Deloitte.

October 2005 – Special Edition

Assurance & Advisory

IAS Plus.

Published for our clients and staff throughout the world

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New Standard on Disclosures for Financial Instruments

On 18 August 2005, the International Accounting Standards Board (IASB) issued IFRS 7 **Financial Instruments: Disclosures**. The Standard:

- adds new disclosures about financial instruments to those currently required by IAS 32 **Financial Instruments: Disclosure and Presentation**;
- replaces the disclosure requirements currently imposed on financial institutions by IAS 30 **Disclosures in the Financial Statements of Banks and Similar Financial Institutions**; and
- puts all of those financial instruments disclosures together in a new combined Standard. The remaining parts of IAS 32, which will be renamed **Financial Instruments: Presentation**, deal only with presentation matters, including classifying instruments as debt or equity, compound financial instruments, offsetting, and treasury shares.

This project had started out to develop a Standard on presentation and disclosure in the financial statements of financial institutions and similar entities, with a view to replacing IAS 30. However, in late 2002, the IASB made a fundamental change in the direction of this project. The final Standard applies to all entities.

IFRS 7 is effective for annual periods beginning on or after 1 January 2007, with earlier application encouraged. Early adopters are given some relief with respect to comparative prior period disclosures. Both IAS 30 and the disclosure requirements of IAS 32 are withdrawn.

Overview

IFRS 7 deals with the disclosure requirements in relation to all risks arising from financial instruments (with limited exemptions), and applies to any entity that holds financial instruments. The level of disclosure required depends on the extent of the entity's use of financial instruments and its exposure to financial risk.

The Standard retains many of the disclosure requirements currently within IAS 32 and IAS 30. However, there have been some editorial changes to the existing requirements as well as some additional disclosure requirements added.

The overriding objective of the Standard is that preparers should provide disclosures that enhance a user's understanding of the entity's exposures to financial risks and how the entity manages those risks.

To this end, the Standard requires an entity to disclose:

- information on the significance of financial instruments to the entity's financial position and performance;
- the nature and extent of risk exposures arising from financial instruments (quantitative disclosures); and
- the approach taken in managing those risks (qualitative disclosures).

An appendix of mandatory application guidance is part of the Standard. There is also an appendix of non-mandatory implementation guidance that describes how an entity might provide the disclosures required by IFRS 7.

Principal changes

The more significant changes from the disclosure requirements of IAS 32 and IAS 30 include:

- a new requirement to disclose the carrying amounts of financial assets and financial liabilities under each of the classifications in IAS 39 Financial Instruments: Recognition and Measurement (i.e. financial assets and financial liabilities designated as at fair value through profit or loss (FVTPL), held-to-maturity investments, loans and receivables, available-for-sale financial assets, and financial liabilities measured at amortised cost;
- new disclosure requirements regarding loans and receivables designated as at FVTPL;
- the requirement to disclose the fair value movement on financial liabilities designated as at FVTPL due to changes in credit risk has also been extended to include loans and receivables designated as at FVTPL. In addition, entities are required to disclose the method used to determine the amount of the change;
- new disclosure requirements where there is a difference between the fair value of a financial instrument at initial recognition and the amount that would be determined at that date using a valuation technique (known as "day one P&L"). IFRS 7 requires disclosure of the entity's accounting policy for recognising that difference in profit or loss, and the aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference;
- new disclosure requirements for financial assets that are either past due or impaired. IFRS 7 requires an analysis of the age of financial assets that are past due and, unless impracticable, an estimate of the fair value of collaterals held by the entity;
- where an entity records an impairment on a financial asset or a group of financial assets through an allowance account (e.g. for bad debts), as opposed to a direct reduction to the carrying amount of the financial asset, it shall disclose, for each class of financial asset, a reconciliation of changes in carrying amounts in that account during the period;
- separate disclosure of the amount of ineffectiveness recognised in profit or loss on cash flow hedges and hedges of net investments in foreign operations;
- separate disclosure of the gains or losses in fair value hedges arising from remeasuring the hedging instrument and on the hedged item attributable to the hedged risk;
- disclosure of the net gain or loss on 'held-to-maturity investments', 'loans and receivables' and 'financial liabilities measured at amortised cost'; and
- additional requirements on providing sensitivity analysis of market risks and how changes in these risks would have impacted profit or loss and equity in the period.

Effective date

IFRS 7 is effective for annual periods beginning on or after 1 January 2007. Earlier application is encouraged, but not required. If an entity applies IFRS 7 for a period beginning before 1 January 2007, that fact should be disclosed.

Exemption from presentation of certain comparative information for early adopters

To encourage early adoption of IFRS 7, entities that already apply IFRSs and that elect to adopt IFRS 7 for a period beginning before 1 January 2006 are exempted from presenting comparative information for the disclosures required by paragraphs 31 to 42 of the Standard about the nature and extent of risks arising from financial instruments. Note that:

- this exemption is not available to entities adopting IFRS 7 in advance of its effective date (1 January 2007) but on or after 1 January 2006. The Board concluded that such entities do not need such relief, since they have a full calendar year after publication of the Standard to accumulate the necessary information; and
- the exemption does not extend to the accounting disclosures (in paragraphs 7 to 30 of the Standard) that are based on requirements previously in IAS 32. Existing users of IFRSs should not encounter difficulties in providing comparative information for these disclosures.

First-time adopters

Entities that adopt IFRSs for the first time before 1 January 2006, and that elect to adopt IFRS 7 in their first IFRS financial statements, are not required to present comparative information for any of the disclosures required by IFRS 7 in those first financial statements. This exemption is intended to facilitate first-time adopters (e.g. with 31 December 2005 year ends) who wish to adopt IFRS 7 immediately, without having to adopt IAS 30 and IAS 32 for only one period.

Note that this relief is not available for entities adopting IFRSs for the first time in periods beginning on or after 1 January 2006 (but before 1 January 2007). Such entities can choose whether to apply IAS 30 and IAS 32, or IFRS 7, in their first financial statements but, if they elect to adopt IFRS 7, they are required to present comparative information.

Concurrent revisions to IAS 1

The IASB has also amended IAS 1, Presentation of Financial Statements to add requirements for disclosures of:

- the entity's objectives, policies and processes for managing capital;
- quantitative data about what the entity regards as capital;
- whether the entity has complied with any capital requirements; and
- if it has not complied, the consequences of such non-compliance.

These disclosure requirements apply to all entities, effective for annual periods beginning on or after 1 January 2007, with earlier application encouraged. Illustrative examples are added to IAS 1 as guidance.

Designed and produced by The Creative Studio at Deloitte, London.

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