

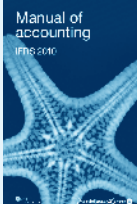
A practical guide to IFRS 7

For investment managers and
investment, private equity and real estate funds

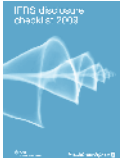
April 2010




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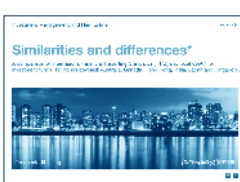
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Understanding financial instruments – A guide to IAS 32, IAS 39 and IFRS 7
Comprehensive guidance on all aspects of the requirements for financial instruments accounting. Detailed explanations illustrated through worked examples and extracts from company reports.

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Introduction

IFRS 7, 'Financial instruments: Disclosures', applies to financial and non-financial institutions and therefore also applies to investment funds, private equity funds, real estate funds and investment managers. The extent of disclosure required depends on the extent of the fund's use of financial instruments and its exposure to risk.

IFRS 7 is divided into two sections. The first section covers quantitative disclosures about the numbers in the balance sheet and the income statement. The second section deals with risk disclosures. This is what takes the disclosures to a new level. The risk disclosures arising from financial instruments under IFRS 7 are given 'through the eyes of management' and should reflect the way management perceives, measures and manages the fund's risks.

Seeing risk 'through the eyes of management' is a welcome opportunity to bring financial reporting more closely in line with the way funds are managed; it also allows management to disclose internal measures not previously recognised under IFRS. IFRS 7 enhances the fund's ability to demonstrate the strengths of its control environment, but it could also expose any flaws in the risk assumptions underlying key accounting judgements and estimates.

The amendment to IFRS 7, issued in October 2008, amended the standard to include disclosure requirements regarding the newly permitted reclassification of non-derivative financial assets (other than those designated at fair value through profit or loss). A further amendment issued in November 2008 clarified the effective date and transition date of the requirements. A third amendment to IFRS 7, issued in March 2009, addresses application issues and requires enhanced disclosures about fair value measurement and liquidity risk to provide useful information to users.

Entities should apply the amendments issued in 2008 on or after July 2008. The most recent amendment, issued in March 2009, applies for annual periods beginning on or after 1 January 2009; no comparatives are required in the first year of application.

This publication contains questions and answers on the application of IFRS 7 for investment managers and private equity, real estate and investment funds. The document is not intended to be prescriptive; it aims to provide guidance on how IFRS 7 could be applied under different scenarios.

This publication, which is based on the requirements of IFRS 7 applicable to financial periods beginning on or after 1 January 2009, is not a substitute for reading the standards and interpretations themselves or for professional judgement as to fairness of presentation. It does not cover all possible disclosures that IFRS 7 requires, nor does it take account of any specific legal framework. Further specific information may be required in order to ensure fair presentation under IFRS. We recommend that readers refer to our publication *IFRS disclosure checklist 2009*. Additional accounting disclosures may be required in order to comply with local laws, or stock exchange or other regulations.

1. Scope

The objective of IFRS 7 is to require entities to provide disclosures in their financial statements 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 during the period; and
- How the entity manages the risks.

[IFRS 7 para 1].

IFRS 7 applies to all entities and to all types of financial instrument – recognised and unrecognised [IFRS 7 paras 3 to 4].

1.1 Investment manager A, who manages several investment funds for third-party investors, is exposed to significant operational risk. Does IFRS 7 require disclosures about operational risk?

No. Operational risk disclosures are not within the scope of IFRS 7.

1.2 A real estate fund is exposed to significant market risk for the property held. Does IFRS 7 require disclosure of the market risk of real estate?

It depends. IFRS 7 applies to financial instruments. There is no requirement to disclose the risk inherent in the holding of real estate property. However, if the real estate fund is a fund of funds or is invested in real estate property indirectly through participation in real estate property companies, disclosures about the indirect property risk might be required for market risk of the instrument held.

1.3 An investment fund accrues for the performance fee to be paid. Are accruals for performance fees included in the scope of IFRS 7?

It depends. Accruals that represent a right to receive cash or an obligation to deliver cash are included in the scope of IFRS 7. When the performance period is completed and the right to receive cash by the investment manager is established, the performance fee payable is a financial liability in the scope of IAS 39, 'Financial instruments: Recognition and measurement', and should be included in the IFRS 7 disclosures.

However, at interim periods – when the performance period is not complete – the investment fund has a policy choice to account for the performance fee either in accordance with IAS 39 or IAS 37, 'Provisions, contingent liabilities and contingent assets'. The performance fee accrual is included in the IFRS 7 disclosures if the investment fund chooses to account for the performance fee payable in accordance with IAS 39; it is excluded from the IFRS 7 disclosures if the performance fee payable is accounted for as provision in accordance with IAS 37 [IAS 37 para 2 and IFRS 7 paras 3 to 4 in combination with IAS 39 para 2(j)].

1.4 Investment manager A pays an independent financial adviser trail commissions. Is the trail commission payable in the scope of IFRS 7?

Yes. Trail commission payables are financial liabilities of investment manager A; they should therefore be included in the IFRS 7 disclosure.

1.5 An investment fund issues one class of redeemable participating shares that are classified as equity instruments in the fund's stand-alone financial statements in accordance with IAS 32, 'Financial instruments: Presentation', para 16A and 16B. Are such redeemable participating shares in the scope of IFRS 7 (from the issuer's perspective)?

No. Instruments that are required to be classified as equity instruments in the issuer's financial statements are excluded from the scope of IFRS 7 [IFRS 7 para 3(f)]. This scope exception includes equity instruments that are required to be classified as equity in accordance with the amendment to IAS 32 (issued February 2008).

However, the investment fund should disclose a summary of quantitative data about the amount classified as equity and its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period [IAS 1 para 136A(a) and (b)]. In addition, it should disclose the expected cash outflow on redemption or repurchase of that class of financial instrument and information on how the expected cash outflow on redemption or repurchase was determined [IAS 1 paras 136A(c) and (d)].

1.6 An investment fund issues one class of redeemable participating shares that are classified as equity instruments in the fund's stand-alone financial statements in accordance with IAS 32 paras 16A and 16B and for which IFRS 7 disclosures are not required from the fund's perspective [IFRS 7 para 3(f)]. Does IFRS 7 apply to the non-controlling interest classified as a financial liability in accordance with IAS 32 para AG29A in the investment manager's consolidated financial statements (from the investor's perspective)?

Yes. The exception to classify the redeemable participating shares as equity is not extended to the classification of the non-controlling interests in consolidated financial statements [IFRS 7 para AG29A]. Such interests are financial liabilities for which disclosures in accordance with IFRS 7 are required.

1.7 During the commitment period, investors in a private equity fund commit themselves to invest in the fund. Are uncalled capital commitments, which are accounted for as off-balance sheet financial instruments, in the scope of IFRS 7?

Yes. IFRS 7 applies to both recognised financial instruments and unrecognised financial instruments [IFRS 7 para 4]. Uncalled capital commitments are accounted for in the same way as loan commitments. As loan commitments are specifically referred to as an example of unrecognised financial instruments for which disclosures are required by IFRS 7, the same principle applies to capital commitments in private equity funds.

1.8 A real estate investment fund enters into a forward purchase contract, which requires the fund to purchase a property in three months time. The forward purchase contract provides for an option either to transfer the rights and obligations of the property in three months time or to settle the contract net in cash. Does IFRS 7 apply to forward purchase contracts that can be settled net in cash?

Yes. IFRS 7 applies also to contracts to buy or sell a non-financial instrument if this contract is in the scope of IAS 39 [IFRS 7 para 5 with IAS 39 paras 5 to 7]. However, if the forward purchase contract is excluded from the scope of IAS 39, as it is only a contract that is held to receipt or delivery of a property without any option to settle the contract net in cash, no IFRS 7 disclosure is required.

1.9 A real estate investment fund receives lease payments under an operating lease agreement. The lease payments are paid in advance (end of December for January). Are operating leases within the scope of IFRS 7?

No, except for individual payments that are currently due and payable (for example, receivables from tenants). Other payments under operating leases are not regarded as financial instruments [IAS 32 para AG9]. Advances received from lessees are non-financial liabilities (obligation to lease out for another month) and are not in the scope of IFRS 7.

1.10 A real estate investment fund enters into a construction contract that requires advanced payments to the constructor. Are the amounts paid in advance in the scope of IFRS 7?

No. IFRS 7 applies only to financial instruments. Advances paid to a constructor are non-financial liabilities (obligation to perform work) and are not in the scope of IFRS 7.

2. Classes of financial instrument

IFRS 7 requires certain disclosures by class of financial instrument – for example, the reconciliation of an allowance account [IFRS 7 para 16] and the fair value of financial assets and financial liabilities [IFRS 7 paras 25 to 27B]. IFRS 7 does not provide a prescriptive list of classes of financial instrument. However, IFRS 7 states that a class should contain financial instruments of the same nature and characteristics and that the classes should be reconciled to the line items presented in the balance sheet [IFRS 7 para 6].

2.1 When IFRS 7 refers to ‘classes of financial instrument’, is this the same as disclosure by category as defined in IAS 39?

No. A ‘class’ of financial instruments is not the same as a ‘category’ of financial instruments. Categories are defined in IAS 39 as financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables, available-for-sale financial assets, financial liabilities at fair value through profit or loss and financial liabilities measured at amortised cost. Classes are determined at a lower level than the measurement categories in IAS 39 and are reconciled back to the balance sheet, as required by IFRS 7 para 6.

2.2 Can an investment fund disclose ‘investments in debt instruments’ as a single class, or should these be split further into separate classes?

In the case of an investment fund, the category ‘investments in debt instruments’ generally comprises more than one class of financial instrument unless the debt instruments have similar characteristics (that is, corporate bonds with similar credit ratings). In this case, ‘investments in debt instruments’ can be one class.

2.3 What considerations should an investment fund invested solely in debt instruments apply in identifying different classes of financial instrument, as a prescriptive list of classes is not provided?

An investment fund portfolio generally comprises more than one class of debt instrument. However, the level of detail for a class is determined on an entity-specific basis. This requires management to take into account the characteristics of the financial instrument as well as whether the classes are appropriate to disclose useful information [IFRS 7 paras 6 and 7]. This judgement would be based on the way in which the investments are reported to and evaluated by the fund’s key management personnel.

For example, in the case of an investment fund investing in debt instruments, it may be appropriate to disclose separate classes by:

- Type of debt instrument (for example, government bonds, corporate bonds, asset-backed securities);
- Credit rating of issuers (for example, AAA, AA, A, BBB);
- Payment of interest (for example, fixed rate debt, floating rate debt).

2.4 What considerations should a private equity fund apply in identifying different classes of financial instrument that are all classified as financial assets at fair value through profit or loss?

In the case of private equity investments, we would expect the category 'financial assets at fair value through profit or loss' to comprise more than one class. However, the level of detail for a class is determined on an entity-specific basis. This requires management to take into account the characteristics of the financial instruments as well as whether the classes are appropriate to disclose useful information [IFRS 7 paras 6 and 7]. This judgement would be based on the way in which the investments are reported to and evaluated by the fund's key management personnel. For example, it may be appropriate to disclose separate classes by:

- Type of financial instrument (for example, ordinary shares, preference shares, convertible loans, convertible preferred equity certificates, shareholder loans and payment-in-kind notes);
- Type of investment (for example, automotive, technology, healthcare);
- Management strategy (for example, buy out, venture capital, infrastructure, growth capital, quoted private equity).

2.5 Where IFRS 7 requires disclosures by class of financial instrument (for example, IFRS 7 paras 25, 27 and 37), the question arises whether different classes of redeemable participating shares issued by an investment fund can be grouped together even though they are legally different.

Investment fund X issues different classes of redeemable participating shares that do not meet the identical features criteria in IAS 32 para 16A(c). It therefore classifies the amounts attributable to unit holders as financial liabilities.

Should investment fund X split the amounts attributable to unit holders into separate classes in accordance with IFRS 7 para 6?

It depends. Such a disclosure is not required if all redeemable participating share classes have similar characteristics. IFRS 7 is less restrictive than the criteria in IAS 32. The aggregated share classes do not therefore need to have identical features in order to be deemed similar. However, if the rights and obligations associated with the share classes are significantly different. The amounts attributable to unit holders should be split into separate classes for IFRS 7 disclosures. The share classes might be significantly different if, for example, one share class is redeemable at any time without a notice period and another share class is only redeemed within a one-year notice period.

2.6 Are the identified classes applied consistently across all class-specific financial statement disclosures required by IFRS 7, or can management use different classes for each disclosure?

There is no requirement in IFRS 7 to use the same classes consistently across all class-specific disclosures. IFRS 7 para 6 states 'an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments'. For example, some disclosures of class-specific information for an investment fund investing in debt instruments may be more appropriately disclosed by type of debt instrument or, in other instances, by credit rating of the issuer. However, in all instances, sufficient information should be provided to permit reconciliation to line items presented in the balance sheet.

3. Fair value measurement disclosures

A. Disclosures by class of financial instrument

IFRS 7 para 25 requires the disclosure of the fair value of financial assets and financial liabilities by class in a way that permits it to be compared with its carrying amount for each class of financial asset and financial liability.

An entity should disclose for each class of financial instrument the methods and, when valuation techniques are used, the assumptions applied in determining fair values of each class of financial asset or financial liability. If a change in valuation technique has been made, the entity should disclose that change and the reasons for making it [IFRS 7 para 27].

3.1 Is the disclosure of the fair value required for all financial instruments, including those measured at amortised cost?

Yes. IFRS 7 para 25 requires the disclosure of the fair value irrespective of the fact that a financial instrument is measured at amortised cost in the statement of financial position. The disclosure is presented in a way that allows a comparison of the amounts disclosed and the carrying amounts. However, if the amounts disclosed in the statement of financial position are assumed to be the fair values (or approximately the fair values), the fund discloses that fact but is not required to disclose a separate table.

The following examples illustrate when the amounts disclosed in the statement of financial position approximately equal the fair values to be disclosed under IFRS 7 para 25:

- An investment fund designates all its investments at fair value through profit or loss: the amounts attributable to unit holders would be assumed to approximate the fair value.
- The carrying amount of trade receivables due within one year (for example, receivables from tenants) less impairment approximates the fair value of the amounts receivable.
- The fair value of the variable interest bank borrowings is estimated to be the discounted contractual future cash flows.

3.2 IFRS 7 para 25 requires the disclosure of the fair value of financial assets and financial liabilities by class. Uncalled capital commitments might not be in the scope of IAS 39 [IAS 39 para 4]. However, they are included in the scope of IFRS 7 [IFRS 7 para 4].

The investors of a private equity fund committed themselves to invest C150 million into the fund over the next 10 years. The fund already called C50 million over the past two years. The remaining uncalled capital commitments amount to C100 million at the balance sheet date.

Is a private equity fund required to disclose the total amount of outstanding uncalled capital commitments (C100 million) under that requirement?

No. IFRS 7 applies to both recognised and unrecognised capital commitments. However, the disclosure requirements in IFRS 7 para 25 only requires the disclosure of the fair value of such commitments, which should be assessed by applying an option price model. The fair value of such capital commitments in private equity funds is usually nil, as the new fund units are issued at fair value. However, disclosure of the total amount may not be required under IFRS 7 para 25 but is required under IAS 37. IAS 37 para 89 requires the disclosure of an estimate of the financial effects, measured using the principles set out for provisions in IAS 37 para 36 to 52.

3.3 IFRS 7 para 27 requires the disclosure of the valuation methods used to determine the fair values of the financial instruments. Is the disclosure of the valuation methods used only required for financial instruments measured at fair value in the statement of financial position?

