Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

Sent electronically through the IASB Website (www.iasb.org)

15 December 2008

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

IASB Exposure Draft of Proposed amendments to IFRS 7 *Improving Disclosures about Financial Instruments*

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on the captioned Exposure Draft. Our responses to the questions raised in your Exposure Draft are set out in the Appendix for your consideration

We agree with the IASB's view that under the current global financial crisis, users of financial statements need supplementary information about an entity's exposure to liquidity risks and how it determines the fair value of financial instruments, especially those that are particularly complex.

We support the idea of requiring entities to disclose the fair value of financial instruments using a fair value hierarchy. However, we do not agree with the proposed disclosures based on a three-level fair value hierarchy as set out in the Exposure Draft, given that they are not consistent with the existing fair value hierarchy in IAS 39 *Financial Instruments: Recognition and Measurement*.

We understand that information about the reliability of the inputs to fair value measurements is useful to users of financial statements. In this regard, we suggest that disclosures should be required only for those assets and liabilities measured at fair value based on valuation techniques at the end of the reporting period.

We support the exposure draft to strengthen the relationship between the quantitative and qualitative disclosures about liquidity risk. We believe that the disclosure of information based on how an entity manages the liquidity risk can assist a user's assessment of the financial position and financial performance of an entity or of the amount, timing and uncertainty of its future cash flows.

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If you have any questions on our comments, please do not hesitate to contact me at ong@hkicpa.org.hk.

Yours faithfully,

Steve Ong

Steve Ong
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SO/WC/ac

Hong Kong Institute of CPAs

Comments on the IASB Discussion Paper on Proposed amendments to IFRS7 *Improving Disclosures about Financial Instruments*

<u>Fair value disclosures</u>

<u>Question 1</u>

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?

<u>Question 2</u>
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?

Our response covers both Question 1 and Question 2.

We support the idea of requiring entities to disclose the fair value of financial instruments using a fair value hierarchy.

However, we do not agree with the proposed disclosure based on a three-level fair value hierarchy as set out in paragraph 27A, as they are not consistent with the existing fair value hierarchy in IAS 39. As set out in paragraph BC103, the IASB decided not to adopt a three-tier fair value measurement hierarchy and decided to simplify the fair value measurement hierarchy by requiring the fair value of financial instruments for which there is not an active market to be determined on the basis of valuation techniques, including the use of recent market transactions between knowledgeable, willing parties in an arm's length transaction. Paragraph 48A of IAS 39 requires fair value to be determined as quoted prices in an active market or using a valuation technique if the market for a financial instrument is not active whereas the proposed hierarchy recognizes a level using a combination of quoted prices and valuation techniques (Level 2 - fair value is determined based on 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). We are of the view that this will confuse users and create practical problems for preparers to differentiate the classification required between Level 2 and Level 3 in the context of the extant IAS 39.

In addition, we believe that differences in the definition of "active market" in IFRSs and US GAAP will result in different classification within the fair value hierarchy. For example, since paragraph AG 73 of IAS 39 includes instruments valued using rates quoted in an active market, this will result in instruments being attributed to Level 1 under IFRS 7 which would be Level 2 under US GAAP.

We agree with the objective of the proposal that under the credit crisis, entities should explain more clearly to the market how they determine the fair value of financial instruments when markets are no longer active. Therefore, we suggest that disclosures should be required only for those assets and liabilities measured at fair value based on valuation techniques at the end of the reporting period.

Question 3

Do you agree with the proposals in:

(a) paragraph 27B to require expanded disclosures about the fair value measurements 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?

(a) – (b) As discussed in Questions 1 and 2, we understand that information about the reliability of the inputs to fair value measurements is useful to users of financial statements. In this regard, we would support the adoption of expanded disclosures only to those fair value measurements that at the end of the reporting period are based on valuation techniques.

In addition, we would like the IASB to provide more information in the Basis for Conclusions on what is the rationale behind each of the expanded disclosures in order to allow commentators to better assess the costs and benefits arising from each of the proposed disclosures. In particular we noted that the requirement in paragraph 27B(c) on the disclosure of unrealized gains or losses for the period for fair value measurements classified in Level 3 might bring little benefit to users but would be burdensome to certain preparers as based on our understanding, not all financial reporting systems are designed to separate the realized and unrealized gains or losses. It is expected that significant modification costs would be required on financial reporting systems if the amendment is to be adopted effectively.

Furthermore, there is no general definition of realized or unrealized concepts in IFRS and this may lead to inconsistent disclosures across entities.

Liquidity risk disclosures

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 generally agree with the proposal in paragraph 39(a), however, we consider that including a clarification on the application of the “unrecognized derivative financial liability” in paragraph B11C would be beneficial. It is not clear as to whether the intention of the Standard applies to sale, purchase and services contracts that are non-financial instruments but within the scope of IAS 39 or contracts between an acquirer and vendor in a business combination to buy or sell an acquiree at a future date. We understand these disclosures are intended for loan commitment and financial guarantee contracts and hence recommend these be specifically identified in the amended standard.

In addition, we suggest the IASB to provide further clarification on whether disclosures of a quantitative maturity analysis for derivative financial liabilities should be based on undiscounted or discounted cash flows. It is noted that the example in paragraph B11D(c) explicitly states that "the contractual amounts disclosed in the maturity analysis for non-derivative financial liabilities are the contractual undiscounted cash flows", however, the example in paragraph B11C(b) is not sufficiently clear as to whether the "expected net cash flows" is based on undiscounted or discounted cash flows.

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?

We agree with the proposal in paragraph 39(b) to require an entity to disclose the remaining expected maturities of non-derivative financial liabilities (in addition to their remaining contractual maturities) if the entity manages liquidity risk on the basis of expected maturities. We believe that such information is useful for users of financial statements if the remaining expected maturities of non-derivative financial liabilities are significantly different from their remaining contractual maturities.

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 agree with the amended definition of liquidity risk in Appendix A.

Effective date and transition

Question 7

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

Question 8

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

Our response covers both Question 7 and Question 8.

In view of the urgent need for improvements to financial instruments disclosures under current credit crisis, we recommend that the IASB consider an earlier effective date commencing from annual periods beginning on or after 1 January 2009 combined with the exemption from providing comparative information given the expected practical implementation difficulties that may be encountered by entities which currently adopt financial systems that do not support such information.