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IAS Plus Update.

IFRS 7 amended to improve disclosures about financial instruments

On 5 March 2009, the International Accounting Standards Board (IASB) issued *Improving Disclosures about Financial Instruments (Amendments to IFRS 7 Financial Instruments: Disclosures).* The amendments are in response to calls from constituents for enhanced disclosures about fair value measurements and liquidity risk in the wake of the recent financial crisis.

The revised disclosure requirements are applicable for annual periods beginning on or after 1 January 2009.

Fair value disclosures

The amendments expand the disclosures required in respect of fair value measurements recognised in the statement of financial position. For the purpose of these expanded disclosures, a three-level hierarchy has been introduced (see Table 1 overleaf), which is similar to the hierarchy set out in the US Accounting Standard SFAS 157 *Fair Value Measurements.* In its Basis for Conclusions, the IASB makes clear that this hierarchy has relevance only for disclosures, not measurement – there is no link between the fair value measurement hierarchy in IAS 39 *Financial Instruments: Recognition and Measurement* and the disclosures required by IFRS 7.

The expanded disclosure requirements are described in Table 2 overleaf. The following points should be noted.

- These disclosure requirements (included in a new paragraph IFRS 7.27B) apply only to financial instruments measured at fair value in the statement of financial position. For those instruments not measured at fair value, the requirements regarding disclosure of their fair values (under IFRS 7.25) remain unchanged.
- A financial instrument is always categorised as Level 1, 2 or 3 in its entirety. The appropriate level for an instrument is determined on the basis of the lowest level input that is 'significant' to the fair value measurement. For example, if the fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that instrument is classified as Level 3, notwithstanding that Level 1 and Level 2 inputs may also have been used. For this purpose, the assessment of 'significance' requires judgement, taking into account factors specific to the financial asset or financial liability.

All quantitative disclosures are required to be presented in tabular format unless another format is more appropriate. Examples illustrating these disclosures are set out in the Appendix to this newsletter.

Liquidity risk disclosures

Amendments have also been made to the liquidity risk disclosures required under IFRS 7.39.

Clarification of scope of liquidity risk disclosures

The amendments clarify the scope of items to be included in the maturity analyses required under IFRS 7 by changing the definition of liquidity risk to state that liquidity risk only includes financial liabilities **that are settled by delivering cash or another financial asset.** This results in the exclusion of financial liabilities that are settled by the entity delivering its own equity instruments or non-financial assets.

In addition, the amendments clarify that a hybrid contract (i.e. a contract that contains one or more embedded derivatives) that is a financial liability is not separated for the purpose of providing the maturity analysis and is treated as a non-derivative financial liability.

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Table 1. Hierarchy for fair value disclosures

Level 1.	**Fair value determination** Quoted prices (unadjusted) in active markets for identical assets or liabilities.
Level 2.	**Fair value determination** Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
Level 3.	**Fair value determination** Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Table 2. Expanded disclosure regarding fair value measurements

For fair value measurements recognised in the statement of financial position, an entity shall disclose the following for each class of financial instruments. [IFRS 7.27B]

1. The **level in the fair value hierarchy** into which the fair value measurements are categorised in their entirety, segregating fair value measurements in accordance with the levels of the fair value hierarchy set out in Table 1 above.

2. Any **significant transfers between Level 1 and Level 2** of the fair value hierarchy and the reasons for those transfers. Transfers into each level shall be disclosed and discussed separately from transfers out of each level. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities.

3. For fair value measurements in Level 3 of the fair value hierarchy, a **reconciliation** from the beginning balances to the ending balances, disclosing separately changes during the period attributable to the following:

   a. total gains or losses for the period recognised in profit or loss, and a description of where they are presented in the statement of comprehensive income or the separate income statement (if presented);

   b. total gains or losses recognised in other comprehensive income;

   c. purchases, sales, issues and settlements (each type of movement disclosed separately); and

   d. transfers into or out of Level 3 (e.g. transfers attributable to changes in the observability of market data) and the reasons for those transfers. For significant transfers, transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.