No. IFRS 7 para 27 is applicable to all financial instruments for which fair values are disclosed. This is the case for all financial instruments carried at fair value in the statement of financial position, for financial instruments carried at amortised cost and for unrecognised financial instruments for which fair value disclosures are presented in the notes in accordance with IFRS 7 para 25.

The disclosure required in IFRS 7 para 27 should be given by class of financial instrument. It should include the disclosure of the assumptions applied relating to the information presented. Such assumptions include:

- Interest rates and discount rates.
- Credit risk and liquidity risk.
- Estimated credit losses.
- Earnings multiples.

B. Applying the fair value hierarchy

As part of the disclosure requirements for fair value measurements, an entity should classify fair value measurements using a 'fair value hierarchy' that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has three different levels (IFRS 7 para 27A):

- Quoted prices in active markets for identical assets or liabilities (Level 1);
- Inputs other than quoted prices included within Level 1 that are observable either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2);
- Inputs that are based on unobservable inputs (Level 3).

The categorisation of the fair value measurement into one of the three different levels should be determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. The significance of an input is assessed against the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, considering factors specific to the asset or liability [IFRS 7 para 27A].

3.4 What is the impact of the use of valuation models on the classification within the fair value hierarchy?

The use of a valuation technique (rather than simply taking a price from the market) precludes the use of Level 1. The level within the hierarchy is determined based on the valuation inputs, not on the methodology or complexity of the model. The use of a model does not automatically result in a Level 3 fair value measurement. For example, a standard valuation model used to compute a value by using all observable inputs is likely to result in a measurement that is classified as Level 2. However, to the extent that adjustments or interpolations are made to Level 2 inputs in an otherwise standard model, the measurement may fall into Level 3, depending on whether the adjusted inputs

are significant to the measurement. If a reporting entity uses a valuation model that is proprietary and relies on unobservable inputs, the resulting fair value measurement is categorised as Level 3.

3.5 Does the valuation technique (for example, multiples, discounted cash flows) selected by a private equity fund impact the classification of the fair value measurement within the fair value hierarchy?

No. The IFRS 7 fair value hierarchy prioritises the inputs to the valuation techniques, not the valuation techniques themselves. Selecting the appropriate valuation technique(s) should be based on an assessment of the facts and circumstances specific to the asset or liability being measured and should be independent of the classification of inputs used within the fair value hierarchy.

3.6 Does the IAS 39 category (at fair value through profit or loss, available for sale, held to maturity, loans and receivables) in which an investment is classified, impact the classification of the fair value measurement within the fair value hierarchy?

No. There is no direct link between the category an investment is classified in and the classification of the fair value measurement within the fair value hierarchy. However, some categories prohibit financial instruments classified in that group from being quoted in an active market (for example, loans and receivables), which indicates that for such investments Level 1 classification would not be appropriate.

3.7 How does the use of a pricing service or broker quotes impact the classification of an input in the fair value hierarchy?

Many reporting entities obtain information from pricing services – such as Bloomberg, Interactive Data Corporation, Loan Pricing Corporation, Markit’s Totem Service, broker pricing information and similar sources – for use as inputs in their fair value measurements. The information provided by these sources could be any level in the fair value hierarchy, depending on the source of the information for a particular security.

The following table summarises the classification of some common sources of pricing inputs.

Level 1 inputs	Level 2 inputs	Level 3 inputs
Level 1 is only used for items traded on an exchange or an active index/market location. For a price to qualify as Level 1, reporting entities should be able to obtain the price from multiple sources.	Level 2 values may include: <ul style="list-style-type: none"> • Posted or published clearing prices, if corroborated.¹ • Broker quotes corroborated with observable market data.¹ • A dealer quote for a non-liquid security, provided the dealer is standing ready and able to transact at that price. 	Examples of Level 3 values include: <ul style="list-style-type: none"> • Inputs obtained from broker quotes that are indicative (that is, not being transacted upon) or not corroborated with observable market data. • Models that incorporate management assumptions that cannot be corroborated with observable market data.

The above are examples of inputs that may be considered appropriate for the levels indicated. However, the facts and circumstances applicable to the measurement should always be assessed.

¹ In order to support an assertion that a broker quote or information obtained from a consensus pricing service represents a Level 2 input, the entity should typically perform due diligence to understand how the price was developed, including understanding the nature and observability of the inputs used to determine that price. Additional corroboration could include: discussions with pricing services, dealers or other entities to collect additional prices of identical or similar assets to corroborate the price; back-testing of prices to determine historical accuracy; comparisons to other external or internal valuation model outputs.

3.8 Is the management of an investment fund required to test the valuations provided by pricing services and brokers for reasonableness?

Yes. The management of an investment fund has the ultimate responsibility of asserting that its financial assets and liabilities are carried at an appropriate fair value and the use of either third-party pricing services or broker-dealers does not reduce that responsibility. Management cannot assume that the information provided by third parties represents fair value without having appropriate processes in place (price verification checks or other means) to check the reasonableness of methodologies and input assumptions used to develop the valuations provided.

This is particularly important in the context of determining the level in the fair value hierarchy in which the investment should be classified. Third-party prices might only be indicative prices and not firm quotations upon which the third party would actually trade². Management will need to understand the following features in order to have the considerable insight necessary to determine in which level a measure should be classified in accordance with IFRS 7 para 27B:

- The valuation technique or method used by the third party to price the financial instrument;
- The inputs used in the methodology;
- The adjustments made to observable data; and
- The availability of corroborative evidence that exists for that type of financial asset or liability.

However, the level of detail and extent of such an analysis depends upon facts and circumstances, such as type and complexity of a financial instrument, observability of the liquidity of that type of instrument in the market and generally known pricing methodologies for the instruments. The level of work necessary could include discussions with the pricing service/dealer to gain an understanding of how the securities are being priced and whether all significant inputs are observable through trading of similar or identical securities.

3.9 How should an investment fund assess the significance of an input in determining the classification of a fair value measurement within the fair value hierarchy?

There are no bright lines for determining the significance of an input to the fair value measurement in its entirety. Two different investment funds may reach different conclusions from the same facts.

In assessing the significance of unobservable inputs to an asset or liability's fair value, management should:

- Consider the sensitivity of the asset or liability's overall value to changes in the data; and
- Reassess the likelihood of variability in the data over the life of the asset or liability.

For example, if an interest rate swap with an 11-year life has an observable yield curve for 10 years, provided that the extrapolation of the yield curve to 11 years is not significant to the fair value measurement of the swap in its entirety, the fair value measurement is considered Level 2.

Given the level of judgement that may be involved, a reporting entity should document the rationale taken when determining the classification of inputs. In addition, a reporting entity should develop and consistently apply a policy for determining significance.

² Prices from pricing services or brokers might come with descriptive disclaimers stating that the prices are for financial reporting or operational purposes only and do not represent prices that they would be willing to buy or sell at.

3.10 An investment fund invests solely in financial instruments that are listed on a stock exchange but which are thinly traded. Can the fund still classify all financial instruments held in Level 1?

It depends. IFRS 7 para 27A states that Level 1 financial instruments have quoted prices in active markets. An active market is one in which transactions are taking place regularly on an arm's lengths basis. If transactions occur frequently enough to obtain reliable pricing information on an ongoing basis, the market is considered active.

The price quote may be a Level 2 or Level 3 input where:

- There are few transactions for the instrument;
- The price is not current;
- Price quotations vary substantially either over time or among market makers (for example, some brokered markets); or
- There is little publically available information.

3.11 An investment fund invests solely in financial instruments that are listed on stock exchanges. The investments are widespread and include holdings listed in Asia and Canada. The fund values its investments at closing of the New York Stock Exchange. However, due to the early closing of the Asian market, the fund does not value the Asian holdings with the last transaction price provided by the Hong Kong stock exchange but adjusts the prices by an expected market shift (sometimes referred to as indexation or ITG/IDC fair value pricing). The expected market shift is calculated on an instrument-by-instrument basis and takes into account the development of the later-closing stock exchanges. Based on past experience, there is a strong correlation between developments on the New York Stock Exchange and the Asian financial instruments. Can the investment fund disclose all its investments as Level 1?

No. IFRS 7 para 27A(a) requires Level 1 fair values to be quoted prices in an active market for identical assets. As the fund adjusts certain quoted prices to reflect expected market fluctuations after the closing of the stock exchange, the quoted prices are no longer unadjusted and therefore do not qualify as Level 1. In the above scenario, the fair value measurement of such investments is most likely considered Level 2, as it represents an adjustment for new information to quoted prices in active markets for identical assets or liabilities. The adjustment puts the fair value measurement at a lower level. Due to the relatively mechanical nature of the calculation and correlation factors that are based on market observable inputs, it is unlikely to be considered a Level 3 valuation as long as the calculation and the correlation factors are relevant and observable.

3.12 Is it appropriate to look at the investments of a fund when determining the level in the fair value hierarchy in which the fair value measure should be categorised?

No. The investor in shares of a fund should consider the nature of the fund shares itself and not look at the underlying investments held by the fund in determining the valuation level. This is because the unit of account is the investment in the fund and not the investment in the fund's underlying assets. If transactions are observable for the fund, they should be taken into account when determining the level of the fair value hierarchy. If no observable market input for the shares themselves is available, valuation techniques should be applied, and the level of inputs used to determine the fair value will determine the level of fair value hierarchy.

3.13 Investment bank A issues fund-linked notes that are linked to the performance of Fund X. The underlying Fund X is classified as a Level 1 investment. The fund-linked notes exactly mirror the fund investment. Can the investor invested in the fund-linked notes classify the notes as Level 1 with reference to the classification of the underlying fund?

No. Investment bank A should consider the nature of the fund-linked notes rather than the nature of the underlying fund. This is because the unit of account is the notes. If transactions are observable for the notes, they should be taken into account when determining the level of the fair value hierarchy. If the fund-linked note is quoted in an active market, Level 1 classification is appropriate.

However, if no observable market input for the shares themselves is available, valuation techniques should be applied, and the level of inputs used to determine the fair value will determine the level of fair value hierarchy. Among those inputs, A will consider the observability. One of the inputs used is the net asset value of the fund, but additional factors such as the credit risk of the issuer would be expected to be considered to determine the fair value of the fund-linked notes. Depending on the significance of the additional inputs and their observability, the fund-linked note may be classified in either Level 2 or Level 3.

3.14 Can an investor in an investment fund that issues securities that are listed on a stock exchange, but that is thinly traded, classify the participation in the fund in Level 1 of the fair value hierarchy?

It depends. IFRS 7 para 27A(a) states that Level 1 financial instruments have quoted prices in active markets. An active market is one in which transactions take place regularly on an arm's lengths basis. If transactions occur frequently enough to obtain reliable pricing information on an ongoing basis, the market is considered active.

The price quote may be a Level 2 or Level 3 input where:

- There are few transactions for the instrument;
- The price is not current;
- Price quotations vary substantially either over time or among market makers (for example, some brokered markets); or
- Little information is released publically.

Level 1: Investments in exchange-traded investment funds (ETF) are classified as Level 1 if transactions occur with sufficient frequency and volume to provide pricing information on an ongoing basis

Level 2: Investments in ETFs are classified as Level 2 if transactions occur less frequently and with a low trading volume.

Level 3: Investments in ETFs are classified as Level 3 if the ETF cannot be traded at the stock exchange (listed for marketing purposes only) and price quotations received from brokers and market-makers are indicative prices and not firm quotations upon which the broker respective market maker would actually trade.

3.15 Can an investor classify as Level 1 its participating shares in an open-ended investment fund that is redeemable at any time and for which a daily NAV is reported?

It depends. Level 1 inputs are unadjusted quoted prices in an active market for identical assets and liabilities that the entity can access at the measurement date. If subscriptions and/or redemptions at the fund's net asset value (NAV) take place with sufficient frequency and volume to provide observable pricing information on an ongoing basis, the fund's redeemable participating shares valued at the NAV should be classified in Level 1. However, with less frequent subscriptions and/or redemptions, the NAV may be considered a Level 2 input. As the unit of account is the redeemable participating shares and not the underlying assets of the investment fund, mutual fund shares for which the underlying investments are valued using Level 2 or Level 3 inputs might be considered a Level 1 valuation for the fund of fund's interest in such funds (and vice versa).

The following questions may be helpful in determining whether an active market exists:

- How frequently is the reported NAV available?
- Is the price based on recent subscriptions and/or redemptions?
- What volume of subscriptions and/or redemptions exists?
- Are there any indications that the investor would not be able to redeem the investments at NAV at the reporting date (that is, due to illiquidity of investments)?

Level 1: Open-ended funds that are redeemable at any time, that report a daily net asset value (NAV) and for which sufficient subscriptions and redemptions occur at NAV that support the assessment that an active market exists.

Example: retail mutual funds with (subscriptions and) redemptions on a daily basis, with sufficient volume at a daily reported redemption price (for example, NAV less redemption cost).

Level 2: Open-ended funds that are redeemable at the reportable NAV at the measurement date, for which none or no significant subscriptions and redemptions occur, if a transaction at NAV could have taken place at the balance sheet date.

Example: Open-ended funds held by a single investor (dedicated funds, special funds) for which NAV is calculated on a quarterly basis and on each date a subscription or redemption takes place.

Level 3: Open-ended funds that might be redeemable at a future date if the length of the time until the investment will become redeemable is considered significant and thus an adjustment would be made to NAV for credit and liquidity risk.

Example: Mutual funds for which the redemption has been suspended temporarily.

Open-ended funds for which significant unobservable adjustments to NAV are made when valuing the fund units.

Example: Mutual fund for which an adjustment has been made to NAV to reflect the developments at a stock market that occurred after the NAV has been calculated (indexation).

3.16 Investment fund X is an open-ended investment fund that is redeemable at any time and for which a daily net asset value (NAV) is reported. As the fund has significant investments in illiquid investments (for example, investment properties), redemptions may be suspended or postponed at the discretion of the management. In the case of a suspension, a discount for illiquidity might be applied to the NAV when the investment in the fund is valued. Can an investor classify the investment at Level 2?

It depends. If the investor entity is not comfortable with the initially reported NAV or the level of the holdback is significant, the valuation at NAV less illiquidity discount should be considered Level 3 rather than Level 2.

3.17 Can an investor classify as Level 2 its investments in a closed-ended investment fund that cannot be redeemed at any time but for which a secondary market exists?

It depends. Level 2 inputs are inputs that are observable either directly or indirectly – for example, closed-ended funds with recent transactions on a secondary market³ if the observed price used for valuation purposes is classified as Level 2. Closed-ended funds that cannot be redeemed or traded at the reporting date are classified as Level 3 if the valuation technique applied uses significant unobservable inputs.

Level 1: Closed-ended funds with a secondary market for which the trading volume supports the assessment that an active market exists (this is expected to be a very rare scenario).

Level 2: Closed-ended funds with recent transactions in a secondary market if the observable price is used to value the fund units.

Level 3: Closed-ended funds that cannot be redeemed by the reporting entity at all until maturity.

Example: Fixed-life private equity fund with no secondary market.

Closed-ended funds that are valued using a valuation technique (significant unobservable inputs) and/or for which no current NAV is reported.

Example: Private equity fund with only quarterly reportings.

Funds for which significant unobservable adjustments to NAV are made when valuing the fund units.

Example: Hedge funds for which significant adjustments for credit and liquidity risk are made.

³ Absent information to the contrary, there is a rebuttable presumption that such a transaction represents the fair value of the private equity fund at the transaction date. However, an investor should consider the timing of the transaction and whether the facts and circumstances related to the transaction are meaningful when measuring fair value at subsequent measurement dates.

3.18 An investor holds an investment in a closed-ended investment fund for which no secondary market exists and for which no current transaction is observable. The participation in the fund is therefore measured using a valuation technique. The fund is invested solely in investments traded in an active market for which quoted prices exist (Level 1 investments) with the exception of a small amount of cash at bank. Can the investor classify the investment as Level 2?

