mid-month, or on a specific date), (b) how to compute unrealised gains and losses included in profit or loss and settlements for contracts subject to periodic net settlements (e.g., swaps), and (c) whether the amounts to disclose under the Level 3 reconciliation should be disclosed for both interim-to-date and year-to-date periods, in interim financial statements. We suggest the Board provides application guidance on the Level 3 reconciliation disclosures to help ensure consistency in application and usefulness of such disclosures.

   In addition, to reduce burden and ensure consistency with Statement 157 (footnote 12) and hence enhance comparability, we recommend that the Board permits derivative assets and liabilities to be presented "net" in the reconciliation of Level 3 balances (proposed in paragraph 27B(b)).

   Further, we propose that the following revision be made to paragraph 27B(c) to clarify that the requirement to disclose total amounts of unrealised gains or losses relates to financial instruments that are "recognised" in the statement of financial position (consistent with paragraph 27B) as of the reporting date, rather than "held" by the entity. Suggested revisions to clarify the proposed sentence are noted below (changes are indicated in strikethrough or underline):

   > "the total amount of unrealised gains or losses for the period in (b)(i) included in profit or loss for those assets and liabilities still ~~held~~<u>recognised and classified as Level 3</u> at the end of the reporting period [...]"

   Finally, we recommend that the Board incorporate the disclosure requirement in IFRS 7.12A to disclose the amounts reclassified into and out of each financial instrument category (that is, for financial instruments transferred from the FVTPL and AFS categories per the recent amendment to IFRS 7) as a separate line items in the Level 3 reconciliation disclosure in paragraph 27B(b). This proposed disclosure will further enhance the usefulness of the Level 3 reconciliation by providing users with greater transparency into the measurement attribute of such reclassifications.

4. <u>Proposed paragraph 27B(d)</u> requires an entity to disclose the effect of changes in fair value (to the extent significant) when the valuation technique(s) uses a significant input that is not based on observable market data. It appears from the proposed paragraph that the entity is only required to consider alternative assumptions related to significant unobservable inputs. However, it is possible that the significant unobservable input may be correlated or inversely related to other inputs used in the valuation technique(s).

Changing only the unobservable input may distort the fair value disclosed. As such, the proposed amendment should incorporate the requirement for the entities to disclose the basis on which they have changed the assumptions and whether the impact on other observable or unobservable inputs has been incorporated into the sensitivity.

5. Proposed paragraph 27C implies that all financial instruments not measured at fair value in the statement of financial position are required to be disclosed, by level, in the fair value hierarchy, as proposed in paragraph 27A. It is unclear from the proposed paragraph whether non-recurring measurements (for example, impaired assets measured using the practical expedient in paragraph AG84 of IAS 39), which are recorded at fair value in the statement of financial position upon the occurrence of a triggering event (e.g., impairment), are required to be disclosed under paragraph 27B or paragraph 27C.

Question 4

Do you agree with the proposal in paragraph 39(a) to require entities to disclose a maturity analysis for derivative financial liabilities based on how the entity manages the liquidity risk associated with such instruments? If not, why? What would you propose instead, and why?

We support the Board's objective of providing enhanced liquidity risk disclosures and clarifying certain practice issues (in the proposed amendment) that exist under current IFRS 7.39. However, in order to provide additional clarity and promote consistency in application we ask the Board to consider the following comments on paragraph 39(a) and Application Guidance B11C related to derivative financial liabilities.

1. Proposed paragraph 39(a) states, in part, "a maturity analysis for derivative financial liabilities that is based on how the entity manages the liquidity risk associated with such instruments." The proposed paragraph is unclear whether (a) it excludes from disclosure requirements two-directional derivatives (for example, currency, commodity or interest rate swaps), which may switch from a gain position (an asset) to a loss position (a liability) prior to maturity, (b) the disclosure requirement is limited to current expected amounts, that is, based on the current forward curve as of the reporting date, or includes potential amounts, which may be known or reasonably estimable, and (c) the maturity analysis is based on the "net" derivative financial liability (that is after considering master netting arrangements). The Board should clarify such application and implementation issues prior to issuing the final amendment.

   Further, it is not clear from the proposed amendment whether non-financial liabilities (for example commodity contracts that require the delivery of a physical commodity and are not considered "own use") are within the scope of the proposed paragraph. Paragraph 5 of IFRS 7 implies that the disclosure requirements of IFRS 7 apply to non-financial items that are within the scope of IAS 39. Clarification by the Board of whether such contracts are in scope of the liquidity risk disclosures will help ensure consistency in application.

