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N°

PARIS, 22TH OCTOBER 2004

CL 49

Ms Andrea PRYDE

Assistant Project Manager

IASB

30 Cannon Street

London EC4M 6XH

Re : ED 7 *Financial Instruments : Disclosures*

Dear Ms,

The Conseil National de la Comptabilité (CNC) appreciates the opportunity to comment on the Exposure Draft ('ED 7') on *Financial Instruments : Disclosures.*

We support the IASB's objective to review existing disclosures in IAS 30 and IAS 32 and to locate in one place all disclosures relating to financial instruments.

Regarding the scope of the Exposure Draft, we note that it applies to all entities. It is mentioned in paragraph IN4 that *"the extent of disclosure required depends on the extent of the entity's use of financial instruments"*. We consider it should have been more appropriate to distinguish requirements for financial institutions and insurance companies from requirements for others for the two main following reasons :

- extending the scope to entities that have few financial instruments might cause difficulties for non financial companies in collecting and publishing data, particularly concerning market risks ;

- if financial institutions can collect and disclose data required in this Exposure Draft, some requirements are not appropriate for these financial entities because more detailed presentation is given elsewhere. One example would be the requirements on paragraph 40 (a) on the analysis of the age of financial assets that are past due and on paragraph 42 (a) which requires maturity analysis for financial liabilities which are not key analytical information for financial institutions ; on the contrary, these disclosures are essential to industrial companies for which accounts receivable and accounts payable constitute the core of their financial instruments.

The Exposure Draft proposes that entities disclose information on all market risks arising from financial instruments in the financial statements, even if they do not refer specifically to items of the balance sheet and the income statement. Consequently, we believe they should be part of the information provided by management outside the financial statements. In this context, we encourage the IASB to start discussion on a standard on Management's Discussion and Analysis (MD&A).

The Exposure Draft also proposes certain capital disclosures. We do not support the proposals to disclose, even in the MD&A, objectives, policies and processes for managing capital, and in particular whether it has complied with internal capital targets set by management. Internal capital targets are defined in conjunction with other control measures and a breach of internal rules is often acceptable with appropriate approval. We therefore do not consider this to be useful or relevant information for users to assess the financial position and recent performance of the company.

Finally, the Exposure Draft requires disclosures on income statement amounts, and in particular, net gains and losses on financial instruments (paragraph 21). We consider that the Exposure Draft should provide further explanations on these new requirements, because it is not clear whether net gains and losses (§ 21 (a)) include interest and dividend income (§ 21 (b) and § BC 16), impairments or fair value attributable to the hedged risk.

If you want further information on these points, do not hesitate to contact Mrs Marie-Pierre Calmel (tel : 00.33.1.53.44.52.12).

Yours sincerely,

Antoine BRACCHI

Appendix

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?

We understand that the classification proposed in paragraphs 10 and 21 does not have to be shown on the face of the balance sheet and the income statement, and we consider that the requirements are only for disclosure purposes.

Regarding the disclosures on income statement amounts, the Exposure Draft should provide further explanations on these new requirements, and in particular on net gains and losses on financial instruments (paragraph 21). It is not clear whether net gains and losses (§ 21 (a)) include interest and dividend income (§ 21 (b)), impairments or fair value attributable to the hedged risk. As mentioned in paragraphs BC 15 and BC 16, *"the Board noted that some entities include interest and dividend income in gains and losses on financial assets and financial liabilities held for trading and others do not".* The Exposure draft should mention this possibility in paragraph 21.

Regarding the information about any allowance account (paragraph 17), the Exposure Draft proposes that disclosure on financial assets impaired by credit losses is required only when an allowance account is used, and not when carrying amounts are reduced directly. We consider that information on credit losses for each class of financial assets is useful for assessing impairment losses and for comparing one entity against others. This information has not to depend on the method of credit provisioning. Consequently, the wording of this paragraph 17 should be modified.

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?