It depends. Level 2 classification requires inputs based on observable market data to be used when a valuation technique is used to value the investment in a fund. The calculation of the NAV based on the quoted prices in an active market could be interpreted as a valuation technique that is solely based on observable market data. However, the investor in the above scenario needs to carefully assess whether the NAV is a sufficient estimate of the fair value of the investment. The illiquidity of the investment is expected to be taken into account when valuing the fund units. Such an input to the valuation is likely to be significant; the fund would therefore be classified Level 3.

3.19 A private equity fund holds investments in unlisted private equity investments. The valuation of the investments is done by using multiples (that is, a multiple of earnings or revenue or similar performance measures) derived from observable market data. Can the fund classify the investments in Level 2 of the fair value hierarchy?

It depends. Many of the fair value measures for private equity transactions incorporate observable data and unobservable data known only to the investor. Consideration should be given to the impact of such unobservable data on the fair value measurement when classifying the level of inputs. Observable data is:

- Not proprietary.
- Readily available.
- Regularly distributed.
- From multiple, independent sources.
- Transparent.
- Verifiable.

Level 2 inputs are therefore data that is readily available for market participants and that requires no assumption to be made in order to be determined. The use of earnings multiples is likely to be a Level 3 input, as the multiples are derived from observable market data by applying assumptions on the comparability of the businesses, considering operational, market, financial and non-financial factors.

In addition, if the valuation includes a financial forecast (for example, cash flows of earnings) developed using the reporting entity's own data, the fund classifies the investments in Level 3 of the fair value hierarchy.

3.20 Hedge funds may allocate a percentage of capital to side-pocket investments (also referred to as side-pocket shares). These investments may not be redeemable until the investment has been realised or written off. How should an investor in a hedge fund categorise the side-pocket shares when applying the IFRS 7 fair value hierarchy?

If the interest in the side pocket can be distinguished from the other interest in the fund (for example, a separate class of shares), the investor should consider the attributes and characteristics of the side-pocket interest separately from those of the fund interest in determining the proper valuation and the level within the valuation hierarchy for that interest. As such investments are illiquid in nature – with no active market – it is likely that the side-pocket interest will be valued using significant unobservable inputs.

If the side pocket interests cannot be separated from the other interest in the fund (for example, the investor entity has one aggregated capital interest in the hedge fund), the investor should consider the significance of the unobservable value of the side pocket on the total investment in the hedge fund in determining the classification of the interest in the hedge fund within the hierarchy. If the side-pocket exposure was deemed to be significant to the interest as a whole, and that side-pocket investment was derived using unobservable inputs, the entire investment in the hedge fund partnership is a Level 3 valuation.

3.21 IAS 39 para 46(c) allows investments in equity instruments that do not have a quoted price in an active market and whose fair value cannot be reliably measured to be measured at cost. Investor A invests in a private equity fund for which there is no reliable fair value available. It therefore accounts for its investment at cost. However, when the investment is considered to be impaired, it is written down to the present value of the future cash flows discounted at the current market rate for a similar investment [IAS 39 para 66]. Are such investments subject to IFRS 7 fair value disclosures and if so, in what level of the hierarchy should the investments be classified?

Investments recorded at cost in accordance with IAS 39 para 46(c) are not subject to fair value measurement and are therefore not subject to the IFRS 7 disclosure requirements.

However, in the event of an impairment and a write-down of the investment to its present value of the future cash flows, as required in IAS 39 para 66, the investor should disclose the method used and the assumptions applied in determining the present value as best estimate of fair value in accordance with IFRS 7 para 27. Such valuations should be classified as Level 3.

C. Level 3 disclosure requirements

For fair value measurements in Level 3 of the fair value hierarchy, a reconciliation from the opening balance to the closing balance should be disclosed [IFRS 7 para 27B(c)]. In addition, IFRS 7 para 27B(d) requires disclosure of the total gains and losses for the period included in profit or loss that are attributable to those assets and liabilities held at the end of the reporting period.

If changing one or more of the inputs to reasonably possible alternative assumptions would change the fair value significantly, management states that fact and discloses the effect of those changes. Management also discloses how the effect of a change to a reasonably possible alternative assumption has been calculated.

3.22 Are specific disclosures required for purchases and sales in financial instruments classified in Level 3?

Yes. For fair value measurements in Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances should be presented (IFRS 7 para 27B(c)), disclosing separately changes during the period attributable to:

- Purchases, sales, issues and settlements (each type of movement disclosed separately);
- Total gains or losses for the period recognised in profit or loss respectively, recognised in other comprehensive income (including disclosures on where the total gains or losses are recognised in profit or loss of the period);
- Transfers into and out of Level 3 (including the reason for such transfers).

IFRS 7 IG13B gives an illustrative example on how the above reconciliation should be presented.

3.23 In measuring fair value in Level 3, if changing one or more of the inputs to reasonably possible alternative assumptions changes the fair value significantly, management should state that fact and disclose the effect of those changes, as required by IFRS 7 para 27B(e). Is there likely to be a sensitivity analysis for all Level 3 measurements where fair value measurement is sensitive to underlying assumptions?

No. There is a different definition of significant for the two disclosure requirements. In determining whether to classify an instrument as Level 3, the entity considers whether an unobservable input is significant to the fair value of that individual instrument in its entirety. However, IFRS 7 para 27B(e) is explicit that for the purpose of disclosure of sensitivity analysis for each class of financial instrument with Level 3 measurements, significance should be judged with respect to the reporting entity's profit or loss, total assets or total liabilities, or when changes in fair value are recognised in other comprehensive income or total equity.

3.24 Investment Company X has a 'fund of fund' structure and invests in other private equity funds (the underlying funds). The underlying funds, which are managed by a third-party manager not related to X, are invested directly in private equity investments (the underlying investments). X periodically receives information on the NAV of the underlying funds. However, only a few transactions are entered into at NAV; the NAV does not therefore represent a quoted price in an active market. X needs to apply valuation techniques to determine the fair value of the fund investments.

X does not just rely on the NAV received but performs a high-level check on the valuation of the underlying investments. It normally uses multiples on earnings to determine the fair value of the investments in the underlying fund.

Does X need to disclose the multiples used to control the reliance of the fair value measurement received from a third party?

No. X uses the multiples only for control purposes and to back-test whether NAV is a reliable measure for fair value. The value is not therefore required for the disclosure of the multiples applied to back-test, but X should provide information on how the NAV has been determined. This might require the disclosure of parameters used by the underlying funds to value their assets.

The answer might change if, in the case of a significant difference between NAV and the value calculated by using multiples, the investment company measures the investment by applying this calculated value. In that case, disclosures of the multiples applied by X to value its investments will be required.

3.25 A private equity fund acquires unlisted securities. The transaction price is different from the fair value at initial recognition determined by using a valuation technique. Does IFRS 7 require entities to disclose that difference?

It depends. The best evidence of fair value on initial recognition is normally the transaction price. If this is the case, there would be no difference to disclose, by definition. However, if the conditions in IAS 39 para AG76 are met (that is, if the fair value is better evidence with reference to comparable and observable market transactions), a difference may exist.

When the conditions are met, IFRS 7 para 28 requires disclosure of 'day 1' profit not recognised in profit or loss. In addition, IFRS 7 para 28 requires entities to disclose the reconciliation of changes in the amount not recognised in the profit or loss and the accounting policy for determining when it is recognised in profit or loss.

3.26 What comparative information is required in the first year of application of the IFRS 7 amendment on fair values:

- (a) by an entity without any past disclosures with respect to a fair value hierarchy?**
- (b) by an entity that has voluntarily presented information similar to that required by FAS 157, but which may not have fully complied with all aspects of the FAS 157 hierarchy?**

IFRS 7 para 44G states that, in the first year of application, an entity need not provide comparative information for the disclosures required by the amendments. Earlier application is permitted.

- (a) No comparative information needs to be provided for fair value hierarchy.
- (b) Those entities that previously made voluntary fair value disclosures should be encouraged either to keep the fair value disclosure with a clear statement that this was voluntary and might not be in line with the new amendment, or to modify the comparatives to comply with the new amendment.

4. Risk disclosures

A. General requirements

Management should disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period [IFRS 7 para 31]. The disclosures require focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, liquidity risk and market risk [IFRS 7 para 32].

Qualitative and quantitative disclosures are required. Management should therefore disclose, for each type of risk arising from financial instruments:

- The exposures to risk and how they arise, and its objectives, policies and processes for managing the risk and the methods used to measure the risk (qualitative disclosure) [IFRS 7 para 33]; and
- Summary quantitative data about its exposure to that risk at the end of the reporting period (quantitative disclosures) [IFRS 7 para 34].

If the quantitative data disclosed at the end of the reporting period is unrepresentative of an entity's exposure to risk during the period, management should provide further information that is representative [IFRS 7 para 35].

4.1 How should a fund with two distinct investment portfolios (for example, a bond portfolio and an equity portfolio) present its risk disclosures required by IFRS 7 para 34(a) if management monitors each portfolio separately?

A fund with two distinct investment portfolios should present the disclosures based on the management reporting [IAS 7 para 34(a)] separately for the bond portfolio and the equity portfolio, if that is the way management monitors the financial risks.

4.2 How should the fund with two distinct investment portfolios (for example, a bond portfolio and an equity portfolio) present the minimum risk disclosures required by IFRS 7 para 34(b) and IFRS 7 paras 36 to 42?

A fund with two distinct investment portfolios could provide the minimum disclosures on a consolidated basis for the bond portfolio and the equity portfolio. All disclosures should be provided on a consolidated basis in accordance with IAS 27 para 22 unless there is a specific exception (such as for those disclosures that are based on management's reporting).

The fund could provide the minimum disclosures separately for the bond portfolio and the equity portfolio to reflect the way management monitors the financial risks, unless there were material transactions between the portfolios. In this case, the separate disclosures could be misleading.

4.3 Fund A and Fund B have similar portfolio compositions investing solely in stocks included in the S&P 500 stock index. Fund A's management follows a 'top-down' approach when selecting investments, deciding first how much of the fund's portfolio to allocate to different industry sectors, then deciding what stocks within those sectors to invest in. Fund B's management follows a 'bottom-up' approach. Fund B's management does not manage the portfolio by industry sector or utilise any analysis of the portfolio by sector. When making investment decisions, Fund B's management focuses solely on each individual investment. When preparing risk disclosures under IFRS 7, could the risk disclosures vary between Fund A and B even though the portfolio compositions are similar?

Yes. The basis for much of the risk disclosures under IFRS 7 is 'through the eyes of management' – that is, based on the information provided to key management personnel. Two funds with different management approaches but similar portfolio compositions would be expected to provide differing risk disclosures in some areas. However, there are specific risk disclosures applicable to all entities, so management should provide a common benchmark for financial statement users when comparing risk disclosures across different entities.

4.4 Fund A invests solely in S&P 500 stocks. Fund A's management follows a 'top-down' approach when selecting investments, deciding first how much of the fund's portfolio to allocate to different industry sectors, then deciding what stocks within those sectors to invest in. At year end, Fund A invested in two stocks, together comprising 35% of the portfolio. One stock was in the banking sector and represented 15% of the total portfolio and 75% of the 'banking' sector; the other stock was in the oil and gas sector and represented 20% of the total portfolio and 100% of the oil and gas sector. Information provided to management is by sector and then by stock. What level of disclosure should be given when providing summary quantitative data about Fund A's exposure to equity price risk under IFRS 7 paras 34(a) and (c)?

The use of the above 'top-down' approach should result in summary quantitative risk disclosures being provided by industry sectors, given this is how management views risk and manages the portfolio. Such disclosure would show the industry concentrations. However, stock-specific concentrations also exist and would therefore need to be disclosed in addition to the industry sector information – for example, 75% of the banking sector and 100% oil and gas sector were in a single investment.

4.5 Would the answer in the above scenario be different if Fund A followed a 'bottom-up' approach, not managing the portfolio by industry sector and not utilising any analysis of the portfolio by sector?

Yes. The answer would be different if a 'bottom-up' approach was used by management. Summary quantitative data would not need to be provided at the industry sector level. However, Fund A should disclose, as a minimum, that two stocks comprise 35% of the portfolio and the industry concentrations they form part of, irrespective of whether the fund is managed by industry sector.

IFRS 7 has a 'through the eyes of management' approach to risk disclosures, but it also has a list of minimum disclosures. Concentration of risk is one of them. So even though information is not provided to management by sector, the above investments do represent an individual-plus-sector concentration and should therefore be disclosed in accordance with IFRS 7 para 34(c).

- 4.6 Should management in the following situations disclose additional information that is representative of an entity's exposure to risk during the period in addition to disclosure of period-end positions (IFRS 7 para 35)?**
- (a) Investment entity A held a significant amount of US sub-prime debt for an insignificant portion of the year, which resulted in large losses. For the remainder of the year and at year end, investment entity A held virtually no sub-prime debt.**
 - (b) Investment entity B held a significant amount of US sub-prime debt for a significant portion of the year. By year end it held virtually no sub-prime debt.**
 - (c) Investment entity C has liquidated its equity investments during the period in anticipation of redeeming all shareholders as part of an orderly wind-up. As at the reporting date, investment entity C has investments in cash only.**
 - (d) Investment entity D operated as a feeder fund into a master fund for a significant portion of the year. Investment entity D then reorganised itself into a fund of funds, investing directly into a portfolio of other investment entities that it was previously exposed to indirectly via its investment in the master fund.**
 - (e) Investment entity E traded some equity index derivatives during the period; however, it held no such derivatives at year end. The net profit and loss from such trading during the period was insignificant; however, for a significant amount of the period, the overall exposure from such derivatives was significant to the entity.**

Yes. The investment entities should disclose additional information if the quantitative data as at the reporting date is not representative of the financial period. A mere statement that the data is not representative is not sufficient under IFRS 7 para 35. To meet the requirement in IFRS 7 para 35, the entity might disclose the highest, lowest and average amount of risk to which it was exposed during the period [IFRS 7 IG20]. Therefore:

- (a) Investment entity A presents additional disclosure of risk during the period given the significance of the exposure and resultant large losses.
- (b) Investment entity B presents additional disclosure of risk during the period because the positions at year end are not representative of the risks to which the entity was exposed during the period.
- (c) Investment entity C presents additional disclosure of risks during the period because during the year the entity was exposed to the risk inherent in the equity investments.
- (d) Investment entity D presents additional disclosure of risk during the period, although such additional disclosure could simply explain qualitatively the structure prior to the reorganisation if the ultimate exposures are similar if not the same.
- (e) Investment entity E presents additional disclosure of risk during the period. This is because it is the actual risk exposures that are relevant when considering compliance with IFRS 7 para 35 rather than how much profit and loss was made from the activity that resulted in the risk exposures.

4.7 When considering the requirement to disclose concentrations of credit risk, should a concentration of credit risk be disclosed under IFRS 7 para 34(c) in the following scenarios?

- (a) The issuers of debt in which the entity invests are concentrated in the manufacturing and retail sectors.**
- (b) The debt instruments in which the entity invests are concentrated in the sub-prime market.**
- (c) The entity invests in the debt of European corporate issuers. At year end, the entity's investments are concentrated in the issuers of an individual country.**
- (d) The entity invests a significant portion of its funds in the debt of a group of closely related companies.**

Yes. Separate disclosure of the concentration of credit risk is required, if the concentration of credit risk arising from the following is not apparent from other disclosures:

- (a) Two individual sectors;
- (b) Investment in debt of similar credit quality;
- (c) Investment in issuers in individual countries; or
- (d) Investing in a limited number of issuers or groups of closely related issuers.

Disclosure of the concentrations of risk include:

- A description of how management determines the concentrations;
- A description of the shared characteristics that identifies each concentration (for example, counterparty, geographical area, currency, market or industry); and
- The amount of the risk exposure associated with all financial instruments sharing that characteristic.

