BASIS FOR CONCLUSIONS ON EXPOSURE DRAFT

ED 7 Financial Instruments: Disclosures

Comments to be received by 22 October 2004

International
Accounting Standards
Board®

Basis for Conclusions on Exposure Draft

ED 7 FINANCIAL INSTRUMENTS: DISCLOSURES

Comments to be received by 22 October 2004

This Basis for Conclusions accompanies the proposed International Financial Reporting Standard (IFRS) set out in ED 7 *Financial Instruments: Disclosures* (see separate booklet). Comments on the draft IFRS and its accompanying documents should be submitted in writing so as to be received by **22 October 2004.**

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Basis for Conclusions on ED 7 Financial Instruments: Disclosures

This Basis for Conclusions accompanies, but is not part of, the draft IFRS.

INTRODUCTION

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in ED 7 *Financial Instruments: Disclosures*. Individual Board members gave greater weight to some factors than to others.

BC2 During the late 1990s, the need for a comprehensive review of IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* became apparent. The Board's predecessor, IASC, issued a number of Standards that addressed, more comprehensively, some of the topics previously addressed only for banks in IAS 30. Also, fundamental changes were taking place in the financial services industry and in the way in which financial institutions manage their activities and risk exposures. This made it increasingly difficult for users of banks' financial statements to assess and compare their financial position and performance, their associated risk exposures and their processes for measuring and managing those risks.

BC3 In 1999, IASC added a project to its agenda to revise IAS 30 and in 2000 it appointed a steering committee.

BC4 In 2001, the Board added this project to its own agenda. To assist and advise it, the Board retained the IAS 30 steering committee, now renamed the Financial Activities Advisory Committee (FAAC), as an expert advisory group. FAAC members have experience and expertise in banks, finance companies and insurance companies and include auditors, financial analysts, preparers and regulators. The FAAC's role was:

(a) to provide input from the perspective of users, preparers and auditors of financial statements of entities that have large exposures to financial instruments; and

(b) to assist the Board in developing a Standard and Implementation Guidance for risk disclosures arising from financial instruments and for other related disclosures.

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SCOPE

The entities to which the IFRS would apply

BC5 As noted above, ED 7 arose from a project to revise IAS 30 and hence at the start was intended to apply only to banks and similar financial institutions.

BC6 However, when the Board adopted this project in 2001, it made a fundamental change to its scope. The Board decided that an IFRS arising from the project should address disclosure and presentation issues that arise for all types of entities that engage in financial activities, irrespective of whether they are regulated and supervised as banks. The Board concluded that the reduction in regulatory barriers in many countries, and increasing competition between banks, non-bank financial services firms and financial conglomerates in providing the same types of financial services make it inappropriate to limit the scope to banks and similar financial institutions. Thus, the scope was revised to cover entities that undertake specified activities commonly undertaken by banks and other financial institutions, namely deposit-taking, lending and securities activities.

BC7 In 2002, the Board decided to widen the scope of the project again to cover risk arising from financial instruments in all entities. It made this decision for the following reasons:

(a) disclosures about risks associated with financial instruments are useful to users of the financial statements of all entities that hold financial instruments, not only to banks and similar financial institutions or only entities with deposit-taking, lending and securities activities.

(b) the Board found it could not satisfactorily define deposit-taking, lending and securities activities. In particular, it could not satisfactorily differentiate an entity with securities activities from an entity holding a portfolio of available-for-sale assets for investment and liquidity management purposes.

(c) comments received in response to the Exposure Draft of Improvements to IAS 32 *Financial Instruments: Disclosure and Presentation* indicated that improvements could be made to its risk disclosure requirements that were applicable to entities that do not have deposit-taking, lending and securities activities.

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(d) the exclusion of some financial instruments from the disclosures proposed would increase the danger that risk disclosures could be incomplete and possibly misleading. For example, a debt instrument issued by an entity could significantly affect its exposures to liquidity risk, interest rate risk and currency risk, but no disclosure would be required for the instrument.

