

25 March 2009

Status: Final

Effective date:

Periods beginning on or
after 1 January 2009

Accounting impact:

Changes the disclosure requirements
in respect of the fair value of
financial instruments and liquidity risk



International Financial Reporting Bulletin

Improving Disclosures about Financial Instruments (Amendments to IFRS 7)

Background

The International Accounting Standard Board (IASB) has published Improving Disclosures about Financial Instruments (Amendments to IFRS 7), which amends the disclosure requirements in respect of the fair value of financial instruments and liquidity risk.

The Amendment introduces disclosures that are based on those required in US GAAP (SFAS 157) including the analysis of each class of financial instrument into a three-level hierarchy and more detailed disclosures for financial instruments measured using valuation techniques which rely heavily on unobservable data. It also changes the definition of liquidity risk to exclude financial liabilities settled in equity instruments or non-financial assets and requires a separate maturity analysis for derivative and non-derivative financial liabilities.

The Amendment is mandatory for accounting periods beginning on or after 1 January 2009, but no comparatives are required in the first year of application. Early adoption is permitted.

Requirements

Fair value disclosures

The Amendment requires an entity to classify financial instruments using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- (a) Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- (b) Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. prices from observable market transactions) or indirectly (i.e. derived using a valuation technique that uses only data from observable markets).
- (c) Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The level in the fair value hierarchy within which a financial instrument is categorised is determined on the basis of the lowest level input that is significant to the fair value measurement. For instance, if a fair value measurement of a

financial instrument uses observable inputs (Level 2) that require significant adjustment based on unobservable inputs (Level 3), that financial instrument would be classified in Level 3.

The Amendment requires disclosures for each **class** of financial instrument. Classes of financial instrument are determined by the reporting entity, and are distinct from the categories specified by IAS 39. An entity determines classes of financial instrument, taking into account the type of financial information disclosed and the nature of the financial instruments. At a minimum, this includes distinguishing between those instruments measured at amortised cost and those at fair value. The required disclosures are:

- (a) The level in the fair value hierarchy into which financial instruments are categorised.
- (b) Significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers with transfers into each level being disclosed and discussed separately from transfers out of each level.
- (c) For financial instruments in Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:
 - (i) Total gains or losses for the period recognised in profit or loss (including those relating to instruments disposed of during the period), and a description of where they are presented in the statement of comprehensive income or the separate income statement (if presented).
 - (ii) Total gains or losses recognised in other comprehensive income.
 - (iii) Purchases, sales, issues and settlements (with each type of movement being disclosed separately).
 - (iv) 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 are required to be disclosed and discussed separately from transfers out of Level 3.
- (d) The amount of total gains or losses for the period in (c)(i) 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).
- (e) 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, this fact should be stated and the effect of those changes disclosed. The disclosures should also include how the effect of a change to a reasonably possible alternative assumption was calculated.

The requirement to disclose the methods and assumptions applied in determining fair values of each class of financial assets or financial liabilities and the requirement to disclose the reasons for any change in the valuation methodology included in the original standard have been retained in the amended version.

Liquidity risk disclosures

The Amendment changes the definition of liquidity risk so that it is limited only to financial liabilities that are settled by delivering cash or another financial asset.

The Amendment continues to require a contractual maturity analysis for non-derivative financial liabilities. The method of preparing this analysis is unchanged in that it should be based on contractual, undiscounted cash flows that are analysed according to the earliest date that the counterparty can require settlement.

Unlike the original standard, a separate maturity analysis for derivative financial liabilities should only be based on the remaining contractual maturities for those derivative financial liabilities where contractual maturities are essential for an understanding of the timing of the cash flows. As an example, this could apply to an interest rate swap with a remaining maturity of five years which is used in an economic cash flow hedge of a variable rate financial asset or liability. In other cases, such as where the outflows of cash (or another financial asset) could either occur significantly earlier than when they are contractually due or for significantly different amounts (e.g. a derivative that allows the counterparty the option to require gross or net settlement), a maturity analysis based on expected maturities should be presented.

The Amendment also provides additional guidance on how to meet the requirement in the paragraph 39(c) to provide a description of how it manages the liquidity risk inherent in the maturity of financial liabilities. Included in this guidance is a requirement to disclose a maturity analysis of financial assets it holds for managing liquidity risk (e.g. financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities), if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk.

Effective date and transitional provisions

The Amendment is mandatory for annual periods beginning on or after 1 January 2009. In the first year of application, an entity need not provide comparative information for the disclosures required by the Amendment. Earlier application is permitted. If an entity applies the Amendment for an earlier period, it discloses that fact.



BDO International

BDO International is a world wide network of public accounting firms, called BDO Member Firms, serving international clients. Each BDO Member Firm is an independent legal entity in its own country. The network is coordinated by BDO Global Coordination B.V. incorporated in the Netherlands, with an office in Brussels, Belgium, where the International Executive Office is located.

The information in this bulletin is for general guidance only and is not a substitute for professional advice. The BDO Member Firms accept no responsibility for any actions taken or not taken on the basis of the information in this bulletin. © BDO Global Coordination B.V. 2009.

<http://www.bdointernational.com>