[IFRS 7 App B8].

4.8 Feeder fund ABC Ltd invests solely in master fund DEF Ltd, which invests solely in the Japanese equity market. ABC Ltd is not required to prepare consolidated accounts. It has provided broad qualitative disclosure of the nature of its investment in DEF Ltd in its stand-alone financial statements; it states that DEF Ltd invests in the securities of Japanese companies listed on the Tokyo Stock Exchange. ABC Ltd and DEF Ltd operate as an integrated structure. Management of ABC Ltd and DEF Ltd are comprised of the same parties and view the risk exposures of ABC Ltd to be the same as those of DEF Ltd.

As a result of IFRS 7's 'through the eyes of management' approach, should additional detailed quantitative disclosure of the financial risks relating to the portfolio of DEF Ltd be made in the financial statements of ABC Ltd in addition to the qualitative disclosures previously mentioned?

Yes. IFRS 7 para 34(a) requires the disclosure of quantitative data about ABC Ltd's exposure to the risks of investing in DEF Ltd. The disclosures should be based on how ABC Ltd views and manages its risks – that is, using the information provided to management [IFRS 7 BC47]. Given the integrated structure and management's view that the risk exposures of ABC Ltd are the same as those of DEF Ltd, full disclosure of the risks inherent in the portfolio of DEF Ltd should be made in the stand-alone financial statements of ABC Ltd. In other words, in this instance, a 'through the eyes of management' approach should be adopted.

4.9 An investment entity invests in a foreign currency bond maturing in one year and simultaneously enters into an FX forward contract with a corresponding maturity to offset the foreign currency risk. IFRS 7 para 34(b) requires specific risk disclosures for material risks. Is the materiality of the foreign currency risk on the bond assessed with or without the FX forward contract?

The materiality of the foreign currency risk on the bond is assessed without the FX forward contract. The bond and the FX forward are dissimilar items [IAS 1 para 29]; the materiality assessment of the foreign currency risk is therefore performed without considering the FX forward contract.

If it is established that the foreign currency risk is material, the disclosure required in the sensitivity analysis [IFRS 7 paras 40 and 41] is based on the net FX exposure – that is, after offsetting the foreign currency bond against the FX forward contract.

The same approach would apply for the assessment of credit risk, liquidity risk and other market risk.

4.10 The management of an investment entity claims it does not ‘manage’ currency risk, it simply ‘trades’ it. Management does not therefore intend to make any risk disclosures under IFRS 7. Does IFRS 7 still require risk disclosure in situations where management believes risks are not managed?

Yes. IFRS 7 requires qualitative [IFRS 7 para 33(a)] and quantitative [IFRS 7 para 34] disclosures of risk, irrespective of whether such risks are considered by management to be managed. IFRS 7 IG15(b) refers to the need for management to disclose the reporting entity’s policies and processes for accepting risk, in addition to those for measuring, monitoring and controlling risk.

4.11 Investment entity ABC Ltd, with a functional currency of New Zealand dollars, invests in a global equity portfolio. As a result, it has significant foreign currency exposure through its investments in the yen, euro and US dollar. Is ABC Ltd considered to have currency risk for the purpose of meeting the IFRS 7 requirements?

No. IFRS 7 does not consider currency risk to arise from financial instruments that are non-monetary [IFRS 7 App B23], such as equity investments. The foreign currency exposure arising from investing in non-monetary financial instruments would be reflected in the other price risk disclosures as part of the fair value gains and losses.

4.12 ABC Ltd, in the prior year, reported its policies and processes for managing risk. In response to an increase in the risks arising from the markets in which ABC Ltd invests, management of ABC Ltd developed its risk management systems during the year and designed additional policies and processes for dealing specifically with credit risk. Should such changes be disclosed in the financial statements of ABC Ltd?

Yes. IFRS 7 para 33(c) requires an entity to report any change in qualitative disclosures from the previous period and explain the reason for the change – specifically, in this instance, changes in the policies and process for managing and measuring risk.

Note: If the change in policies and processes results in a change in accounting policies, additional disclosures may be required [IAS 8 para 29].

4.13 Should an investment entity restate the comparative risk disclosures for changes in volatility – for example, the reasonably possible change in an exchange rate changes from 5% in the prior year to 8% in the current year?

No. The prior-year disclosures should not be restated if the volatility (and therefore the range for a reasonable change) increases or decreases between two balance sheet dates.

B. Credit risk – credit quality

IFRS 7 para 36 requires an entity to disclose information about its exposure to credit risk by class of financial instrument. Such disclosures include information on the credit quality of financial assets with credit risk.

4.14 IFRS 7 para 37(a) requires investment entities to disclose an analysis of the age of financial assets that are past due at the reporting date but not impaired. Investment fund A's management monitors financial assets only when they are overdue more than one month. What does 'past due' mean?

As defined in IFRS 7 App A, a financial asset is past due when a counterparty has failed to make a payment when contractually due. Past due therefore includes all financial assets that are one or more days overdue. Although IFRS 7 para 34(a) requires risk disclosures that are based on the information provided to key management personnel, there are also some minimum disclosure requirements defined by IFRS 7 (IFRS 7 paras 36 to 42) that should always be disclosed, irrespective of how management monitors the risk.

However, the entity may take the way management monitors financial assets into account when defining the appropriate time bands used in the credit risk table. In the above scenario, it may disclose the amounts past due less than a month and amounts past due more than a month.

4.15 IFRS 7 para 37(a) requires an analysis of the age of financial assets that are past due as at the reporting date but not impaired. What amount should be disclosed to satisfy this requirement? Should this be:

- **Only the amount past due (that is, the instalment not paid when contractually due);**
- **The whole balance that relates to the amount past due; or**
- **The whole balance that relates to the amount past due, including any other balances with the same debtor?**

The investment entity should disclose the whole balance that relates to the amount past due.

IFRS 7 BC55(a) explains that the purpose of the disclosure required in IFRS 7 para 37(a) is to provide users of the financial statements with information about those financial assets that are more likely to become impaired and to help users to estimate the level of future impairment losses. The whole balance that relates to the amount past due should therefore be disclosed, as this is the amount that would be disclosed as the amount of the impaired financial assets if impairment crystallises.

Other associated balances to the same debtor should not be disclosed as past due but not impaired, as the debtor has not failed to make a payment on these when contractually due.

4.16 A private equity fund holds equity investments in other entities. Its management asserts that the IFRS 7 credit risk disclosures [IFRS 7 paras 36 to 38] are not relevant. Do the credit risk disclosures required by IFRS 7 para 36 to 38 apply to an entity's holdings of equity investments?

Only the disclosures required by IFRS 7 para 37(b) apply (see Q&A 4.18). The definition of equity in IAS 32 requires that the issuer has no obligation to pay cash or transfer other assets. It follows that such equity investments are subject to price risk, not credit risk. Most of the IFRS 7 credit risk disclosures are therefore not relevant to investments in equity instruments.

However, IFRS 7 para 37(b) requires entities to disclose an analysis of financial assets that are impaired. This disclosure is relevant and should be given for impaired equity investments classified as available for sale.

4.17 A private equity fund holds an equity investment categorised as AFS, which was assessed as being impaired in 20x1. The related loss was included in the income statement as an impairment loss. As the asset is impaired, it is included in the disclosures of impaired financial assets [IFRS 7 para 37(b)] in the year of impairment. Should there be a disclosure in the subsequent year as well?

As long as the fair value of the financial asset is below its historical cost, the financial asset is considered as 'impaired'. It should therefore be included in the disclosure of impaired financial assets irrespective of the fact that the entity recognises a valuation gain in the current year's financial statements. When the fair value returns to above its historical cost, the asset should be excluded from the disclosure (note: this answer is also applicable to a debt instrument classified as AFS).

4.18 Disclosure includes an analysis of financial assets that are individually determined to be impaired as at the reporting date, including the factors the entity considered in determining that they are impaired [IFRS 7 para 37(b)].

A real estate investment fund has C3 million of receivables (that is, outstanding lease payments), which have been treated as follows:

- (a) C1 million of the receivables have been assessed individually for impairment; based on the conditions stated in IAS 39 paras 58-61, management concludes that they are impaired;**
- (b) C1 million of a collection of insignificant receivables are individually concluded to be impaired on the basis of the IAS 39, but the impairment calculation is carried out on the C1m amount for efficiency purposes; and**
- (c) C1 million of a portfolio of assets has observable data indicating that there is a measurable decrease in the estimated future cash flows from that group of financial assets, although the decrease cannot be identified with individual financial assets [IAS 39 para 59(f)].**

Which of these require disclosure under IFRS 7 para 37(b)?

Treatments (a) and (b) require disclosure under IFRS 7 para 37(b), as these receivables are individually assessed for impairment.

The disclosure is not required for (c), as the receivables are assessed on a portfolio basis rather than an individual basis. However, actual impairment loss on the portfolio of assets should also be disclosed for income statement purposes under IFRS 7 para 20(e).

C. Liquidity risk – maturity analysis

Management should disclose a maturity analysis for all non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities [IFRS 7 para 39(a)]. The maturity analysis required for derivative financial liabilities should include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows [IFRS 7 para 39(b), IFRS 7 App B11].

4.19 Should the following financial instruments be shown in one maturity bucket, or split across the maturity buckets in which the cash flows occur:

- (a) A derivative for which contractual maturities are essential to an understanding of the timing of the cash flows and that has multiple cash flows?
- (b) A 10-year loan that has annual contractual interest payments?
- (c) A five-year loan that has annual contractual interest and principal repayments?

All the financial instruments should be split across the maturity buckets in which the cash flows occur. The requirement is to disclose each of the contractual payments in the period when it is due (including principal and interest payments). The objective of this particular disclosure is to show the liquidity risk of the entity.

4.20 Is a maturity analysis for financial assets required?

IFRS 7 App B11E requires an entity to disclose a maturity analysis of financial assets it holds for managing liquidity risk (for example, 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.

Investment funds may use financial assets to manage their liquidity risk (for example, real estate funds that hold some highly liquid investments to meet the daily redemption requests). In these circumstances, the information is likely to be necessary to enable users of financial statements to evaluate the nature and extent of liquidity risk; in which case, we would expect them to present a maturity analysis of financial assets.

4.21 Can an investment fund present one maturity table for all of its non-derivative and derivative financial liabilities?

Yes, provided it is clear to the users of the financial statements whether the disclosure is based on contractual maturities or expected maturities and whether the financial liabilities are derivatives or non-derivatives.

4.22 When is quantitative information based on how management manages liquidity required [IFRS 7 App B10A]?

Additional quantitative information based on how management manages liquidity risk is required if the outflow of cash could occur significantly earlier than indicated in the data (for example, a bond that is callable by the issuer in two years but has a remaining contractual maturity of 12 years).

In addition, if the cash outflow could be for a significantly different amount than that indicated in the maturity table, this should also be disclosed.

4.23 An investment fund has issued participating shares redeemable at the discretion of the holders and classified them as liabilities. In which time band in the maturity analysis should the shares be included, given it is unknown when exactly the holders will put the shares back to the entity?

A maturity analysis is always required based on the remaining contractual maturity for non-derivative financial liabilities and derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows. Shares that are classified as liabilities and can be put back to the issuer at anytime without restriction should be classified in the earliest time band for the purpose of the maturity analysis based on the contractual maturity [IFRS 7 App B11C(a)].

However, including such shares in the earliest time band may not reveal the expected maturities of such liabilities – that is, the redemption expected in normal circumstances. In addition to the maturity analysis based on the remaining contractual maturity, an entity might disclose a maturity analysis for (financial assets and) financial liabilities showing expected maturity, if this is the information provided to key management personnel to manage the business. As a minimum, if management’s monitoring of liquidity risks is substantially different from the analysis of contractual maturity of liabilities, the entity should provide qualitative disclosures about the way management is monitoring liquidity risk [IFRS 7 para 39(c)].

If significant, the difference between the contractual and expected liquidity profile of the entity should be explained.

4.24 An investment fund has issued participating shares redeemable at the discretion of the holders and classified them as liabilities. In which time band in the maturity analysis should the shares be included if there are restrictions on the redemptions (for example, no more than 50% of the entity shares can be put back in any month)?

If there were restrictions on the number of shares that can be redeemed at any time, the maturity analysis should reflect such restrictions. IFRS 7 allows judgement in determining the appropriate number of time bands used in the maturity analysis [IFRS 7 App B11]. However, in the instance when only 50% of the shares can be put back in any given month, due to the significance of the item, a time band of not later than one month should be disclosed.

4.25 An investment fund, which is to a significant extent invested in illiquid investments, has issued participating shares redeemable at the discretion of the holders and classified them as liabilities. Management of the fund received significant redemption requests, so it decided to close the fund for redemptions for the next six months and announced that to the investors. In which time band in the maturity analysis should the shares be included if there are restrictions on the redemptions?

The investment contract provides the investment manager with the option to temporarily dispense the redemption of the fund units. The contractual maturity of the units has changed as a result of the fund closure. The investment fund discloses the amounts attributable to unit holders in the due-after-six-months time band [IFRS 7 App B11C].

4.26 Investment manager A's own holding in mutual fund B, which he controls, is 45%. The remaining 55% is held by retail clients. Fund B issues only puttable shares, which can be put back at any time without any notice period. Based on historic data, the average investment period of a retail client is four years.

In investment manager A's consolidated financial statements, fund B is included as subsidiary according to IAS 27, 'Consolidated and separate financial statements'. The minority interest of the retail clients is classified as a financial liability.

Can investment manager A present the third-party interest in consolidated funds, which is classified as financial liability in the liquidity analysis using the expected maturity date – that is, the historic average maturity of four years?

Investment manager A should present as a minimum a maturity analysis based on contractual maturities [IFRS 7 para 39(a)]. In this case, this is the earliest time band the entity can be required to pay because the counterparty has a choice of when an amount is paid [IFRS 7 App B11C(a)]. As the minority interest is puttable on demand, the liability should be shown within the earliest time bucket.

In addition to the disclosure requirements in IFRS 7 para 39(a), the entity should provide summary quantitative data about its exposure to liquidity risk based on information provided internally to key management personnel of the entity as required in IFRS 7 para 34(a) and App B10A.

4.27 Private equity fund ABC LP has a contractual maturity of 12 years. The fund presents the paid-in capital as a financial liability. The partnership agreement requires ABC LP to make liquidity distributions within 90 days of a private equity investment being sold. The liquidity distributions include the redemption of a proportionate share of the invested capital. How should ABC LP present the maturity analysis?

The private equity fund ABC LP should disclose the drawn amount in the time band that reflects when the repayment is contractually due (for example, when the fund is liquidated). However, if the fund's management expects to repay the drawn amount significantly earlier, this fact should be disclosed. Such earlier repayment is usually required because of contractually required liquidity distributions that arise when the fund liquidates some of its investments. When the fund disposes of an investment, the contract might require a liquidity distribution within, for example, 90 days. In this case, the contractual maturity (rather than the expected maturity) of the amount to be distributed is 90 days.

Note: The undrawn amount does not represent future cash outflow and is therefore not included in the maturity analysis.

4.28 During the commitment period, investors commit themselves to invest in a private equity fund. What amounts should be included in the maturity analysis in respect of this facility?

The investor should include the undrawn amount of the capital commitment in the earliest period in which the private equity fund may be able to draw it [IFRS 7 App B11C(b)]. Such disclosures can be made either in a separate table including the off-balance sheet items, or together with the recognised financial liabilities. IFRS 7 App B11D is not relevant, as the amount the investor is required to pay in cash is fixed.