(e) users of financial statements need to be able to compare similar activities, transactions and events of different entities on a consistent basis. Hence, the disclosure principles that apply to regulated entities should not differ from those that apply to non-regulated, but otherwise similar, entities.

BC8 The Board concluded that the most straightforward way to implement its decision that the IFRS should apply to all types of entities that have financial instruments was for the scope to be the same as that of IAS 32.

BC9 In addition, the Board decided that it would be more helpful to constituents to have all required disclosures relating to financial instruments contained in one Standard. Accordingly, the Board proposes to move all such disclosure requirements from IAS 32 to the proposed IFRS. As a result, ED 7 contains disclosures about:

(a) the significance of financial instruments for an entity's financial position and performance. Many of these proposed requirements are in IAS 32 and would be relocated into the IFRS without change. When the Board develops its Basis for Conclusions on the IFRS arising from this Exposure Draft, it intends to include in it relevant paragraphs from the Basis for Conclusions on IAS 32. The reasons for the proposed changes are given in paragraphs BC12-BC18.

(b) the risks arising from financial instruments. These proposed requirements are new and replace requirements in IAS 32. The reasons for them are given in paragraphs BC19-BC40.

(c) capital. These proposed requirements are new and the reasons for them are given in paragraphs BC45-BC54.

Should the IFRS exempt insurers from its scope?

BC10 The Board also considered whether it would be appropriate for the IFRS to apply to entities that both have financial instruments and issue insurance contracts. The Board could not justify an exemption for entities that issue insurance contracts. It noted that an entity that has financial instruments is subject to risks arising from those financial instruments

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regardless of what other assets and liabilities it has. Accordingly, an entity that both issues insurance contracts and has other financial instruments should apply the proposed IFRS to its financial instruments in addition to IFRS 4 *Insurance Contracts.* However, the Board also decided to propose to amend the disclosures required by IFRS 4 to make them consistent with the proposed disclosures (see paragraphs BC57-BC61).

Should the IFRS exempt small and medium-sized entities from its scope?

BC11 The Board considered whether it should exempt small and medium-sized entities from the scope of the IFRS. The Board noted that the extent of disclosures required by the IFRS will depend on the extent to which the entity uses financial instruments and the extent to which it has assumed associated risks. An entity with few financial instruments and few risks will be required to give few disclosures. Also, many of the proposed disclosures are based on information provided internally to the entity's key management personnel. This also helps to avoid unduly onerous requirements that would not be appropriate for smaller entities. Accordingly, the Board decided not to propose a scope exemption for small and medium-sized entities. However, it also decided to keep this decision under review in its project on financial reporting for small and medium-sized entities.

DISCLOSURES ABOUT THE SIGNIFICANCE OF FINANCIAL INSTRUMENTS FOR AN ENTITY'S FINANCIAL POSITION AND PERFORMANCE

The principle

BC12 In deciding to amend non-risk disclosures in IAS 32, the Board concluded that it was important that any additional disclosure requirements should result from the application of an explicit disclosure principle. As a result, the Board decided to include the principle that an entity should disclose information that enables users of its financial statements to evaluate the significance of financial instruments to an entity's financial position and performance.

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Balance sheet disclosures

Classification

BC13 In paragraph 10 the Board proposes a new requirement to disclose financial assets and financial liabilities by the measurement classifications in IAS 39 *Financial Instruments: Recognition and Measurement*. This is because the Board concluded that such disclosure by classification is needed in order for users to understand the financial position of an entity's financial instruments, given the different measurement bases in IAS 39.

Allowance account for credit losses

BC14 In paragraph 17 the Board proposes to require disclosure of a reconciliation of the allowance account. An allowance account is used by some entities instead of recognising a credit loss on a financial asset directly against that financial asset. The Board was informed that analysts and other users find this information useful in assessing the adequacy of the allowance for impairment losses for such entities and when comparing one entity with another. The Board also noted that information about the allowance account is at present required by IAS 30.

