KPMG

IFRS Briefing Sheet

Publication of IFRS 7 *Financial Instruments: Disclosures*

September 2005, **Issue 34**

This Briefing Sheet discusses the International Accounting Standards Board's (IASB's) publication of IFRS 7 *Financial Instruments: Disclosures*, which was issued on 18 August 2005. The standard requires disclosure of the significance of financial instruments for an entity's position and performance, and qualitative and quantitative information on risks arising from financial instruments. IFRS 7 applies to all entities, including those that have only few financial instruments.

A supplement to KPMG's publication IFRS in Brief

Background

IFRS 7 is the product of a review of financial instrument and risk management disclosure requirements in several standards. The IASB's objective in issuing IFRS 7 is to reconsider disclosures related to financial instruments in light of new risk management concepts and approaches that have evolved in recent years and new techniques used by entities for measuring and managing exposures to risks arising from financial instruments.

IFRS 7 includes all disclosure requirements related to financial instruments and supersedes IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* and the disclosure requirements in IAS 32 *Financial Instruments: Disclosure and Presentation*. The presentation requirements in IAS 32 remain unchanged.

Objective

The objective of IFRS 7 is to require entities to provide disclosures that enable users to evaluate:

- the significance of financial instruments for the entity's financial position and performance
- the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages them.

Scope

IFRS 7 is not an industry-specific standard and applies to all entities, including entities outside the financial services sector that may have only few financial instruments. For example, it applies to manufacturers whose only financial instruments might be receivables and payables. However, the extent of disclosures required by the standard depends on how extensively the entity uses financial instruments and its exposure to resulting risks.

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The standard applies to all risks arising from all financial instruments except those that are covered specifically by another standard, such as interests in subsidiaries, associates and joint ventures, acquirer's interest in contracts for contingent consideration in a business combination, employers' rights and obligations arising from employee benefit plans, share-based payments and insurance contracts.

IFRS 7 applies to both recognised and unrecognised financial instruments within its scope, even when the financial instruments are outside the scope of IAS 39 *Financial Instruments: Recognition and Measurement* (e.g., some loan commitments).

Disclosure Requirements

IFRS 7 requires entities to disclose:

- the significance of financial instruments for an entity's financial position and performance
- qualitative and quantitative information about the nature and extent of risks arising from financial instruments.

Significance of Financial Instruments

Balance Sheet Disclosures

IFRS 7 includes disclosure requirements currently in IAS 32 regarding reclassification of financial assets, derecognition, collateral, compound financial instruments, instruments with multiple embedded derivatives, and defaults and breaches. In addition IFRS 7 requires disclosure of:

- the carrying amount for each category of financial assets and liabilities; IAS 32 required such disclosure only for financial assets designated as at fair value through profit or loss
- the impact of credit risk on financial liabilities designated as at fair value through profit or loss, including the changes in fair value over the period arising from credit risk and the methods used for determining these amounts
- additional information on loans and receivables designated as at fair value through profit or loss, including the maximum exposure to credit risk, any economic hedge provided by a credit derivative on the resulting exposure, changes in fair value over the period arising from credit risk and the methods used for determining these amounts, as well as changes in fair values of any related credit derivatives since the loan or receivable was designated as at fair value through profit or loss.

Income Statement and Equity Disclosures

Disclosure requirements relating to the income statement and changes in equity include requirements related to interest income and expense, interest income on impaired assets and impairment losses on different classes of financial assets that previously were in IAS 32. In addition IFRS 7 requires disclosure of:

- net gains and losses on held-to-maturity investments, loans and receivables, available-for-sale financial assets, financial liabilities subsequently measured at amortised cost, financial instruments held for trading, and financial instruments designated as at fair value through profit or loss. The net gain or loss for each category of assets must be disclosed separately.
- the fee income or expense, except for amounts included in the calculation of the effective interest rate.

Disclosures on Accounting Policies, Hedge Accounting and Fair Value

Requirements for disclosures of accounting policies include requirements related to hedge accounting and fair value that previously were included in IAS 32. In addition IFRS 7 requires disclosure of:

- the ineffective portion of cash flow and net investment hedges recognised in profit or loss
- the profit or loss adjustment of the hedged item and the change in fair value of the hedging instrument in a fair value hedge
- the unamortised portion of 'day 1' profit or loss at the balance sheet date, with a reconciliation to the previous period
- how 'day 1' profit or loss is amortised.

See *IFRS Briefing Sheet* – issue 15, Publication of Amendments to IAS 39 *Financial Instruments: Recognition and Measurement* – Transition and Initial Recognition of Financial Assets and Financial Liabilities, January 2005, for a discussion of 'day 1' profit recognition.

IFRS 7 does not require disclosure of fair value in some situations in which it was required by IAS 32. In particular, under IFRS 7 the disclosure of fair value is **not** required for:

- financial instruments if their fair value reasonably approximates their carrying amount (e.g., short-term trade receivables)
- unquoted equity instruments or derivatives linked to such instruments and contracts with a discretionary participation feature that are measured at cost because their fair value cannot be measured reliably.

However, for such instruments an entity is required to disclose information that could help users make their own judgement on the extent of possible differences between the carrying amount of such instruments and their fair value.

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Disclosures on the Nature and Extent of Risks Arising from the Financial Instruments

Qualitative Disclosure Requirements

Disclosures related to the nature and extent of risks arising from financial instruments are required for each type of risk (e.g., credit risk, liquidity risk) and include:

- the exposures to risks and how they arise
- the entity's objectives, policies, processes and methods used for managing and measuring the risks.

Quantitative Disclosure Requirements

The level of detail of quantitative disclosures should be based on the information provided internally to key management of the entity (e.g., board of directors, CEO). Quantitative disclosures are required at a minimum in respect of credit risk, liquidity risk and market risk.

Required credit risk disclosures include:

- the reporting entity's maximum exposure without taking account of collateral or credit enhancements and a description of any collateral and credit enhancements
- the credit quality of financial assets that are neither past due nor impaired
- the carrying amount of financial assets with renegotiated terms that otherwise would be past due.

Required liquidity risk disclosures include a contractual maturity analysis for financial liabilities.

Required market risk disclosures include:

- a sensitivity analysis for each type of market risk (i.e., currency risk, interest rate risk and other price risk) showing how profit or loss and equity would have been affected by changes in the relevant risk variables, and methods and assumptions used in preparing such sensitivity analyses
- for entities that prepare sensitivity analyses reflecting interdependencies between risk variables, such as value-at-risk, and use such sensitivity analyses to provide the disclosures required by IFRS 7, the standard requires the entity to provide an explanation of the method used in preparing the analysis, its objectives and limitations, and the main parameters and assumptions used.

If the quantitative disclosures do not result in providing the information representative of an entity's exposure to risk, then an entity has to provide further information that is representative.

Effective Date

IFRS 7 applies to annual periods beginning on or after 1 January 2007, with earlier application encouraged. If an entity applies IFRS 7 for annual periods beginning before 1 January 2006, then it need not present comparative information for the disclosures on the nature and extent of risks arising from financial instruments.

If you would like further information on any of the matters discussed in this issue of *IFRS Briefing Sheet*, please talk to your usual local KPMG contact or call any of KPMG firms' offices.

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