4.29 What liquidity risk disclosures are required for derivative financial liabilities?

Referring to IFRS 7 para 39(b), please see the table below:

	Gross settled derivatives	Net settled derivatives
Contractual maturity is essential to understanding	<ul style="list-style-type: none">• Disclose pay leg based on contractual maturity• Disclosure of receive leg	<ul style="list-style-type: none">• Disclose net cash flows based on contractual maturity
Contractual maturity is not essential to understanding	<ul style="list-style-type: none">• Disclose pay leg either based on contractual maturity or how the risk is managed – for example, expected maturity• Disclosure of receive leg optional	<ul style="list-style-type: none">• Disclose net cash flows either based on contractual maturity or how the risk is managed – for example, fair value

4.30 Should derivatives with a positive fair value be included in the maturity analysis?

Generally, only derivatives in a liability position at the balance sheet date (that is, having a negative fair value) are required to be included in the maturity analysis.

However, entities should also include derivative financial assets where such information is necessary to understand the nature and extent of liquidity risk [IFRS 7 App B11E]. For example, this might be the case where there are significant offsetting derivative positions.

4.31 If gross cash flows are exchanged under a derivative contract, does IFRS 7 require disclosure of the gross cash flows, even if the exchange occurs simultaneously?

Yes. For derivative financial liabilities, IFRS 7 App B11D(d) is clear that contractual amounts exchanged in a derivative financial instrument (for example, a currency swap) should be disclosed on a gross basis if gross cash flows are exchanged. This is the case even if the cash flows are exchanged simultaneously.

4.32 How is a written put option for which contractual cash flows are essential to an understanding of liquidity treated in the maturity analysis?

It depends on whether the option is settled net or gross and whether the option is in our out of the money at the balance sheet date.

If the option is out of the money and net settled, no liability is required to be disclosed in the maturity table, because there is no obligation to make a payment based on the conditions existing at the balance sheet date [IFRS 7 App B11D].

For gross-settled derivatives where the counterparty can force the issuer to make a payment, the pay leg is disclosed in the maturity analysis irrespective of whether the instrument is in or out of the money.

An American-style option should be disclosed in the earliest time band; a European-style option is disclosed in the time band in which the exercise date falls.

4.33 If the counterparty to a derivative contract has the ability to settle early on demand, in which time band in the contractual maturity analysis should undiscounted cash flows be presented when analysing liquidity risk?

When the counterparty to the derivative instrument has a choice of when an amount is paid, the liability is included on the basis of the earliest date on which the entity can be required to pay. Therefore, if the counterparty to the derivative has the ability to settle early on demand, the derivative cash flows should be included in the earliest maturity band.

4.34 An investment entity is party to a derivative instrument that it (but not the counterparty) has the ability to settle early on demand. In which time band in the contractual maturity analysis should undiscounted cash flows be presented when analysing liquidity risk?

The maturity analysis should reflect the contractual obligations of the entity at the time it is prepared. The ability of the investment entity to settle early on demand does not change its contractual obligations. The cash flows arising from the respective derivatives instruments should therefore be included in the relevant time bands based on the contractual cash flows.

4.35 A private equity fund invests in unlisted securities. These securities are highly illiquid, and the private equity fund finds it difficult to find a buyer. Is the fund required to provide additional disclosures because of the lack of liquidity of the investment?

In addition to the disclosure requirements in IFRS 7 para 25 to 27B (fair value measurement disclosures), the entity should provide summary quantitative data about its exposure to liquidity risk based on information provided internally to key management personnel of the entity as required in IFRS 7 para 34(a).

IFRS 7 para 39(c) requires the entity to describe how it manages the liquidity risk inherent in the maturity analysis of financial liabilities required in IFRS 7 paras 39(a) and (b). An entity should disclose a maturity analysis of financial assets that it holds for managing liquidity risk if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk [IFRS 7 App B11E].

Given the nature of most private equity funds investments (significant investments in unquoted, often illiquid, investments), management would rarely consider the liquidity of its investments when managing its ability to settle financial liabilities as they come due. As a result, unless there are liabilities that are expected to be settled via asset realisations, a private equity fund would not be expected to make further disclosures about the illiquidity of its investments.

While many limited partnerships are funded by partnership contributions that are classified as debt instruments, this would not ordinarily present a liquidity risk. This is because the ultimate settlement of these financial liabilities is often based on the pre-determined, contractual termination date of the partnership once the investments had been realised, providing cash to return to investors.

4.36 What rate should be used to determine the amounts to be disclosed for floating rate financial instruments and instruments denominated in a foreign currency, where amounts are required to be disclosed in the maturity table based on contractual undiscounted cash flows [IFRS 7 App B11D]? Should this be the current rate or the forward rate?

An entity has a policy choice that needs to be applied consistently. IFRS 7 App B11D states that amounts not yet fixed at the reporting date are determined by reference to the conditions existing at the reporting date. This could either be viewed as the current spot rate or the forward rate.

4.37 Should exposure to collateral calls be disclosed?

Collateral requirements on financial instruments can pose a significant liquidity risk. For example, an entity with a derivative liability may be required to post cash collateral on the derivative should the liability exceed certain limits. As a result, if collateral calls do pose significant liquidity risk, such entities should provide quantitative disclosures of their collateral arrangements, as those cash flows could occur earlier than the contractual maturity [IFRS 7 App B10A]. Whenever an entity is subject to collateral calls, it is recommended that additional qualitative disclosures are provided and include a description of whether the entity is exposed to collateral calls on financial instruments and how this risk is managed [IFRS 7 para 33].

4.38 How should an entity disclose a perpetual debt instrument with mandatory interest payments in the analysis of contractual maturities (undiscounted cash flows) per IFRS 7 para 39(a)?

Interest payments should be shown in each time band based on when they are contractually due. With regards to the repayment of the nominal amount, entities may present this in a number of ways – for example, using a ‘thereafter’ column or presenting it in a column labelled ‘no contractual maturity’. Whichever method is used, this should be complemented by a narrative description of the terms of the instrument.

4.39 What comparative information is required in the first year of application of the IFRS 7 amendment on fair value and liquidity risk?

IFRS 7 para 44G states that an entity need not provide comparative information in the first year of application for the disclosures required by the amendments. The entity can either keep its previous disclosures (but disclose if this is the case) or adapt the comparative information to be consistent with that required by the amendment.

D. Market risk – sensitivity analysis

Management should disclose a sensitivity analysis for each type of market risk to which the entity is exposed at the reporting date. This should show how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date [IFRS 7 para 40(a)]

4.40 Is management required to provide sensitivity analysis on a ‘worse case scenario’ basis?

No. IFRS 7 para 40(a) requires a sensitivity analysis to show the effect on profit or loss and equity of reasonably possible changes in the relevant risk variable. A reasonably possible change is judged relative to the economic environments in which the entity operates; it does not include remote or ‘worst case’ scenarios or ‘stress tests’.

Furthermore, entities are not required to disclose the effect for each change within a range of reasonably possible changes of the relevant risk variable. Disclosure of the effects of the changes at the limits of the reasonably possible range would be sufficient [IFRS 7 App B18-19].

4.41 IFRS 7 para 40(a) requires a sensitivity analysis to show the effect on profit or loss and equity of reasonably possible changes in the relevant risk variable. When determining a ‘reasonably possible’ change based on historical data, is there any explicit guidance as to how long the historical period should be?

No. Each entity should judge what a reasonably possible change is; assessments may differ from entity to entity. However, reasonably possible movements should be assessed based on a period until the entity next presents the disclosures – it is usually the next annual reporting period [IFRS 7 App B19 (b)].

When providing such sensitivity information, management will generally be disclosing reasonably possible changes over the next year. It would therefore make sense that historical annual movements over a similar period be considered over as many historical periods as possible in an effort to minimise extremes.

There are inherent weaknesses in using historical data to predict future returns; any changes in the fundamental structure, risk and returns of the relevant markets in the risks that arise should also be considered when basing future movements on historical sensitivities. Irrespective of what methodology is adopted, it should be consistently applied and sufficiently described so that the user of the financial statements has an understanding of how the sensitivity analysis has been derived [IFRS 7 para 40(b)].

4.42 Fund ABC Ltd invests in five funds (‘the Funds’), all of which invest in global corporate debt markets. ABC Ltd is a fund of funds, focusing on investing in funds with global long/short corporate debt strategies. While not being actively involved in managing the Funds’ investment portfolios, ABC Ltd’s management utilises information on the underlying portfolios, particularly with respect to risk and return, when deciding to which Funds to allocate resources. While ABC Ltd is not directly exposed to interest rate and currency risk, it has significant indirect exposures through its equity investment in the Funds. How should management meet the IFRS 7 para 40 requirement to prepare a sensitivity analysis?

Management should identify the relevant risk variables that reflect best the entity’s exposure to market risk. Management of ABC Ltd views and considers the primary financial exposure of ABC Ltd to be to interest rate and foreign exchange movements, given ABC Ltd’s narrow focus on funds following a global long/short debt strategy. Management has determined the relevant risk variables to be interest and foreign currency rates. When preparing the sensitivity analysis for ABC Ltd, management should reflect the quantitative impacts of the interest and foreign currency rate sensitivities of the Funds.

4.43 Investment entity ABC Ltd (a ‘fund of funds’) invests in a number of other investment entities (‘the Funds’). The Funds invest in a variety of global markets. Management manages the portfolio by allocating and reallocating money to specific investment strategies and specific managers within those strategies after performing comprehensive due diligence. As at year end, ABC Ltd invested in 37 Funds, which could be categorised into six major strategies with 15 sub-strategies. ABC’s investment in the Funds is evidenced by way of shares or units in those Funds. Management of ABC Ltd considers ABC’s exposure to risk to be to the managers of the underlying Funds they invest and to the respective strategies. In assessing that risk, management obtains monthly overall performance figures from the respective underlying managers. While management is aware of the types of risk ABC Ltd is exposed to via its investments in the Funds, no information is utilised on the underlying portfolios.

ABC Ltd is directly exposed to equity price risk, being the sensitivity of ABC Ltd to movements in the value of the shares or units issued by the Funds, and indirectly exposed to many risks that influence the value of those shares or units – for example, interest rates, foreign exchange rates, commodity prices, equity prices, etc.

How should management meet the IFRS 7 para 40 requirement to prepare a sensitivity analysis?

Management should identify the relevant risk variable(s) that reflect best the exposure of the entity to market risk.

As management considers ABC’s exposure to risk to be to the managers of the underlying Funds they invest in and to the respective strategies, the sensitivity of the portfolio could be disclosed by fund strategy. If the relevant risk variable is determined to be fund strategy, management should look to provide meaningful disclosure of the sensitivity of ABC Ltd to movements in the respective strategies. In addition, management should disclose qualitative information on the types of risk the Funds within each strategy are directly exposed – that is, the inherent risks of each of the Funds within a strategy.

As an example, management of ABC Ltd could provide the following disclosure in the financial statements:

“The table below summarises the impact on ABC’s post-tax profit of reasonably possible changes in the returns of each of the strategies to which ABC is exposed through the 37 Funds in which it invests at year end. A reasonably possible change is management’s assessment, based on historical data sourced from [add source], of what is a reasonably possible percentage movement in the value of a fund following each respective strategy over the next year in USD terms. The impact on post-tax profit is calculated by applying the reasonably possible movement determined for each strategy to the value of each fund held by ABC Ltd. The analysis is based on the assumption that the returns on each strategy have increased or decreased as disclosed, with all other variables held constant. The underlying risk disclosures represent the market risks to which the Funds are exposed: I, F, O, representing interest rate, currency and other price risks respectively. In accordance with IFRS 7, currency risk is not considered to arise from financial instruments that are non-monetary items, such as equity investments.”

Strategy	Sub- strategy	Underlying risk exposures	Number of funds	Reasonably possible change (%)	Impact on post-tax profit ("000)	
Equity long/short						
	Sector specialists	O	4	5.2	115	
	Short bias	O	3	3	157	
	Opportunistic	O	1	6.7	155	
Fund of funds						
	Fund of funds	I,F,O	6	7.5	365	
	Multi- manager	I,F,O	2	6.6	113	
Directional trading						
	Global macro	I,F,O	4	8	313	
	Market timing	I,F,O	1	7	34	
	Commodity pools	I,F,O	1	5.3	45	
Event driven						
	Distressed Securities	I, F	2	7.5	113	
	Merger arbitrage	O	1	5.6	56	
	Emerging markets	I,F,O	2	9.5	169	
Relative value						
	Convergence arbitrage	I,F,O	2	6.7	145	
	Fixed income arbitrage	I,F	1	8.0	37	
	Convertible arbitrage	I,F,O	1	5.7	45	
	MBS strategy	I,F	1	7.8		
Multi-strategy			I,F,O	5	7.0	450
Total			37		2,312	

4.44 ‘Tracking error’ (TE) is a tool that may be used by management to monitor the results of a fund against a benchmark. TE is a measure of how closely a portfolio follows an index. Can TE be used as a form of sensitivity analysis to satisfy the requirements of IFRS 7 paras 40 and 41?

No. IFRS 7 para 40 requires the disclosure of a sensitivity analysis of each type of market risk to which an entity is exposed, showing how profit or loss and equity would be affected by changes in the relevant risk variable that were reasonably possible at the balance sheet date. In addition, IFRS 7 para 41 allows an entity that uses a sensitivity analysis (for example, value at risk (VAR)) that reflects inter-dependency between different risk variables to disclose such a sensitivity analysis.

TE does not provide the information required by IFRS 7 para 40, as it does not show how the profit or loss and equity of a fund will be impacted from a change in a market risk variable. In addition, while the TE figure itself is somewhat based on interdependencies between risk variables, it will also take account of other factors such as fees, rebalancing costs, cash holdings, etc. The resulting TE figure is not therefore a VAR figure but only an estimate as to how closely the fund will track an index. It does not therefore provide the information required by IFRS 7.

4.45 When providing sensitivity analysis in accordance with IFRS 7 para 40(a), should the impact on profit and loss and equity as a result of changes in the relevant risk variable be net of fees, which may increase or decrease as a result of such changes?

The impact on profit and loss and equity as a result of a change in the relevant risk variable may be disclosed net or gross of fees, provided the methods and assumptions used in preparing the sensitivity analysis are disclosed [IFRS 7 para 40(b)].

4.46 Investment entity ABC Ltd invests in a debt portfolio primarily concentrated in the region of Eurasia. Many of the countries in Eurasia have similar economic environments. However, one country, Utopia, has a more developed economic environment, which is dissimilar to the other countries within the region. When providing a sensitivity analysis for interest rate risk, should ABC Ltd provide disaggregated information showing the sensitivity of ABC Ltd to reasonably possible movements in interest rates in all the countries it invests?

It depends. The management of ABC Ltd decides how it aggregates information to display the overall picture without combining information with different characteristics about exposures to risks from significantly different economic environments [IFRS 7 App B3 and B17]. Because many of the countries in Eurasia have similar economic environments, it could be possible to aggregate the information providing it is not unreasonable to assume a reasonably possible change in interest rates would be the same in these countries – for example, a 50 basis point move. However, it would never be appropriate to aggregate these countries with Utopia due to differences in the economic environments.

4.47 IFRS 7 requires the disclosure of a sensitivity analysis for each type of market risk to which the entity is exposed at the reporting date [IFRS 7 para 40(a)] or a sensitivity analysis that reflects interdependencies between risk variables if that is how the entity manages its financial risks [IFRS 7 para 41].

The investment fund uses a VAR methodology that reflects interdependencies between risk types for its equity portfolio but manages its bond portfolio using a methodology that reflects each type of market risk.

Can the fund disclose its VAR figures for the equity portfolio and a sensitivity analysis for each type of market risk for its bond portfolio?

Yes. The investment fund may provide different types of sensitivity analysis for different classes of financial instrument [IFRS 7 App B21] or may choose to applying the sensitivity analysis outlined in IFRS 7 para 40(a) for the whole of the fund. However, it is not permitted to disclose VAR figures for the whole (see Q&A 4.48).