Income statement disclosures

Income, expenses, gains and losses

BC15 In paragraph 21(a) the Board proposes to add a requirement to disclose income statement gains and losses by the measurement classifications in IAS 39 (which complement the balance sheet disclosure requirement described in paragraph BC13). The Board concluded that the disclosure is needed for users to understand the financial performance of an entity's financial instruments, given the different measurement bases in IAS 39.

BC16 In conjunction with this requirement, the Board decided that an entity should disclose how the income statement amounts are determined. For example, an entity should disclose whether net gains and losses on financial assets and financial liabilities held for trading include interest and dividend income. The Board noted that in practice 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 Board decided

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that requiring information of this type would assist users of financial statements in comparing income arising from financial instruments across different entities.

Fee income and expense

BC17 In paragraph 21(d), the Board has added to the requirement to disclose items of income, expenses, gains and losses a proposed requirement to disclose fee income and expense (other than amounts included in determining the effective interest rate) arising from financial assets and financial liabilities and from trust and other fiduciary activities that result in the entity holding or placing assets on behalf of individuals, trusts, retirement benefit plans and other institutions. The Board decided that this information indicates the level of such activities and helps users to estimate possible future income of the entity.

Accounting policies

BC18 The Board noted that the accounting policies disclosure at present in paragraph 66 of IAS 32 requires the disclosure of policies that were subsequently specified in IAS 39. This paragraph would be retained as paragraph 23 in the IFRS, but the examples of accounting policy disclosures required have been updated to reflect the policy choices permitted in the improved IAS 39.

DISCLOSURES ABOUT THE NATURE AND EXTENT OF RISK ARISING FROM FINANCIAL INSTRUMENTS

BC19 The Board was informed that users of financial statements value information about the risks arising from financial instruments, such as credit risk, liquidity risk and market risk, to which entities are exposed and the techniques used to identify, measure, monitor and control those risks. Therefore, the Board decided to require disclosure of this information. The Board also decided that, in requiring disclosure of this information, it should balance two objectives:

(a) consistent requirements should apply to all entities so that users receive comparable information about the risks they incur.

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(b) the disclosures provided should depend on the extent of the entity's use of financial instruments and the extent to which it assumes associated risks. Entities with many financial instruments and related risks should provide a greater amount of disclosure to communicate those risks to users of financial statements. Conversely, entities with few financial instruments and related risks should provide less extensive disclosure.

BC20 The Board decided to balance these two objectives by developing a concise IFRS that sets out high level requirements applicable to all entities, supported by guidance on implementing the IFRS. The high level requirements balance qualitative disclosures based on how management views and manages its risks and minimum quantitative disclosures. The guidance on implementing the IFRS would illustrate how an entity might apply the IFRS; its relevance depends on the extent of the entity's use of financial instruments and its resulting exposure to risk. This guidance is consistent with the disclosure proposals for banks developed by the Basel Committee (known as Pillar 3), so that banks can prepare, and users receive, a single co-ordinated set of disclosures about financial risk. However, the overall volume of disclosures has been reduced compared with those in IAS 30 and IAS 32.

Qualitative disclosures

BC21 Paragraph 34 requires qualitative disclosure of the entity's exposure to risks, how the exposure arose, the entity's objectives, policies and processes for managing the risk and the methods used to measure it. The Board believes that the way in which and the extent to which entities manage their financial risk exposures conveys useful information. However, the way in which entities manage risks also varies between entities and, accordingly, the extent of qualitative disclosures depends on the circumstances of the entity and requires the exercise of judgement.

Quantitative disclosures

Information based on how the entity manages risk

BC22 The Board concluded that disclosures about an entity's exposure to risks arising from financial instruments should be required, and should be based on how the entity views and manages its risks, ie using the

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information provided to the entity's key management personnel (for example, its board of directors or chief executive officer). The Board noted that this approach:

(a) provides a useful insight into how the entity views and manages risk;

(b) results in information that has more predictive value than information based on assumptions and methods that management does not use, for instance, in considering the entity's ability to react to adverse situations;

(c) is more effective in adapting to changes in risk measurement and management techniques and developments in the external environment;

(d) has practical advantages for preparers of financial statements, because it allows them to use the data they use in managing risk; and

(e) is consistent with the approach used in IAS 14 *Segment Reporting*.