   In addition, it is also not clear from the proposed amendment whether non-derivative financial liabilities that are classified as held-for-trading as noted in IAS 39.AG15 (for example, obligations to deliver financial assets borrowed by a short seller), are within the scope of the proposed paragraph 39(a). Maturity analysis for such non-derivative financial liabilities classified as 'held for trading' should also be disclosed based on how an entity manages the liquidity risk associated with such instruments.

   Furthermore, we recommend the Board provide application guidance on how non-financial entities that may not actively manage the liquidity risk associated with derivatives would present a maturity analysis for derivative financial liabilities. Also, the Board should clarify how an entity should present the maturity analysis for derivative financial liabilities, when an entity manages risk based on a term that is greater than the expected maturity of the derivative, for example, a rollover strategy whereby derivatives with discrete contractual maturities "roll" thereby creating longer dated strategies from an economic perspective (as opposed to contractual maturities). We recommend that maturity analysis for such strategies be based on the earliest time band.

2. Proposed application guidance in paragraph B11C, states, in part, "quantitative maturity analysis for derivative financial liabilities (including financial instruments that would meet the definition of a derivative financial liability if they were recognised)." It is unclear what the Board means by "derivative financial liability if they were recognised." For example, does this include financial instruments scoped out of IAS 39, "own use" contracts, unrecognised firm commitments, or derivatives that may be liabilities in the future? The Board should clarify what is meant by the proposed sentence to avoid application and implementation issues.

3. Proposed application guidance in paragraph B11C(c) is unclear whether the expected cash outflows related to loan commitments and financial guarantees represent discounted or undiscounted cash flows. The Board should explicitly clarify the measurement attribute (discounted or undiscounted) in the application guidance to ensure consistency in application and comparability.

Question 5

Do you agree with the proposal in paragraph 39(b) to require entities to disclose a maturity analysis for non-derivative financial liabilities based on remaining expected maturities if the entity manages the liquidity risk associated with such instruments on the basis of expected maturities? If not, why? What would you propose instead, and why?

As stated in our response to Question 4, we support the Board's effort to enhance liquidity risk disclosure requirements. We believe the Board should clarify that for non-derivative financial liabilities, when an entity manages liquidity on the basis of expected maturities, whether the amounts related to these financial liabilities should be presented as discounted or undiscounted cash flows in the maturity analysis.

Question 6

Do you agree with the amended definition of liquidity risk in Appendix A? If not, how would you define liquidity risk, and why?

We do not agree with the amended definition of liquidity risk as the proposed amendment results in a too narrow definition of liquidity risk.

In particular, certain contracts may allow an entity to settle the financial liability via delivery of either cash (or another financial asset) or equity or non-financial assets. We believe that under the proposed definition entities may try to circumvent the liquidity risk disclosure requirements by asserting that the liability will be settled via issuance of equity or non-financial assets. We believe that a contract should not be excluded from the liquidity risk disclosure solely because an entity may have an option to use a variable quantity of its own shares or a non-financial asset that is readily convertible to cash as "currency" to settle the obligation.

Further, it is unclear from the proposed definition whether convertible notes that may mature at a specified future but may be settled in cash or shares of the entity at the holder's option are required to be included in the maturity analysis. We believe that such instruments whose settlement is not within the control of the issuer/entity should be included in the maturity analysis.

In addition, the proposed definition of liquidity risk excludes obligations settled by non-financial assets. As such, it is unclear from the proposed definition whether the Board purposely meant to exclude commodity contracts that are accounted for as derivative instruments under IAS 39, for example, because under such contracts, the commodity delivered is considered "readily convertible to cash" and the contract is not for the entity's "own use."

Although paragraph BC9 clarifies that the Board intends to exclude from the disclosure requirements, financial liabilities that are settled in entity's own **equity** instruments (emphasis added), it is unclear from the proposed definition whether financial liabilities (for example, share-settled debt) that are settled via issuance of entity's own shares (for which the amount is not known at inception and fluctuates over the contract term) are meant to be excluded from the liquidity risk disclosures.

Finally, if the entity intends to settle a financial liability via issuance of own equity for which it may not have enough authorised and unissued shares to permit the settlement in shares (that is, the entity would need to purchase additional shares in the market or obtain shareholder approval to increase the number of shares outstanding to settle the financial obligation), we believe that additional disclosure may be warranted given the execution risk involved in settling the liability.