4.48 Investment entity ABC does not use VAR to manage risk. However, it wishes to use VAR to satisfy the IFRS 7 requirement to provide a market sensitivity analysis. Is this acceptable?

No. In order to use VAR, or any sensitivity analysis that reflects interdependencies between risk variables, IFRS 7 para 41 states that the entity should use such analysis to 'manage financial risks'. If the entity does not use VAR to manage its financial risks, it cannot use VAR to satisfy IFRS 7 para 41. The entity should disclose a sensitivity analysis in accordance with IFRS 7 para 40.

4.49 If an entity uses VAR to manage financial risk and chooses to disclose VAR in the financial statements in accordance with IFRS 7 para 41, is there any explicit guidance on what confidence interval to use, what the holding periods are and whether to disclose VAR solely at year end versus maximum, minimum and average VAR?

No. There is no explicit guidance. An entity should disclose the sensitivity analysis it actually uses to manage/monitor risk. An explanation of the method used in preparing the analysis and main parameters and assumptions underlying the data should be disclosed, along with an explanation of the objectives of the method used and of any limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved [IFRS 7 para 41(a) and (b)].

4.50 The IFRS 7 para 40 sensitivity analysis determined as at year end for investment entity ABC Ltd would vary if events occurring after year end were considered when determining what is a 'reasonably possible' change in the relevant risk variables. Should these events after year end be considered when determining what is a 'reasonably possible' movement as at year end?

It depends. Management should consider the economic environment in which it operates when determining what a 'reasonably possible' change in the relevant risk variable is [IFRS 7 App B19(a)]. Management should consider historical movements, future expectations and economic forecasts at the balance sheet date. This would include consideration of events occurring subsequent to year end that provide evidence of the economic environment that existed at year end. Events occurring subsequent to year end that are indicative of the economic environment subsequent to year end should not be considered when determining what is a 'reasonably possible' change at the balance sheet date.

4.51 Investment entity ABC Ltd, with a functional currency of New Zealand dollars, invests in a global debt portfolio and as a result has significant exposure to the yen, euro and US dollar. When preparing a sensitivity analysis for foreign currency risk, in accordance with IFRS 7 para 40, should ABC disaggregate the information by significant currency exposure?

Yes. Even though the management of ABC Ltd has some discretion over what it aggregates and disaggregates [IFRS 7 App B3], aggregation in this instance would obscure the risk that each currency exposure represents. For the purpose of IFRS 7, no currency risk is deemed to arise from financial instruments that are non-monetary items – for example, equity investments. In accordance with IFRS 7 para 40(b), the methods used in preparing the sensitivity analysis needs to be very clear and should state specifically that the foreign currency sensitivity analysis reflects only the sensitivity of monetary items.

4.52 Fund ABC Ltd invests in a long/short equity portfolio with a focus on S&P 500 stocks. It measures its performance against the S&P 500. However, management manages ABC Ltd so that the beta (sensitivity to movements in the market) of the overall portfolio (including long and short positions) to the S&P 500 is as close to zero as possible – that is, the portfolio has no or little sensitivity to the movement in market prices (in this case the S&P 500). How should this be reflected in the sensitivity analysis when showing equity price risk?

IFRS 7 defines market risks as including ‘other price risk’. Other price risk is defined as ‘The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market’. Therefore, while the sensitivity of ABC to movements in the market (represented by the S&P 500 in this instance) may be close to neutral, ABC remains sensitive to movements in the price of the portfolio it invests. Management should make quantitative disclosure of the sensitivity of ABC Ltd to movements in the S&P 500, even if the sensitivity is very minor, and qualitative disclosure of how it manages exposure to the index. It should also disclose that the entity is exposed to movements in the price of the securities in which it invests and that movements in those prices will have a proportional impact on the net income and equity of the entity.

4.53 Fund ABC Ltd invests in a long-only equity portfolio focusing on S&P 500 stocks. The management of ABC Ltd does not measure performance or manage risk against the S&P 500; it focuses instead on providing returns 4%-5% above a risk-free rate of return. When disclosing the sensitivity analysis in accordance with IFRS 7 para 40, how should ABC Ltd show its sensitivity to equity price movements?

Even though ABC Ltd does not measure or manage risk against the S&P 500, management is still required to identify a relevant risk variable on which to base the sensitivity analysis. Compliance with IFRS 7 para 40 is not based on how management manages or measures risk; it is based on the identification of a relevant risk variable on which to determine reasonably possible changes. There is no specific guidance in IFRS 7 para 40 as to what is a ‘relevant’ risk variable. However, when determining a risk variable, management should consider what index or benchmark best reflects the risk of the markets in which they invest. In this instance, the S&P 500 would appear to be the most relevant risk variable. Management should therefore provide a sensitivity analysis using the S&P 500 as the risk variable.

4.54 Fund ABC Ltd invests in a global equity portfolio. The management of ABC Ltd does not measure performance or manage risk against any specific benchmark or index; it focuses instead on providing returns 4%-5% above a risk-free rate of return. When disclosing the sensitivity analysis in accordance with IFRS 7 para 40, how should ABC Ltd show its sensitivity to equity price movements?

Even though ABC Ltd does not measure or manage risk against a specific benchmark or index, management is still required to identify a relevant risk variable on which to base the sensitivity analysis. There is no one index that reflects the risk of the markets in which ABC Ltd invests, given its global focus. Management should therefore identify the most relevant risk variable on which to base the sensitivity analysis. This could be by country allocation or sectors, or any other relevant variable.

For example, if management considers the most appropriate risk variable to be allocation by country, other price risk should be analysed by country with an appropriate index of each country being the risk variable. Management should then determine for each index what a reasonably possible shift would be and calculate the sensitivities based on the historical correlation of ABC Ltd's equity instruments to the index. For example:

“The table below summarises the impact of increases in the major equity indexes of countries in which the fund invests on the fund's post-tax profit for the year. The analysis is based on the assumption that the equity indexes have increased/ decreased as disclosed, with all other variables held constant and all the Funds equity investments moved according to historical correlations with the index.”

Index	Reasonably possible change in %	Impact on post-tax profit ('000)
DAX	6	109
Dow Jones	6	250
FTSE	6	67
All Ords	8	45
NZX 50	8	15
Hang Seng	10	25
Total		511

4.55 IFRS 7 para 40 requires management, when providing a sensitivity analysis, to disclose the effect on profit and loss and equity from reasonably possible changes in the relevant risk variable. If there is no effect on equity other than the effect the change in profit and loss has on retained earnings, should the effect on equity be disclosed separately?

No. IFRS 7 para 40 requires management to disclose the effect on the profit and loss and other components of equity if any (for example, effects from categorising some investments as available for sale). If the only effect on equity is the effect an increase or decrease in profit or loss has on retained earnings, no effect on equity needs to be disclosed [IFRS 7 App B27 and IFRS 7 IG 34-36].

4.56 Investment entity X is a fund of fund structure and invests in other private equity funds (the ‘underlying funds’). The underlying funds, which are managed by a third-party manager not related to X, are invested directly in private equity investments (the ‘underlying investments’). X receives periodically the NAVs of the underlying funds. The NAV normally represents the fair value at which transactions could be entered into.

All underlying investments are reported at fair value, which is derived from the NAV of the underlying fund. The historic volatility of the fund was 10%.

What method should be applied to present the other price risk?

IFRS 7 requires management to present a sensitivity analysis for all financial instruments. Fund investments qualify as financial instruments; a sensitivity analysis should therefore be disclosed. The sensitivity can be directly derived from the balance sheet value. If the fair value of the investments increased/decreased by 10%, the profit would increase/decrease by C1 million.

4.57 A private equity fund (ABC) invests in a number of other funds (‘Fund of funds’). The underlying funds invest in a variety of quoted and unquoted portfolio companies spanning multiple industry sectors and geographies. Management manages the portfolio by allocating and reallocating money to specific investment strategies. It specifically manages within those strategies after performing comprehensive due diligence. As at year end, ABC invested in 25 funds that could be categorised into four major strategies. ABC’s investment in the funds is evidenced by way of limited partnership interests. ABC’s management considers ABC’s exposure to risk to be to the managers of the underlying funds they invest and to the respective strategies. In assessing that risk, management obtains quarterly overall investment updates and performance figures from the underlying managers.

While management is aware of the types of risk ABC is exposed to via its investments in the underlying funds, no information, apart from the quarterly investor updates, is requested or obtained in respect of the underlying portfolios. ABC is directly exposed to equity price risk. This is the sensitivity of ABC to movements in the value of the limited partnership interests in the underlying funds and indirectly exposed to equity price risk and other risks that influence the value of their interests (for example, interest rates, FX rates, commodity prices and equity prices).

What information should ABC disclose in the financial statements of ABC to satisfy the requirements of IFRS 7 para 40 (sensitivity analysis with respect to market risk variables), in order to provide a meaningful representation of the risks inherent in the portfolio and the sensitivity of ABC to movements in the respective strategies?

Management should identify the relevant risk variable/s that best reflect the exposure of the entity to market risk.

As management considers ABC's exposure to risk to be to the managers of the underlying funds they invest and to the respective strategies, the sensitivity of the portfolio could be disclosed by fund strategy. If the relevant risk variable is determined to be fund strategy, management should look to provide meaningful disclosure of the sensitivity of ABC to movements in the respective strategies. We would also expect management to disclose qualitative information on the types of risk the funds, within each strategy, are directly exposed to – that is, the inherent risks of each of the funds within a strategy.

The following is an example of disclosure that may be suitable in the above circumstances:

“The table below summarises the impact on ABC’s profit of reasonably possible changes in returns of each of the strategies to which ABC is exposed through the 25 funds in which it invests over the year. A reasonably possible change is management’s assessment, based on historical data sourced from [add source], of what is a reasonably possible percentage movement in the value of a fund following each respective strategy over the next year. The impact on profit is determined by applying the reasonably possible movement of the respective strategy to each fund’s individual fair value. The analysis is based on the assumption that the relevant financial variables have increased or decreased as disclosed, with all other variables held constant. The underlying risk disclosures represent the direct market risks to which the funds are exposed. I, F, O represent interest rate, currency and other price risks”.

Strategy	Underlying risk exposure	Number of funds	Reasonable possible change (+/- %)	Impact on post tax profit (“000)
Pan-European buyout funds	I, F, O	10	5	900
UK buyout funds	I, O	8	5	600
US buyout funds	I, O	4	3	500
UK venture capital, small cap funds	O	3	2	300
Total		25		2,300

There is no one risk variable that reflects the risk of the markets in which ABC is exposed, given ABC's large number of investments in other funds and diverse strategies that it follows. As a result, ABC should identify what management considers to be the most relevant risk variable (strategy) on which to base the sensitivity analysis. The level of disclosure reflects the sensitivity to risk ABC that is exposed to and also the inherent risk of the instruments in which it invests.

4.58 A private equity fund invests in unlisted securities. The fair value of unlisted securities is determined by using valuation techniques. IFRS 7 para 40(a) requires entities to provide sensitivity analysis showing how profit or loss and equity would have been affected by changes in relevant risk variable that were reasonably possible at the reporting date.

A private equity fund typically determines fair value of unlisted securities by using valuation techniques, such as earnings multiples, and sometimes other discounted cash flow and net asset based techniques. These valuation methodologies incorporate a variety of variables, inputs and assumptions.

What factors should be considered by a private equity fund investing in unlisted securities when presenting sensitivity analyses for market risk?

Management should determine the key risk variables and inputs used in the valuation methodologies and provide sensitivity analysis for reasonably possible changes in these variables. IFRS 7 requires information about financial risks only, not operating or business risks. Earnings multiples, interest rates and currency rates are considered market risk variables. However, entity-specific asset values and earnings are not considered risk variables for IFRS 7 purposes. If management expects the key risk variable for a valuation methodology to be the discount rate (with reference to risk-free rates of return) or earnings multiple used (with reference to published private equity multiples), a sensitivity analysis should be disclosed for reasonably possible changes in the discount rate or the earnings multiple.

For example, European Fund LP (EF) invests in management buy-outs across a number of industry sectors in Western Europe. It manages its portfolio of investee companies according to the industries in which they operate, being consumer goods, transportation and technology. EF values these investments on an earnings-multiple basis, with valuation changes disclosed in the income statement. EF also invests in a number of infrastructure projects, which are valued on a DCF basis.

- Buyouts: on the basis that earnings multiples are the key market risk variable impacting the fair value, EF should divide its portfolio into the three industries, determine what a reasonable possible shift of PE multiples would be, by sector, and work out the impact for each investment of applying this variation.
- Infrastructure: on the basis that interest rates are the key market risk variable impacting the fair value, EF should consider past variability in the appropriate interest rate and determine a reasonable change, and apply to its DCF calculations.

Industry	Market risk variable	Number of investee companies	Reasonable possible change (%)	Impact on post-tax profit ("000)
Consumer goods	PE multiple	10	2	500
Transportation	PE multiple	4	1,5	350
Technology	PE multiple	8	4	600
Infrastructure	Interest rates	2	1	200
Total		24		1,650

This Q&A focuses only on the market risk disclosures required by IFRS 7 para 40. Additional disclosures may be required with respect to discounted cash flow calculations. When a valuation technique is used, IFRS 7 para 27 requires disclosure of the assumptions used. If there has been a change in valuation technique, the entity should disclose that change and the reasons for making it. For fair value measurement in Level 3 of the fair value hierarchy, the entity should disclose if a change of one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly. Disclosure of the effect of those changes is required [IFRS 7 para 27B(e)].

4.59 An investment entity is required to show in a sensitivity analysis the impact of a reasonably possible shift in market risks on profit or loss and equity. Should a private equity fund that has AFS equity investments take into consideration its impairment policy to distinguish between impacts on equity (if a reasonably possible decrease in share prices results in an amount below the impairment threshold) and impacts on profit or loss (if a reasonably possible decrease in share prices results in an amount above the impairment threshold)?

Yes. In cases where the fair value of a non-monetary AFS instrument is close to the impairment threshold, the entity should distinguish between profit or loss and equity effects, taking into consideration its impairment policy.

In cases where a non-monetary AFS financial asset is already impaired, the downwards shift should be shown as affecting profit or loss; the upwards shift should be shown affecting equity.

4.60 A private equity fund has a large holding of listed securities of a company. If the securities of that company are sold in its entirety by the private equity fund, the securities would be sold at a discount to the price for a small holding. Should the private equity fund disclose the effect of the discount?

A 'blockage factor' is not recorded for measurement purposes; hence no disclosures are required with reference to market risks. However, certain disclosures may be necessary with reference to market risk sensitivity analysis, disclosing the quoted security price as the market risk variable that is flexed.

The private equity fund also considers disclosure of risk concentration and/or liquidity risks. IFRS 7 para 34 requires disclosure of quantitative data about concentrations of risk [IFRS 7 IG18]. IFRS 7 para 39(c) requires the entity to describe how it manages the liquidity risk inherent in the maturity analysis of financial liabilities. The following additional disclosures might be considered:

- The nature of security;
- The extent of holding; and
- The effect on profit or loss.

5. Reclassification of financial assets

Management may choose to reclassify a non-derivative trading financial asset out of the held-for-trading category if the financial asset is no longer held for the purpose of selling it in the near term. Financial assets other than loans and receivables are permitted to be reclassified out of the held-for-trading category only in rare circumstances arising from a single event that is unusual and highly unlikely to recur in the near term. In addition, management may choose to reclassify financial assets that would meet the definition of loans and receivables out of the held-for-trading or available-for-sale categories if the group has the intention and ability to hold these financial assets for the foreseeable future or until maturity at the date of reclassification.

Reclassifications are made at fair value as of the reclassification date. Fair value becomes the new cost or amortised cost as applicable, and no reversals of fair value gains or losses recorded before reclassification date are subsequently made. Effective interest rates for financial assets reclassified to loans and receivables and held-to-maturity categories are determined at the reclassification date. Further increases in estimates of cash flows adjust effective interest rates prospectively.