Information on averages and concentrations of risk

BC23 The Board considered whether it should require quantitative information about average risk exposures during the period. It noted that information about averages is more informative, in particular if the risk exposure at the reporting date is not typical of the exposure during the period. However, information about averages is also more onerous to prepare. On balance, the Board decided to require disclosure of the exposures at the reporting date in all cases and to require additional information (eg the highest, lowest and average amount of risk the entity was exposed to during the period) only if the information provided at the reporting date is unrepresentative of the entity's exposure to risk during the period.

BC24 The Board also decided to require disclosure of concentrations of risk as at the reporting date. This is because such information helps a user to assess the effect on the entity of an adverse change in a particular risk factor.

Minimum disclosures

BC25 The Board noted that because entities view and manage risk in different ways, the disclosures based on how the entity manages risk are unlikely to be comparable between entities. In addition, for entities that have little

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or no management of risks arising from financial instruments, the disclosures would convey little or no information about the risks the entity has assumed. To overcome these limitations, the Board decided to specify minimum disclosures about risk exposures. These disclosures would provide a common benchmark for financial statement users when they are comparing risk exposures across different entities and would be relatively easy for entities to prepare.

Credit risk

Maximum exposure to credit risk

BC26 Paragraph 39(a) requires disclosure of an entity's maximum exposure to credit risk at the reporting date, ie without taking account of any collateral pledged or other credit enhancements. Such information:

(a) provides users of financial statements with a consistent measure of an entity's exposure to credit risk; and

(b) takes into account the possibility that the maximum exposure to loss may differ from the amount recognised in the balance sheet.

Collateral pledged as security and other credit enhancements

BC27 Paragraphs 39(b) and 40(c) require that, unless impracticable, the entity should disclose the fair value of collateral pledged as security and other credit enhancements. The Board decided to require this disclosure because it provides information about the loss the entity expects to incur in the event of default.

BC28 The Board noted arguments that quantitative data are onerous to prepare and that qualitative information about collateral pledged would be sufficient information for users about the loss that entities might incur in the future. The Board acknowledged that the fair value of collateral is not always readily available (for example, when mortgage loans are collateralised by residential property that is not appraised every year or when corporate loans are secured by a floating charge over all of the assets of a borrower). Therefore, the Board concluded that disclosure of the fair value of collateral pledged should not be required when impracticable.

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Credit quality of assets that are neither past due nor impaired

BC29 The Board noted that information about credit quality gives a greater insight into the credit risk of assets and helps users assess whether such assets are more or less likely to become impaired in the future. The Board decided not to specify a particular method for giving this information, but rather to allow each entity to devise a method that is appropriate to its circumstances and the assets it has because this information will vary between entities.

Financial assets that are either past due or impaired

BC30 The Board decided to require separate disclosure of financial assets that are past due or impaired to provide users with information about financial assets with the greatest credit risk (paragraph 40).

BC31 The Board decided to require disclosure of an analysis of the age of financial assets that are past due as at the reporting date, but not impaired, to provide users with information about those financial assets that are more likely to become impaired and help users to estimate the level of future impairment losses (paragraph 40(a)).

BC32 The Board decided to require disclosure of an analysis of financial assets that are impaired as at the reporting date, including the factors the entity considered in determining that the financial assets are impaired (paragraph 40(b)). The Board concluded that an analysis of the age of financial assets that are impaired would not be useful information, because it does not help the user to understand why the impairment occurred. Rather, it concluded that this information would be better conveyed by requiring an analysis by other factors (eg nature of the counterparty, or geographical analysis of impaired assets). The Board also concluded that disclosure of the factors the entity considered in determining that financial assets are impaired is useful because estimating whether an asset is impaired involves judgement. Hence, this disclosure helps a user to compare one entity with another.