Question 7

Do you agree with the proposed effective date? If not, why? What would you propose instead, and why?

Given the usefulness and increased transparency provided by the proposed amendment to IFRS 7, we believe the amendment should be effective as soon as practicable. We encourage the Board to consult with preparers of financial statements as implementation of the proposed disclosure requirements may prove challenging for certain companies. Such companies may need to implement new systems to capture the data and implement new controls to meet the proposed disclosure requirements.

Question 8

Are the transition requirements appropriate? If not, why? What would you propose instead, and why?

It is unclear from the transition provision whether the proposed disclosure requirements are prospective or require comparative disclosures for all periods presented upon initial adoption. We encourage the Board to consult with preparers as some companies may not have data available from prior periods to comply with the proposed disclosure requirements or providing comparative disclosures may prove to be overly onerous. We encourage the Board to consider to what extent it may provide an exemption from comparative disclosures (for example, for early adopters) to the extent the Board decides to require comparative disclosures for all periods presented.

Appendix B: Other Comments

In addition to our responses to the questions in the invitation to comment, noted below are additional comments that the Board should clarify prior to issuing the final amendment.

Other Specific Comments

1. Paragraph 27C requires disclosure of the fair value of all financial instruments not measured at fair value. The Board should clarify that the disclosure requirement in this paragraph does not apply to financial instruments exempted from such disclosures under paragraph 29.

2. Paragraph 29(b) permits an entity to omit the fair value disclosures for derivatives that are linked to equity instruments that do not have quoted market prices in an active market and are measured at cost in accordance with IAS 39. Similarly, IAS 39.46 states that derivatives that are "linked to **and must be settled by delivery of such unquoted equity instruments**," [emphasis added] shall be measured at cost. Thus, there is a difference in wording between the disclosure requirements of IFRS 7 and the measurement requirements of IAS 39. Although this paragraph is not amended under the proposed amendment, the Board should clarify and conform the wording in this paragraph to IAS 39.

3. Paragraph IG13A states, in part, "An entity might disclose the following for assets to **comply with paragraph 27B(a)**. (Disclosures **by class of financial instruments** would also be required, but are not included in the following example.)" (Emphasis added). The illustrative example contained in the implementation guidance is explicitly based on "categories" of financial instruments (as defined in IAS 39) rather than "class" of financial instruments, as required by paragraph 27B(a). We recommend that to be consistent with the disclosure requirements in paragraph 27B(a), the Board amend the example to require disclosure by "class" of financial instruments only.

   In addition, the Board should ensure that the description of Level 1, Level 2, and Level 3 inputs in the illustrative example is consistent with the descriptions in paragraph 27A.

4. Paragraph IG13B provides a tabular example of Level 3 reconciliation disclosure in accordance with paragraph 27B(b). Included in the disclosure is CU4million in "Total gains and losses in other comprehensive income" under the "financial assets at fair value through profit or loss" category. Although this would be correct if it relates to changes in fair value of derivatives in the FVTPL category classified as cash flow hedges, it may not be clear to others since the amount appears under other comprehensive income and fair value through profit and loss category. Consistent with our comment related to paragraph 1G13A above, we suggest that the Board clarify whether the disclosure requirements in IG13B are by "category" or "class" of financial instruments.

General Comments

1. The Board may wish to consider incorporating the requirement in paragraph 27B(e) to disclose the reasons for all movements between the levels for value hierarchy with that in paragraph 27B(a).

2. To further enhance the liquidity risk disclosures, we recommend the Board considers disclosure requirements in paragraph 44D of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (as amended by FASB Statement 161, *Disclosures about Derivative Instruments and Hedging Activities*), to require entities to disclose the existence and nature of credit-risk related features that could be triggered if a derivative instrument is in a net liability position. This disclosure will help convey useful information to the users of the financial statements about contractual terms that are outside the control of the entity and may result in a payment being immediately due or a requirement to post collateral upon the occurrence of a contractual event.

3. The Board should clarify in the tabular disclosure example in Paragraph IG13A how an entity may illustrate the impact of counterparty netting in the fair value hierarchy disclosures. IAS 32.42 requires financial assets and financial liabilities to be offset and the net amount be presented in the statement of financial position, if certain criteria are met. An amended example illustrating counterparty netting will ensure that such amounts reconcile to the statement of financial position and such disclosures are consistent across entities.