5.1 Can an investment fund reclassify the amounts attributable to unit holders out of the fair value through profit or loss category?

No. Only non-derivative financial assets classified as held for trading can be considered for reclassification out of the fair value through profit or loss category.

5.2 Can an investment fund reclassify financial assets designated at fair value through profit or loss at initial recognition?

No. IAS 39 para 50(b) prohibits entities from reclassifying financial instruments out of the fair value through profit or loss category if they were voluntarily designated into that category on initial recognition.

5.3 Can an investor who committed to an investment in a private equity fund that the investor has classified at fair value through profit or loss because the investor has a past practice of selling the participations resulting from its capital commitments shortly after origination reclassify under the proposed amendments?

No. Loan commitments in the scope of IAS 39 meet the definition of a derivative; they are therefore prohibited from being reclassified under this amendment [IAS 39 para 50(a)].

5.4 Can an investment fund reclassify investments in associates that upon initial recognition were classified as held for trading under IAS 39?

Yes. Entities are permitted to reclassify investments in associates that are no longer held for trading (selling in the near term) in rare circumstances [IAS 39 para 50B]. Those investments are no longer eligible for the scope exemption; equity accounting in IAS 28 should therefore be applied. Fair value on the date of reclassification should be the deemed cost of the investment in associate for subsequent measurement.

However, reclassification is not permitted if the entity upon initial recognition designated the investment as at fair value through profit or loss.

5.5 IAS 1 para 122 requires disclosure of critical accounting judgements. Should an entity treat a decision to reclassify financial assets under the IAS 39 reclassifications amendment as a critical accounting judgement and provide the disclosure required by IAS 1 para 122?

It depends. Where significant judgement was involved and the impact on financial statements is significant, the disclosure required by IAS 1 para 122 should be made. In this case, the significant judgement note should include a cross reference to relevant information presented elsewhere in the financial statements (for example, as part of IFRS 7 reclassification disclosure). If the effect on the financial statements is not significant, the IAS 1 para 122 disclosure may not be required; however, the reclassification disclosures required by IFRS 7 para 12A(a)-(f) should still be given.

6. Other disclosure requirements

A. Collateral

Management should disclose the carrying amount of financial assets that it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with IAS 39 para 37(a) and the terms and conditions relating to its pledge [IFRS 7 para 14].

When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it should disclose [IFRS 7 para 15]:

- The fair value of the collateral held;
- The fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and
- The terms and conditions associated with its use of the collateral.

6.1 How should a fund disclose the financial assets pledged for securities lending?

The extent of the disclosures required depends on the terms and conditions relating to the pledge. For all assets pledged, the fund is required to disclose the carrying amount and the terms and conditions relating to the pledge [IFRS 7 para 14]. However, if the transferee has the right to sell or repledge the collateral received, the fund is required to disclose the financial assets pledged separately in its statement of financial position [IAS 39 para 37(a)].

6.2 IFRS 7 para 14 requires disclosure of the carrying amount of the financial assets that an entity has pledged as collateral for liabilities and the terms and conditions relating to such pledges. Does this include assets pledged as collateral for short sales?

Yes. Short sales are considered a liability for the purpose of complying with IFRS 7 para 14.

6.3 Does IFRS 7 require the quantitative disclosure of the fair value of collateral held as security for financial instruments that are neither past due nor impaired?

It depends. If the collateral held is permitted to be sold or repledged in the absence of default by the owner of the collateral, the fair value of the collateral is disclosed [IFRS 7 para 15(a) and (b)], in addition to qualitative disclosure [IFRS 7 para 15(c)]. If the collateral is not permitted to be sold or repledged, only qualitative disclosure is required [IFRS 7 para 36(b)].

B. Other quantitative disclosures

Management should disclose quantitative information for several items of income, expense, gains or losses either in the financial statements or in the notes.

6.4 Should interest income, interest expense and dividend income on financial instruments at fair value through profit or loss be reported as part of net gains or net losses in these financial instruments or separately as part of interest income, interest expense or dividend income?

IFRS 7 App B5(e) allows an accounting policy choice between these two treatments. The chosen policy should be consistently applied and disclosed.

It is possible to adopt one treatment for interest income and interest expense and a different treatment for dividend income, as no such prohibition exists in IFRS 7. However, the reporting of interest income should be consistent with that of interest expense.

IAS 18 para 35(b)(v) requires entities to disclose the amount of dividend income, if significant. Therefore, if dividend income is reported as part of net gains or net losses on financial instruments at fair value through profit or loss, the amount of dividend income on financial assets at fair value through profit or loss should be disclosed in the notes.

If management reports interest income and interest expense on financial instruments at FVTPL within interest income and interest expense, it should use the effective interest method in accordance with IAS 18 para 30(a) and IAS 39 para 9.

6.5 IFRS 7 para 20 requires a number of items of income, expenses, gains or losses to be disclosed separately, either in the income statement or in the notes. These items include:

- Net gains/losses per category of financial assets and liabilities;
- Total interest income and expense for financial assets not at fair value through profit or loss;
- Fee income and expense;
- Interest income on impaired assets; and
- The amount of any impairment loss for each class of financial assets.

Foreign exchange gains or losses are not mentioned in IFRS 7 para 20. Should the foreign exchange gains and losses be included in the disclosures of net gains or net losses?

It depends. IFRS 7 is silent on this issue; and management should look to the underlying principle of the standard that disclosures should be presented 'through the eyes of management'. Foreign exchange gains and losses on financial instruments should be disclosed externally by analogy based on the information provided to management.

In addition, the requirements of IAS 21 para 52(a) (disclosure of the amount of FX differences recognised in profit or loss) need to be met.

6.6 Investment manager A is acting as manager for funds as well as for individuals. Investment manager A receives a management fee of C10 million. The assets under A's management are C1.5 billion.

Is an investment manager who is engaged significantly in trust activities required to disclose that fact and to give an indication of the extent of those activities?

IFRS 7 does not require specific disclosures for fiduciary activities other than a disclosure of the fees earned and expenses borne [IFRS 7 para 20(c)(ii)]. However, an entity is required to disclose a description of the nature of the entity's operations and its principal activities [IAS 1 para 138(b)]. As a minimum, Investment manager A should disclose the fact that he is acting in a fiduciary capacity.

Even though there is no requirement in IFRS 7 to disclose the assets under management, such a disclosure would be helpful to users of the financial statements, as it would give an indication of the extent of those fiduciary activities.

Note: The disclosure of the assets under management might be required in some jurisdictions.

6.7 Investment manager B is managing investment funds sold to retail and institutional investors. To sell the fund, investment manager B employed an independent financial adviser and pays a trail commission of x% of the relevant net asset value.

Should B disclose the trail commission paid as fee expense from fiduciary capacity?

Yes. The investment manager is acting in a fiduciary capacity while managing the fund, and the fees are paid when an investment contract is secured. The fees paid should therefore be disclosed as expenses born from fiduciary activities.

6.8 Investment management company C is managing investment funds sold to retail and institutional investors. For managing the funds, C employs several fund managers. Each of the fund managers receives a fixed payment; in addition, if the fund's performance exceeds a defined benchmark, they receive a bonus of 10% of the performance fee that Investment management company C receives.

Should C disclose the remuneration of the fund managers as fee expenses from fiduciary capacity?

No. The payments to the employees of the investment manager are not expenses born in a fiduciary capacity.

Appendix: Disclosures required under IFRS

		Y-NA-NM	REF
	1. General disclosures		
IFRS7p6 AppxB1-B3	<i>When IFRS 7 requires disclosures by class of financial instrument, group the financial instruments into classes that are appropriate to the nature of the information disclosed. Take into account the characteristics of those financial instruments. Provide sufficient information to permit reconciliation to the line items presented in the balance sheet.</i>		
IFRS7p7	<p>For each class of financial asset, financial liability and equity instrument, disclose the accounting policies and methods adopted, including the criteria for recognition and the basis of measurement.</p> <p>As part of the disclosure of an entity's accounting policies, disclose, for each category of financial assets, whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (IAS 39 para 38).</p> <p>Provide disclosure of all significant accounting policies, including the general principles adopted and the method of applying those principles to transactions, other events and conditions arising in the entity's business. In the case of financial instruments, such disclosure includes:</p> <ul style="list-style-type: none"> (a) the criteria applied in determining when to recognise a financial asset or financial liability, and when to derecognise it; (b) the measurement basis applied to financial assets and financial liabilities on initial recognition and subsequently; and (c) the basis on which income and expenses arising from financial assets and financial liabilities are recognised and measured. <p>Disclose information that enables users of the financial statements to evaluate the significance of financial instruments for financial position and performance.</p>		
	2. Categories of financial assets and financial liabilities		
IFRS7p8	<p>Disclose either on the face of the balance sheet or in the notes the carrying amounts of each of the following categories, as defined in IAS 39:</p> <ul style="list-style-type: none"> (a) financial assets at fair value through profit or loss, showing separately: <ul style="list-style-type: none"> (i) those designated as such upon initial recognition; and (ii) those classified as held for trading in accordance with IAS 39; (b) held-to-maturity investments; (c) loans and receivables; (d) available-for-sale financial assets; (e) financial liabilities at fair value through profit or loss, showing separately: <ul style="list-style-type: none"> (i) those designated as such upon initial recognition; and (ii) those classified as held for trading in accordance with IAS 39; and (f) financial liabilities measured at amortised cost. 		

		Y-NA-NM	REF
	3. Financial assets or financial liabilities at fair value through profit or loss		
IFRS7p9	<p>1. If a loan or receivable (or group of loans or receivables) is designated as at fair value through profit or loss, disclose:</p> <p>(a) the maximum exposure to credit risk (see IFRS7p36(a)) of the loan or receivable (or group of loans or receivables) at the reporting date;</p> <p>(b) the amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk;</p> <p>(c) the amount of change, during the period and cumulatively, in the fair value of the loan or receivable (or group of loans or receivables) that is attributable to changes in the credit risk of the financial asset determined either:</p> <p>(i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk; or</p> <p>(ii) using an alternative method that the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset. Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate or index of prices or rates; and</p> <p>(d) the amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the loan or receivable was designated.</p>		
IFRS7p10	<p>2. If the entity has designated a financial liability as at fair value through profit or loss in accordance with IAS 39 para 9, disclose:</p> <p>(a) the amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability determined either:</p> <p>(i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see IFRS 7 App B4); or</p> <p>(ii) using an alternative method that the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability. <i>Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates. For contracts that include a unit-linking feature, changes in market conditions include changes in the performance of the related internal or external investment fund;</i> and</p> <p>(b) the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation</p>		
IFRS7p11 AppxB4	<p>3. Disclose:</p> <p>(a) the methods used to comply with the requirements in IFRS 7 para 9(c) and IFRS 7 para 10(a); and</p> <p>(b) if the entity believes that the disclosure it has given to comply with the requirements in IFRS 7 para 9(c) and IFRS 7 para 10(a) does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for</p>		

reaching this conclusion and the factors it believes are relevant.

4. Reclassification

- IFRS7p12** 1. If the entity has reclassified a financial asset (in accordance with paragraphs IAS 39 paras 51-54) as one measured:
- at cost or amortised cost, rather than at fair value; or
 - at fair value, rather than at cost or amortised cost, disclose the amount reclassified into and out of each category and the reason for that reclassification

An amendment to IAS 39, issued in October 2008, permits an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances. The amendment also permits an entity to transfer from the available-for-sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial asset had not been designated as available for sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future.

- IFRS7p12A** 2. If the entity has reclassified a financial asset out of the fair value through profit or loss category in accordance with IAS 39 paras 50B or 50D or out of the available-for-sale category in accordance with paragraph 50E of IAS 39, disclose:
- the amount reclassified into and out of each category;
 - for each reporting period until derecognition, the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods;
 - if a financial asset was reclassified in accordance with paragraph 50B, the rare situation, and the facts and circumstances indicating that the situation was rare;
 - for the reporting period when the financial asset was reclassified, the fair value gain or loss on the financial asset recognised in profit or loss or other comprehensive income in that reporting period and in the previous reporting period;
 - for each reporting period following the reclassification (including the reporting period in which the financial asset was reclassified) until derecognition of the financial asset, the fair value gain or loss that would have been recognised in profit or loss or other comprehensive income if the financial asset had not been reclassified, and the gain, loss, income and expense recognised in profit or loss; and
 - the effective interest rate and estimated amounts of cash flows the entity expects to recover, as at the date of reclassification of the financial asset.

5. Derecognition

- IFRS7p13** If financial assets have been transferred in such a way that part or all of the financial assets do not qualify for derecognition (see IAS 39 paras 15-37), disclose for each class of such financial assets:

- (a) the nature of the assets;
- (b) the nature of the risks and rewards of ownership to which the entity remains exposed;
- (c) when the entity continues to recognise all of the assets, the carrying amounts of the assets and of the associated liabilities; and
- (d) when the entity continues to recognise the assets to the extent of its continuing involvement, the total carrying amount of the original assets, the amount of the assets that the entity continues to recognise, and the carrying amount of the associated liabilities.

6. Collateral

- IFRS7p14** 1. Disclose:
- (a) the carrying amount of financial assets that the entity has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with IAS 39 para 37(a); and
 - (b) the terms and conditions relating to its pledge.
- IFRS7p15** 2. When the entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, disclose:
- (a) the fair value of the collateral held;
 - (b) the fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and
 - (c) the terms and conditions associated with its use of the collateral.

7. Allowance account for credit losses

- IFRS7p16**
AppxB1-B2,
B1(d) When financial assets are impaired by credit losses and the entity records the impairment in a separate account (for example, an allowance account used to record individual impairments or a similar account used to record a collective impairment of assets) rather than directly reducing the carrying amount of the asset, disclose a reconciliation of changes in that account during the period for each class of financial assets.

8. Compound financial instruments with multiple embedded derivatives

- IFRS7p17** If the entity has issued an instrument that contains both a liability and an equity component (IAS 32 para 28) and the instrument has multiple embedded derivatives whose values are interdependent (such as a callable convertible debt instrument), disclose the existence of those features.

9. Defaults and breaches

- IFRS7p18** 1. For loans payable recognised at the reporting date, disclose:
- (a) details of any defaults during the period of principal, interest, sinking fund or redemption terms of those loans payable;
 - (b) the carrying amount of the loans payable in default at the reporting date; and
 - (c) whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.
- IFRS7p19** 2. If during the period there were breaches of loan agreement terms other than those described in IFRS 7 para 18, disclose

the same information as required by IFRS 7 para18 if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the reporting date).

10. Items of income, expense, gains or losses

**IFRS7p20
AppxB1-B3,
B5(d)**

Disclose the following items of income, expense, gains or losses either on the face of the financial statements or in the notes:

- (a) net gains or net losses on:
 - (i) financial assets or financial liabilities at fair value through profit or loss, showing separately those on financial assets or financial liabilities designated as such upon initial recognition, and those on financial assets or financial liabilities that are classified as held for trading in accordance with IAS 39;
 - (ii) available-for-sale financial assets, showing separately the amount of gain or loss recognised directly in equity during the period and the amount removed from equity and recognised in profit or loss for the period;
 - (iii) held-to-maturity investments;
 - (iv) loans and receivables; and
 - (v) financial liabilities measured at amortised cost;
- (b) total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through profit or loss;
- (c) fee income and expense (other than amounts included in determining the effective interest rate) arising from:
 - (i) financial assets or financial liabilities that are not at fair value through profit or loss; and
 - (ii) trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans and other institutions;
- (d) interest income on impaired financial assets accrued in accordance with IAS 39 AG 93; and
- (e) the amount of any impairment loss for each class of financial asset.