Collateral and other credit enhancements obtained

BC33 Paragraph 41 requires the entity to disclose the nature and fair value of assets obtained as collateral and other credit enhancements and its policy for disposing of such assets. The Board concluded that this information is useful because it provides information about the frequency of such activities and the entity's ability to obtain and dispose of the collateral obtained.

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Liquidity risk

BC34 The Board decided to require disclosure of a maturity analysis for financial liabilities that shows the remaining earliest contractual maturities (paragraph 42). The Board concluded that liquidity risk, ie the risk that the entity will encounter difficulty in meeting commitments associated with financial liabilities, arises because of the possibility (which may often be remote) that the entity could be required to pay its liabilities on their earliest contractual maturity date. Therefore, this disclosure shows a worst case scenario.

BC35 However, the Board also noted concerns that such a contractual maturity analysis does not reveal the expected maturity of liabilities that, for some entities, eg banks with many demand deposits, may be different. As such, it does not reveal the risk expected in normal circumstances or how the entity manages liquidity risk. Therefore, the Board decided to require a description of how the liquidity risk portrayed by contractual maturity analysis is managed. This description would include disclosure of factors such as the expected maturity dates of liabilities and how assets held by the entity mitigate liquidity risk.

Market risk—sensitivity analysis

BC36 The Board decided to require disclosure of a sensitivity analysis for each type of market risk (paragraph 43) because:

(a) users have consistently requested disclosure of sensitivity analysis;

(b) a sensitivity analysis can be disclosed for all types of market risk and by all entities, and is relatively easy to understand and calculate; and

(c) as with all the minimum disclosures, it is a minimum requirement suitable for all entities—including non-financial entities—that have financial instruments. It is supported by disclosures of how the entity manages the risk. Thus, it is a simpler and more suitable disclosure than other approaches, including the disclosures of terms and conditions and the gap analysis of interest rate risk currently required by IAS 32.

BC37 The Board acknowledged that a simple sensitivity analysis that shows a change in one variable has limitations. For example, the analysis may not reveal non-linearities in sensitivities or disclose the effects of interdependencies between variables. The Board decided to meet the first concern by requiring additional disclosure when the sensitivity

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analysis is unrepresentative of a risk inherent in a financial instrument. On the second concern, the Board noted that it could require a more complex sensitivity analysis that takes into account the interdependencies between risks. However, such an analysis, although more informative, is also more complex and costly to prepare. Accordingly, the Board decided not to require such an analysis, but to permit its disclosure when it is used by management to manage risk.

BC38 Additionally, the Board noted that information provided by a simple sensitivity analysis would not be comparable across entities. More comparable information would be obtained if the Board imposed specific requirements about the inputs, process and methodology of the analysis, for example disclosure of the effects of a parallel shift of the yield curve by 100 basis points. However, the Board decided against such a specific requirement because a reasonably possible change in a relevant risk variable (such as interest rates) in one economic environment may not be reasonably possible in another (such as an economy with high inflation). Therefore, the Board decided that it was preferable to require entities to disclose the effect of reasonably possible changes in the relevant risk variable, and leave entities to judge what those reasonably possible changes are.

BC39 The Board decided that the proposed sensitivity analysis provided more useful information than the following requirements currently in IAS 32 that are intended to satisfy the same user needs:

(a) disclosures of terms and conditions of financial instruments; and

(b) disclosures about exposure to interest rate risk including contractual repricing or maturity dates.

Accordingly, the Board decided to delete these requirements.

Disclosures of operational risk

BC40 The Board discussed whether it should require disclosure of information about operational risk. However, the Board noted that definition and measurement of operational risk is in its infancy. It also decided that such disclosures would be more appropriately disclosed outside the financial statements. Therefore, the Board decided to address the issue in its research project on management commentary.

