

IFRS Briefing Sheet

Improving Disclosures about Financial Instruments – Amendments to IFRS 7 Financial Instruments: Disclosures

March 2009, **Issue 126**

This IFRS Briefing Sheet summarises the International Accounting Standards Board's (IASB) *Improving Disclosures about Financial Instruments – Amendments to IFRS 7 Financial Instruments: Disclosures*, which was published on 5 March 2009.

Amendments require disclosures of financial instruments measured at fair value to be based on a three-level fair value hierarchy that reflects the significance of the inputs in such fair value measurements.

Amendments require additional qualitative and quantitative disclosures of liquidity risk.

Amendments are effective for annual periods beginning on or after 1 January 2009.

and auditors of financial statements on the effectiveness of disclosures required by IFRS 7. The IASB's response also follows recommendations of the Financial Stability Forum and reflects discussions by the IASB's Expert Advisory Panel on measuring and disclosing fair values of financial instruments when markets are no longer active.

The amendments focus on:

- enhancing disclosures about fair value measurements, particularly those that use the most subjective inputs
- improving disclosures about liquidity risk to address diversity in practice, including proposing quantitative disclosures for derivative financial liabilities based on how liquidity risk actually is managed.

Background and Executive Summary

The amendments to IFRS 7 *Financial Instruments: Disclosures* are a result of the current market conditions, which have increased the focus on the need for transparency regarding entities' financial instruments and the significance of those instruments to an entity's financial position, performance and cash flows. In response, the IASB has held various consultations with users, preparers

Summary of the Amendments **Fair Value Measurement Disclosures** **Fair Value Hierarchy**

The amendments require that fair value measurement disclosures use a three-level fair value hierarchy that reflects the significance of the inputs used in measuring fair values. The fair value hierarchy is made up of the following levels:

- Level 1 – fair values measured using quoted prices (unadjusted) in active markets for *identical* instruments

KPMG's update on International Financial Reporting Standards (IFRSs)

- Level 2 – fair values measured using directly or indirectly observable inputs, other than those included in Level 1
- Level 3 – fair values measured using inputs that are not based on observable market data.

The level in the fair value hierarchy within which the fair value measurement is categorised *in its entirety* is determined based on the lowest level input that is significant to such fair value measurements.

Judgement would be required in assessing which inputs are significant to the fair value measurement disclosures.

The fair value hierarchy is similar to the hierarchy in U.S. FASB Statement of Financial Accounting Standards No. 157 *Fair Value Measurements*.

Quantitative Disclosures

For fair value measurements recognised in the statement of financial position, the amendments require an entity to disclose, for each class of financial instruments, the level in the fair value hierarchy into which the fair value measurements are categorised in their entirety. The amendments require that these fair value measurement disclosures be disclosed in a tabular format unless another format is more appropriate.

Specific Level 3 Fair Value Measurement Disclosures

Specific disclosures are required when fair value measurements are categorised as Level 3 in the fair value hierarchy. For such fair value measurements, an entity discloses, for each class of financial instruments, a reconciliation disclosing separately the changes in the period attributable to:

- total gains or losses (realised and unrealised) recognised in profit or loss, and where they have been

presented in the statement of comprehensive income (or separate income statement)

- total gains and losses recognised in other comprehensive income
- purchases, sales, issues and settlements, each type of which has to be disclosed separately
- transfers into and / or out of the Level 3 category, e.g., transfers attributable to changes in the observability of market data and the reason for such transfers.

The amendments also require, for each class of financial instruments in the Level 3 category, disclosure of:

- the total amount of gains or losses for the period included in profit or loss relating to assets and liabilities held at the end of the reporting period
- where such amounts have been presented in the statement of comprehensive income (or separate income statement).

In addition, the amendments require, for each class of financial instruments, disclosure of the significant effect on the fair value measurements if one (or more) of the inputs used in the fair value measurements is changed to a reasonably possible alternative assumption. How the effect of such a change is calculated also is disclosed.

Other Disclosures

The amendments require that any significant transfers between Level 1 and Level 2 of the fair value hierarchy be disclosed separately, distinguishing between transfers into and out of each level. Furthermore, changes in valuation techniques from one period to another, including the reasons therefor, are required to be disclosed for each class of financial instruments, i.e., also for financial instruments that are not measured at fair value through profit or loss.

Liquidity Risk Disclosures

Scope of Liquidity Risk Disclosures

Under the amendments, the definition of liquidity risk has been amended and, accordingly, liquidity risk disclosures are required only for financial liabilities that will result in an outflow of cash or another financial asset.

Derivative Financial Liabilities

Under IFRS 7 published August 2005, an entity would disclose a quantitative maturity analysis for financial liabilities according to the remaining contractual maturities; however, some entities do not manage liquidity risk for derivative financial liabilities on the basis of remaining contractual maturities.

Accordingly, the amendments require that the maturity analysis include the remaining contractual maturities for derivative financial liabilities that are essential for an understanding of the timing of the cash flows.

In disclosing the maturity analysis, an embedded derivative shall not be separated from a hybrid (combined) financial instrument. For such an instrument, the disclosure requirements for non-derivative financial liabilities apply.

Non-derivative Financial Liabilities

For non-derivative financial liabilities, the quantitative maturity analysis disclosure based on remaining contractual maturities is not changed by the amendments. However, for issued guarantee contracts, the amendments require that the maximum amount of the guarantee be disclosed in the earliest period in which such a guarantee could be called.

How Liquidity Risk is Managed

Under the amendments, additional disclosure is required for the summary quantitative data about exposure to liquidity risk. If the estimated cash flows included in the maturity analysis could occur either significantly earlier than indicated in the maturity analyses,

or at significantly different amounts, then the entity discloses this fact and provides further quantitative information to enable users to evaluate the extent of this risk.

In addition, an entity discloses, if appropriate, a maturity analysis for financial assets it holds as part of managing liquidity risk, such as financial assets that are expected to generate cash inflows to meet cash outflows on financial liabilities.

Effective Date and Transition

The effective date is for annual periods beginning on or after 1 January 2009; earlier application would be permitted. This effective date is earlier than the effective date of 1 July 2009 that was proposed in the exposure draft in response to the urgent needs for enhanced disclosures about financial instruments in current market conditions. In the first year of application, comparative disclosures are not required.

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.

KPMG International Financial Reporting Group is part of KPMG IFRG Limited.

KPMG International is a Swiss cooperative. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2009 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

Publication name: *IFRS Briefing Sheet*

Publication number: Issue 126

Publication date: March 2009