11. Other disclosures

(a) Accounting policies

**IFRS7p21
1p117**

1. Disclose in the summary of significant accounting policies the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements.

**IFRS7
AppxB5**

Disclosure required by IFRS 7 para 21 may include:

- (a) for financial assets or financial liabilities designated as at fair value through profit or loss:
 - (i) the nature of the financial assets or financial liabilities the entity has designated as at fair value through profit or loss;
 - (ii) the criteria for designating such financial assets or financial liabilities on initial recognition; and
 - (iii) how the entity has satisfied the conditions in IAS 39 para 9, IAS 39 para 11A or IAS 39 para 12 for such designation. For instruments designated in accordance with IAS 39 para 9(b)(i) of the definition of

- a financial asset or financial liability at fair value through profit or loss, include a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with IAS 39 para 9(b)(ii) of the definition of a financial asset or financial liability at fair value through profit or loss, include a narrative description of how designation at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy;
- (b) the criteria for designating financial assets as available for sale;
 - (c) whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (see IAS 39 para 38);
 - (d) when an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses:
 - (i) the criteria for determining when the carrying amount of impaired financial assets is reduced directly (or, in the case of a reversal of a write-down, increased directly) and when the allowance account is used; and
 - (ii) the criteria for writing off amounts charged to the allowance account against the carrying amount of impaired financial assets (see IFRS 7 para 16);
 - (e) how net gains or net losses on each category of financial instrument are determined (see IFRS 7 para 20(a)), for example, whether the net gains or net losses on items at fair value through profit or loss include interest or dividend income;
 - (f) the criteria the entity uses to determine that there is objective evidence that an impairment loss has occurred (see IFRS 7 para 20(e)); and
 - (g) when the terms of financial assets that would otherwise be past due or impaired have been renegotiated, the accounting policy for financial assets that are the subject of renegotiated terms (see IFRS 7 para 36(d)).
2. Disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements (see IAS 1 para 122).
- (b) Hedge accounting**
- IFRS7p22** 1. Disclose the following separately for each type of hedge described in IAS 39 (ie, fair value hedges, cash flow hedges and hedges of net investments in foreign operations):
- (a) a description of each type of hedge;
 - (b) a description of the financial instruments designated as hedging instruments and their fair values at the reporting date; and
 - (c) the nature of the risks being hedged.
- IFRS7p23** 2. For cash flow hedges, disclose:
- (a) the periods when the cash flows are expected to occur and when they are expected to affect profit or loss;
 - (b) a description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;

- (c) the amount that was recognised in equity during the period;
- (d) the amount that was removed from equity and included in profit or loss for the period, showing the amount included in each line item in the income statement; and
- (e) the amount that was removed from equity during the period and included in the initial cost or other carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedged highly probable forecast transaction.
- IFRS7p24** 3. Disclose separately:
- (a) in fair value hedges, gains or losses:
- (i) on the hedging instrument; and
- (ii) on the hedged item attributable to the hedged risk;
- (b) the ineffectiveness recognised in profit or loss that arises from cash flow hedges; and
- (c) the ineffectiveness recognised in profit or loss that arises from hedges of net investments in foreign operations.
- IFRIC16p17** 4. If the step-by-step method of consolidation is used, disclose whether the entity has chosen to adjust the amounts reclassified to profit or loss on a disposal (or partial disposal) of a foreign operation to the amount that arises under the direct method.
- (c) **Fair value**
- IFRS7p25** 1. Except as set out in IFRS 7 para 29, for each class of financial assets and financial liabilities (see IFRS 7 para 6), disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.
- AppxB1-B3**
- IFRS7p26** In disclosing fair values, group financial assets and financial liabilities into classes, but offset them only to the extent that their carrying amounts are offset in the statement of financial position.
- AppxB1-B3**
- IFRS7p27** 2. Disclose for each class of financial instrument the methods and, when a valuation technique is used, the assumptions applied in determining fair values of each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates. If there has been a change in valuation technique, disclose that change and the reasons for making it.
- Appx B1-B3**
- IFRS7p27A** 3. To make the disclosures required by paragraph 27B, classify fair value measurements 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) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
- (b) inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2); and
- (c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).
- The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety is determined on the basis of the lowest level input that is significant to the fair

value measurement in its entirety. The significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, considering factors specific to the asset or liability.

- IFRS7p27B 4.** For fair value measurements recognised in the statement of financial position, disclose for each class of financial instrument:
- (a) 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 defined in IFRS 7 para 27A.
 - (b) any significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers. Transfers into each level are disclosed and discussed separately from transfers out of each level. For this purpose, significance is judged with respect to profit or loss, and total assets or total liabilities;
 - (c) 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:
 - (i) 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);
 - (ii) total gains or losses recognised in other comprehensive income;
 - (iii) purchases, sales, issues and settlements (each type of movement disclosed (a) separately); and
 - (iv) transfers into or out of Level 3 (for example, transfers attributable to changes in the observability of market data) and the reasons for those transfers. For significant transfers, transfers into Level 3 are disclosed and discussed separately from transfers out of Level 3;
 - (d) the amount of total gains or losses for the period in (c)(i) 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); and
 - (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, then the entity states that fact and discloses the effect of those changes. The entity discloses how the effect of a change to a reasonably possible alternative assumption was calculated. For this purpose, significance is 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.

Disclose the quantitative disclosures in IFRS 7 para 27B in tabular format unless another format is more appropriate.

		Y-NA-NM	REF
IFRS7p28	<p>5. If the market for a financial instrument is not active, its fair value is established using a valuation technique (see IAS 39 AG74-79). The best evidence of fair value at initial recognition is the transaction price (ie, the fair value of the consideration given or received), unless conditions described in IAS 39 AG76 are met. There could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, disclose, by class of financial instrument:</p> <p>(a) the accounting policy for recognising that difference in profit or loss to reflect a change in factors (including time) that market participants would consider in setting a price (see IAS 39 AG76A); and</p> <p>(b) 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.</p>		
IFRS7p29	<p>6. Disclosures of fair value are not required:</p> <p>(a) when the carrying amount is a reasonable approximation of fair value (for example, for financial instruments such as short-term trade receivables and payables);</p> <p>(b) for an investment in equity instruments that do not have a quoted market price in an active market, or derivatives linked to such equity instruments, that is measured at cost in accordance with IAS 39 because its fair value cannot be measured reliably; or</p> <p>(c) for a contract containing a discretionary participation feature (as described in IFRS 4) if the fair value of that feature cannot be measured reliably.</p>		
IFRS7p30	<p>7. In the cases described in IFRS 7 para 29(b) and (c), disclose information to help users of the financial statements make their own judgements about the extent of possible differences between the carrying amount of those financial assets or financial liabilities and their fair value, including:</p> <p>(a) the fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;</p> <p>(b) a description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;</p> <p>(c) information about the market for the instruments;</p> <p>(d) information about whether and how the entity intends to dispose of the financial instruments; and</p> <p>(e) if financial instruments whose fair value previously could not be reliably measured are derecognised, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognised.</p>		
IFRS7p30	<p>8. Some financial assets and financial liabilities contain a discretionary participation feature as described in IFRS 4. If an entity cannot measure reliably the fair value of that feature, disclose that fact together with a description of the contract, its carrying amount, an explanation of why fair value cannot be measured reliably, information about the market for the instrument, information about whether and how the entity intends to dispose of the instrument and, if financial instruments whose fair value previously could not be reliably measured are derecognised, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognised.</p>		

Applying the liability adequacy test (IFRS 4 paras 15-19) to such comparative information may be impracticable, but it is unlikely to be impracticable to apply other requirements of IFRS 4 paras 10-35 to such comparative information. IAS 8 explains the term 'impracticable'.

12. Nature and extent of risks arising from financial instruments

IFRS7p31 Disclose information that enables users of the financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the reporting date.

IFRS7 AppdxB6 *The disclosures required by IFRS 7 paras 31-42 should either be given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.*

IFRS7p32 The disclosures required by IFRS 7 para 33-42 focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, liquidity risk and market risk.

13. Qualitative disclosures

IFRS7p33 For each type of risk arising from financial instruments, disclose:

- (a) the exposures to risk and how they arise;
- (b) objectives, policies and processes for managing the risk and the methods used to measure the risk; and
- (c) any changes in (a) or (b) from the previous period.

14. Quantitative disclosures

IFRS7p34 AppdxB7, B10A 1. For each type of risk arising from financial instruments, disclose:

- (a) summary quantitative data about exposure to that risk at the reporting date. This disclosure should be based on the information provided internally to key management personnel of the entity (as defined in IAS 24), for example the entity's board of directors or chief executive officer;
- (b) the disclosures required by IFRS 7 para 36-42, to the extent not provided in (a), unless the risk is not material (see IAS 1 paras 29-31 for a discussion of materiality); and
- (c) concentrations of risk if not apparent from (a) and (b).

IFRS7 AppdxB8 IFRS 7 para 34(c) requires disclosures about concentrations of risk. Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions. The identification of concentrations of risk requires judgement, taking into account the circumstances of the entity. Include in the disclosure of concentrations of risk:

- (a) a description of how management determines concentrations;
- (b) a description of the shared characteristic that identifies each concentration (for example, counterparty, geographical area, currency or market); and

	(c) the amount of the risk exposure associated with all financial instruments sharing that characteristic.		
IFRS7p35	2. If the quantitative data disclosed as at the reporting date is unrepresentative of the entity's exposure to risk during the period, provide further information that is representative.		
	(a) Credit risk		
IFRS7p36 AppdxB9-10	Disclose by class of financial instrument:		
	(a) the amount that best represents the entity's maximum exposure to credit risk at the reporting date without taking account of any collateral held or other credit enhancements (for example, netting agreements that do not qualify for offset in accordance with IAS 32);		
	(b) in respect of the amount disclosed in (a), a description of collateral held as security and other credit enhancements;		
	(c) information about the credit quality of financial assets that are neither past due nor impaired; and		
	(d) the carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated.		
	Financial assets that are either past due or impaired		
IFRS7p37	Disclose by class of financial asset:		
	(a) an analysis of the age of financial assets that are past due as at the reporting date but not impaired;		
	(b) an analysis of financial assets that are individually determined to be impaired as at the reporting date, including the factors the entity considered in determining that they are impaired; and		
	(c) for the amounts disclosed in (a) and (b), a description of collateral held by the entity as security and other credit enhancements and, unless impracticable, an estimate of their fair value.		
	Collateral and other credit enhancements obtained		
IFRS7p38	1. When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (for example, guarantees), and such assets meet the recognition criteria in other standards, disclose:		
	(a) the nature and carrying amount of the assets obtained; and		
	(b) when the assets are not readily convertible into cash, the policies for disposing of such assets or for using them in its operations.		
	(b) Liquidity risk		
IFRS7p39 AppdxB10A -B11A, B11C, B11D, B11E and B11F	Disclose:		
	(a) a maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities;		
	(b) a maturity analysis for derivative financial liabilities. The maturity analysis should include the remaining contractual maturities that are essential for an understanding of the timing of the cash flows; and		
	(c) a description of how the liquidity risk inherent in (a) and (b).		
IFRS7 AppdxB11	<i>In preparing the contractual maturity analysis for financial liabilities required by IFRS 7 para 39(a) and (b), use judgement to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:</i>		

- (a) no later than one month;
- (b) later than one month and no later than three months;
- (c) later than three months and no later than one year; and
- (d) later than one year and no later than five years.

(c) Market risk

Sensitivity analysis

**IFRS7p40
AppdxB17-
B19 and
B21-B28**

Unless an entity complies with IFRS 7 para 41, disclose:

- (a) a sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;
- (b) the methods and assumptions used in preparing the sensitivity analysis; and
- (c) changes from the previous period in the methods and assumptions used, and the reasons for such changes.

**IFRS7p41
AppdxB20**

If the entity prepares a sensitivity analysis, such as value at risk, that reflects interdependencies between risk variables (for example, interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis specified in IFRS 7 para 40. Also disclose:

- (a) an explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and
- (b) an explanation of the objective of the method used and of limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved.

IFRS7p42

Other market risk disclosures

When the sensitivity analyses disclosed in accordance with IFRS 7 para 40 or IFRS 7 para 41 are unrepresentative of a risk inherent in a financial instrument (for example, because the year-end exposure does not reflect the exposure during the year), disclose that fact and the reason the sensitivity analyses are unrepresentative.

IFRIC2p13

When a change in the redemption prohibition leads to a transfer between financial liabilities and equity, disclose separately the amount, timing and reason for that transfer.

15. Capital disclosures

1p134,135

1. Disclose information that enables users of its financial statements to evaluate its objectives, policies and processes for managing capital.

1p135

2. To comply with paragraph 134, disclose the following:
 - (a) qualitative information about its objectives, policies and processes for managing capital, including (but not limited to):
 - (i) a description of what it manages as capital;
 - (ii) when an entity is subject to externally imposed capital requirements, the nature of those requirements and how those requirements are incorporated into the management of capital; and
 - (iii) how it is meeting its objectives for managing capital;

- (b) summary quantitative data about what it manages as capital. Some entities regard some financial liabilities (for example, some forms of subordinated debt) as part of capital. Other entities regard capital as excluding some components of equity (for example, components arising from cash flow hedges);
- (c) any changes in (a) and (b) from the previous period;
- (d) whether during the period it complied with any externally imposed capital requirements to which it is subject; and
- (e) when the entity has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

Base these disclosures on the information provided internally to the entity's key management personnel.

1p136

An entity may manage capital in a number of ways and be subject to a number of different capital requirements. For example, a conglomerate may include entities that undertake insurance activities and banking activities, and those entities may also operate in several jurisdictions. When an aggregate disclosure of capital requirements and how capital is managed would not provide useful information or distorts a financial statement user's understanding of an entity's capital resources, the entity should disclose separate information for each capital requirement to which the entity is subject.

1p80A(a)

5. If an entity has reclassified a puttable financial instrument classified as an equity instrument between financial liabilities and equity, disclose:
- (a) the amount reclassified into and out of each category (financial liabilities or equity); and
 - (b) the timing and reason for that reclassification.

1p136A

6. Disclose for puttable financial instruments classified as equity instruments (to the extent not disclosed elsewhere):

1p136A(a)

- (a) summary quantitative data about the amount classified as equity;

1p136A(b)

- (b) its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period;

1p136A(c)

- (c) the expected cash outflow on redemption or repurchase of that class of financial instruments; and

1p136A(d)

- (d) information about how the expected cash outflow on redemption or repurchase was determined.

1p136A(b)

7. If an entity has reclassified an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and is classified as an equity instrument between financial liabilities and equity, disclose:
- (a) the amount reclassified into and out of each category (financial liabilities or equity); and
 - (b) the timing and reason for that reclassification.

**1p136A(a),
(b)**

8. Disclose in relation to dividends:
- (a) the amount of dividends proposed or declared before the financial statements were authorised for issue but not recognised as a distribution to owners in the period, and the related amount per share; and
 - (b) the amount of any cumulative preference dividends not recognised.

16. Financial guarantees

Amendments to IAS 39 and IFRS 4, Financial Guarantee Contracts, was issued in August 2005.

The issuer of financial guarantee contracts may elect to apply either IFRS 4 (if the entity has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts) or IAS 39 for measurement of financial guarantee contracts.

If the entity elects to apply IFRS 4, it should comply with IFRS 4 disclosure requirements to such contracts (refer to Section E).

If the entity elects to apply IAS 39 for measurement of financial guarantee contracts, it should comply with IFRS 7 disclosure requirements for these contracts.

Y-NA-NM REF

Y-NA-NM	REF

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IFRS 7: Potential impact of market risks

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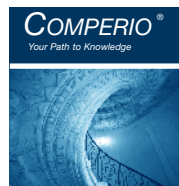
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