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Location of disclosures of risks arising from financial instruments

BC41 The Board discussed the location of disclosures about risks arising from financial instruments. One possibility would be that the disclosures should not be part of the financial statements. Rather they should be part of the information provided by management outside the financial statements. However, the Board noted that there is no present requirement in IFRSs for material accompanying the financial statements, such as a management commentary, so the Board has no other mechanism for ensuring that the necessary information is provided. In addition, the Board decided that the financial statements would be incomplete and potentially misleading without disclosures about risks arising from financial instruments. Hence, it concluded that such disclosures should be part of the financial statements (either directly or by being included in accompanying material and cross-referenced from the financial statements). Also, IAS 32 previously required similar disclosures to be part of the financial statements.

Implementation guidance

BC42 The Board discussed the status of the proposed implementation guidance. The Board concluded that the guidance would be appropriate in its entirety only for an entity with many financial instruments (including many financial institutions). Accordingly, the Board concluded that it should not make the guidance mandatory for all entities because doing so would be excessive and burdensome for entities that do not have large holdings of financial instruments.

BC43 The Board also decided to add an introduction to its implementation guidance, to explain the objective and status of the guidance, and what entities would be expected to do to comply with the IFRS. In particular, the implementation guidance emphasises that it does not create additional requirements; rather it suggests possible ways to apply the proposed disclosures.

BC44 The Board considered whether it should prepare separate implementation guidance for entities with only a few financial instruments and little associated risk. It decided that this was not necessary because for such an entity, the IFRS on its own would provide sufficient guidance. The Board also noted that all entities could apply only the parts of the implementation guidance that are relevant to their circumstances.

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DISCLOSURES ABOUT CAPITAL

BC45 As part of this project, the Board considered whether it should require disclosures about capital. The Board noted that the Insurance Advisory Steering Committee had also proposed in its draft statement of principles that capital disclosure requirements should be introduced for insurers.

BC46 The Board concluded that information about capital should be disclosed. This is because 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 unexpected adverse events. It might also affect the entity's ability to pay dividends.

BC47 The Board considered whether only entities that are subject to external capital requirements (eg regulatory capital requirements established by legislation or other regulation) should be required to disclose information about capital or whether the information should be required for all entities. The Board believes that information about capital is useful for all entities, as is evidenced by the fact that some entities set internal capital requirements, and industry norms have been established for some industries. Therefore, the Board concluded that the information about capital should be disclosed by all entities.

BC48 The Board decided that disclosure about capital should be set in the context of a discussion of the entity's objectives, policies and processes for managing capital. This is because the Board believes that such a discussion both communicates important information about the entity's capital strategy and provides the context for other disclosures.

BC49 The Board considered whether it should require disclosure of any externally imposed capital requirements. Such a capital requirement could be:

(a) an industry-wide requirement that all entities in the industry must comply with; or

(b) an entity-specific requirement imposed on a particular entity by its prudential supervisor or other regulator.

BC50 The Board concluded that there was no need for disclosure of industry-wide requirements because information about the existence and level of such requirements is widely available outside the financial statements. It also noted that whereas some industries and countries have industry-wide capital requirements, others do not. Thus, using industry-wide requirements would not lead to comparability across different entities or across similar entities in different countries.

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BC51 As regards externally imposed entity-specific requirements, the Board noted that some view the disclosure of the existence and level of entity-specific capital requirements as important information for users, because it informs them about the risk assessment of the regulator. Such disclosure would improve transparency and market discipline.

BC52 However, the Board noted the following arguments against requiring disclosure of externally imposed entity-specific capital requirements:

(a) users of financial statements might rely primarily on the regulator's assessment of solvency risk without making their own risk assessment.

(b) the focus of a regulator's risk assessment is for those whose interests the regulations are intended to protect (eg depositors or policyholders). This emphasis is different from that of a shareholder. Thus, it could be misleading to suggest that the supervisor's risk assessment could, or should, be a substitute for independent analysis by investors.

(c) the disclosure of entity-specific capital requirements imposed by a regulator might undermine that regulator's ability to impose such requirements. For example, the information could cause depositors to withdraw funds. Hence, this might discourage regulators from imposing requirements. Furthermore, an entity's supervisory dialogue would become public, which might not be appropriate in all circumstances.