4. The amount of total gains or losses for the period in 3a above included in profit or loss that are attributable to gains or losses relating to those assets and liabilities held at the end of the reporting period and a description of where those gains or losses are presented in the statement of comprehensive income or the separate income statement (if presented).

5. For fair value measurements in Level 3, if changing one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly, the entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to a reasonably possible alternative assumption was calculated. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognised in other comprehensive income, total equity.

Expansion of maturity analysis

IFRS 7.39 has been amended so as to specify different liquidity risk disclosure requirements for derivative and non-derivative financial liabilities:

- for **non-derivative financial liabilities** (including issued financial guarantee contracts), the maturity analysis is required to show the remaining contractual maturities; and

- for **derivative financial liabilities,** the maturity analysis is required to include the remaining contractual maturities where these are essential for an understanding of the timing of cash flows. This would be the case for **all** loan commitments and in circumstances such as an interest rate swap in a cash flow hedge for a variable rate financial instrument.

The revisions to IFRS 7.39 do not specify how the maturity analysis for other derivative financial liabilities should be presented. Where contractual maturity information is not essential for an understanding of the timing of cash flows, consideration should be given to the information provided to key management personnel. One approach that may be acceptable is disclosure of cash flows based on expected maturity.

Enhancing the relationship between qualitative and quantitative disclosures

To enhance the relationship between the qualitative and quantitative disclosures for liquidity risk mandated by IFRS 7, the amendments require an entity to explain how the data disclosed are determined. In addition, unless already provided in the maturity analyses, entities are required to provide additional quantitative information for cash outflows included in those data that could either:

- occur significantly earlier than indicated in the data; or

- be for significantly different amounts from those indicated in the data.

Some of the other factors an entity might consider in providing the disclosures regarding how it manages liquidity risk inherent in its financial liabilities is moved from the (non-mandatory) Implementation Guidance to the (mandatory) Appendix B Application Guidance.

Effective date and transition

The amendments are effective for annual periods beginning on or after 1 January 2009. Therefore, for example, a calendar year-end entity is required to apply the amendments in its 2009 annual financial statements.

Some transitional relief is available. In the first year of application, entities are not required to provide comparative information for the new disclosures.

Appendix

Example of fair value disclosure by fair value hiearchy level (taken from the Implementation Guidance issued with the amendments)

Assets measured at fair value

	Fair value measurement at end of the reporting period using:			
Description	**31 Dec 20X2**	**Level 1 CU million**	**Level 2 CU million**	**Level 3 CU million**
Financial assets at fair value through profit or loss				
Trading securities	100	40	55	5
Trading derivatives	39	17	20	2
Available-for-sale financial assets				
Equity investments	75	30	40	5
Total	**214**	**87**	**115**	**12**

Note: Comparative information also has to be presented (unless the transitional provisions of the amendments apply) and a similar table might be presented for financial liabilities.

Disclosure example of reconciliation of Level 3 fair values (taken from the Implementation Guidance issued with the amendments)

Assets measured at fair value based on Level 3

	Fair value measurement at the end of the reporting period			
	Financial assets at fair value through profit or loss		Available-for-sale financial assets	Total
	Trading securities CU million	**Trading derivatives CU million**	**Equity investments CU million**	**CU million**
Opening balance	6	5	4	15
Total gains or losses				
in profit or loss	(2)	(2)	–	(4)
in other comprehensive income	–	–	(1)	(1)
Purchases	1	2	2	5
Issues	–	–	–	–
Settlements	–	(1)	–	(1)
Transfers out of Level 3	–	(2)	–	(2)
Closing balance	5	2	5	12
Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period	(1)	(1)	–	(2)

Gains or losses included in profit or loss for the period (above) are presented in trading income and in other income as follows:

	Trading income
Total gains or losses included in profit or loss for the period	(4)
Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period	(2)

Note: Comparative information also has to be presented (unless the transitional provisions of the amendments apply) and a similar table might be presented for financial liabilities.

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