The Exposure Draft proposes that entities disclose information on credit risk arising from financial instruments. We consider that information on credit risk should be consistent with the way the entity manages its exposure. The loss that an entity suffers when a counterpart fails to meet its contractual obligations is an information which accurately reflects the credit exposure, and consequently, entities should give information on credit exposures post any legally enforceable master netting agreements. In this context, we believe that the proposed disclosures of the fair value of collateral and other credit enhancements should focus more on providing sufficient information about the management of credit risk and methods of credit enhancement. This would enable the reader to obtain an understanding of the risks of the business.

Furthermore, as mentioned in the cover letter, we believe this information should be part of the information provided by management outside the financial statements. For example, the analysis of credit exposures using an external or internal credit grading system (as mentioned in paragraph IG 17 (a)) requires qualitative explanations and has to be part of the Management's Discussion and Analysis.

The Exposure Draft requires in paragraphs 39 (b) and 40 (c) disclosures of the fair value of collateral pledged as security and other credit enhancements, unless impracticable. The Board noted that in some cases this information is onerous to prepare, not always available and that qualitative information may be sufficient. We agree with these arguments mentioned in paragraph BC 28, and we consider that the term "unless impracticable" is very important. Consequently, we recommend to add more guidance on the interpretation of "impracticable" in paragraph IG 16, giving more examples.

The requirements in paragraph 40 (a) on the analysis of the age of financial assets that are past due but not impaired are not key analytical information for financial institutions, because more detailed presentation is given elsewhere. On the contrary, these disclosures are essential to industrial companies for which accounts receivable and accounts payable constitute financial instruments in the scope of this Exposure Draft. Consequently, it should have been more appropriate to distinguish requirements for financial institutions and insurance companies from requirements for others.

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?

Consistent with our responses to the questions above, we consider that the information on sensitivity analysis should be part of the information provided by management outside the financial statements.

Instead of information on sensitivity analysis, another measure such as the Value at Risk (VAR) methodology which expresses potential loss on a portfolio at a specified confidence level could be applied. This approach provides valuable information on the risk profile of the entity. The

VAR is required for regulatory reporting under the Basel Accord and many banks use it. We recommend that the proposals should clarify that this methodology would be an acceptable way of meeting the sensitivity analysis requirements for financial institutions.

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?

If in certain cases, it would be appropriate to disclose information on the externally imposed capital requirements, this information should be presented outside the financial statements.

Regarding the internal capital targets, we do not support the proposals to disclose, even in the MD&A, objectives, policies and processes for managing capital, and in particular whether it has complied with internal capital targets set by management. Internal capital targets are defined in conjunction with other control measures and a breach of internal rules is often acceptable with appropriate approval. We therefore do not consider this to be useful or relevant information for users to assess the financial position and recent performance of the company.

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?

Many European companies will be preparing their first set of IFRS accounts in 2005. Rather than preparing the disclosures under IAS 30 and IAS 32, they may prefer to adopt the standard early. We would therefore encourage the Board to finalize these proposals as soon as practicable.

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?

As already mentioned, we consider that disclosures about risks should be part of the information provided by management outside the financial statements.

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?

Although we agree that the risk disclosures in IFRS 4 should be amended to make them consistent with the requirements proposed in the draft IFRS, we consider nevertheless that the consequential amendments should not be made to IFRS 4 before phase II of the Insurance Project. Insurers are currently dedicating extensive resources in the implementation to IFRS 4, and it would be too burdensome to change requirements now.

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, BC20 and BC42-BC44). Is the Implementation Guidance sufficient? If not, what additional guidance would you propose?

We believe that the Implementation Guidance is sufficient, except the fact that paragraph IG 16 should be completed (see our response to question 2).

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*
- *(i) 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?

We agree that the requirements in the draft IFRS provide adequate disclosure of fair value compared with those proposed in the FASB's Exposure Draft.

Question 10 – Other comments

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

We do not have any other comments.