(d) because regulators have different tools available, for example formal requirements and moral suasion, a requirement to disclose entity-specific capital requirements could not be framed in a way that would lead to the provision of information that is comparable across entities.

(e) a requirement to disclose capital requirements (and, hence, supervisory judgements) could hamper clear communication to the entity of the regulator's assessment by creating incentives to use moral suasion and other informal mechanisms.

(f) disclosure requirements should not focus on entity-specific capital requirements in isolation, but should focus on how entity-specific capital requirements affect how an entity manages, and hence determines the adequacy of, its capital resources.

(g) a requirement to disclose entity-specific capital requirements imposed by a regulator is not part of the Basel Committee's Pillar 3 requirements.

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BC53 Taking into account all of the above arguments, the Board decided not to require disclosure of externally imposed capital requirements, but to require disclosures about whether the entity complied with any externally imposed capital requirements during the period and, if not, the consequences of non-compliance. This retains confidentiality between regulators and the entity, but alerts users to breaches of capital requirements and the consequences.

BC54 The Board also decided that the requirement to disclose information about breaches of capital requirements should apply equally to breaches of internally imposed requirements, because the information is also useful to a user of the financial statements.

WITHDRAWAL OF IAS 30

BC55 The Board noted that the IFRS would replace the disclosure requirements about risks arising from financial instruments in IAS 32 and IAS 30.

BC56 The Board concluded that the requirements in IAS 30 that do not relate to risk disclosures would either be superseded by the proposed requirements, are no longer relevant or are covered by other Standards. As an example the disclosures of categories of assets, liabilities, income and expenses would be superseded by the requirements of IAS 1 *Presentation of Financial Statements* and the IFRS. As another example, the requirements in IAS 30 about related party transactions are covered by IAS 24 *Related Party Disclosures.*

AMENDMENTS TO IFRS 4

BC57 The Board noted that the disclosure requirements in IFRS 4 were based on requirements in other Standards, particularly IAS 32, or were applications of those requirements. The IFRS would replace many of the requirements in IAS 32 on which the IFRS 4 disclosures were based, resulting in the need for consequential amendments to IFRS 4.

BC58 The Board noted that there were two approaches it could take to amending those disclosure requirements in IFRS 4 that had been based on IAS 32:

(a) it could make only the minimum essential changes to IFRS 4 (such as amending cross-references to IAS 32) and conduct a fuller review of the disclosures in IFRS 4 as part of phase II of the Insurance project; or

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(b) it could make the disclosure requirements of IFRS 4 fully consistent with those in the proposed IFRS.

BC59 The Board noted that IFRS 4 had been issued only a few months before the Exposure Draft and some might consider that it was too soon to make changes to it. The Board acknowledged that insurers that had begun to collect the information necessary to comply with the disclosure requirements in IFRS 4 might not welcome another change in a short period (particularly because further changes may occur in a few years as a result of phase II of the Insurance project).

BC60 However, the Board noted that:

(a) insurers will have both insurance contracts and financial instruments. In particular, some of the investment products issued by insurers are financial instruments, not insurance contracts under IFRSs. It is more useful for users and easier for preparers if the risk disclosures for insurance contracts and financial instruments are the same.

(b) making the disclosure requirements of IFRS 4 fully consistent with the IFRS would result in disclosures that are easier to prepare. In particular, the IFRS would remove the 'terms and conditions' disclosure in paragraph 39(b) of IFRS 4. Some commentators on ED 5 (the Exposure Draft that preceded IFRS 4) objected to this disclosure requirement, believing it to be onerous and not provide the most useful information. The Board decided to consider these objections in this project.

(c) the disclosures proposed in the IFRS were designed to be implemented as a package, and if implemented piecemeal would result in less useful information for users. For example, the proposed risk disclosures are intended to replace the 'terms and conditions' disclosure at present in paragraph 60(a) of IAS 32 and paragraph 39(b) of IFRS 4. Merely updating the reference in paragraph 39(d) of IFRS 4 would result in some, but not all, of the proposed risk disclosures being applicable to insurance contracts and the 'terms and conditions' disclosure being retained.

(d) it is likely that no further significant changes will be required to the risk disclosures as a result of phase II of the Insurance project (although changes are expected to the accounting-related disclosures). However, the guidance to support the disclosures in IFRS 4 may need refinement when phase II is completed, as discussed in paragraph BC207 of the Basis for Conclusions on IFRS 4.

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BC61 The Board concluded that the arguments in paragraph BC60 were persuasive. Therefore, the Board proposes to amend IFRS 4 to be fully consistent with the IFRS. However, the Board also acknowledged the concerns described in paragraph BC59 and therefore decided to ask for constituents' views on this matter.

EFFECTIVE DATE AND TRANSITION

BC62 The Board considered what the effective date of the IFRS and related amendments to IFRS 4 should be. The Board is committed to maintaining a 'stable platform' of unchanged Standards during the period to 2005 when many entities will adopt IFRSs for the first time. In addition, some preparers will need time to make the system changes necessary to comply with the IFRS.

BC63 However, the Board was informed that a number of entities that will be adopting IFRSs from 2005 would like to apply the disclosures proposed in ED 7 from when they first adopt IFRSs, on the grounds that:

(a) the proposals in the IFRS, in particular the proposed risk disclosures, would be more up-to-date than the present requirements in IAS 32 and IAS 30, more relevant to users of financial statements and easier to prepare.

(b) it would be unhelpful to both preparers and users for an entity to change from local GAAP to IAS 32 and IAS 30 and then change again only one or two years later to the proposed new risk disclosures.

BC64 Taking into account the points in paragraphs BC62 and BC63, the Board decided that the effective date of the IFRS and related amendments to IFRS 4 should be annual periods beginning on or after 1 January 2007, with earlier application encouraged.

BC65 As regards transition, the main issue that arises is whether an entity that chooses to apply the IFRS early should be required to provide comparative disclosure in the first year of adoption of IFRSs. The Board believes that entities that apply the requirements only when they become mandatory should be required to provide comparative disclosures because such entities will have enough time to prepare the information. The Board noted the following arguments for giving an exemption for entities that apply the IFRS early:

(a) The Board gave an exemption in IAS 32 to entities that adopt IFRSs for the first time before 1 January 2006. This exemption

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allows such entities not to provide comparative disclosures that comply with IAS 32 in the first year of adoption. Some may argue that entities that choose to apply the IFRS early should be given a similar exemption. Otherwise, such entities may choose to apply the older, less relevant, Standard in order to avoid having to provide disclosures for 2004.

(b) Some entities that would like to apply the proposed new risk disclosures early may not have all the information needed to provide comparative disclosures. For example, although the risk disclosures mainly focus on the position at the reporting date, they require additional information if that position is unrepresentative. This requires the entity to have some information throughout the period. If the entity applies the IFRS early, the comparative period may include time before ED 7 was published.

(c) Some entities that would like to apply the proposed new risk disclosures early may be discouraged from doing so if they have to provide comparative disclosures. For example, a group that in 2004 did not manage risk consistently across the group, but moved to consistent methods in 2005, may choose not to apply the proposed requirements early if doing so would require it to disclose the variety of methods used in 2004.

BC66 The Board also noted the following arguments for requiring all entities to provide comparative disclosures in the first year of application:

(a) the proposed disclosures will be more useful if they are accompanied by comparatives.

(b) most of the proposed requirements are relatively easy to comply with because:

   (i) many of them are based on information used internally to manage risk;

   (ii) the proposed minimum risk disclosures are based on the position at the reporting date unless that position is unrepresentative; and

   (iii) the proposed minimum risk disclosures are fairly minimal and, hence, should not be onerous to prepare.

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BC67 On balance, the Board decided to propose that an entity that both (a) adopts IFRSs for the first time before 1 January 2006 and (b) applies the IFRS before that date should be exempt from the requirement to produce comparative information in the first year of application. The Board noted that such an exemption exists for IAS 32 and IFRS 4 and that this exemption would apply equally to the amendments proposed by ED 7.

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