ACCOUNTING STANDARDS BOARD JULY 2004 FRED 33

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FINANCIAL INSTRUMENTS:

DISCLOSURES

ACCOUNTING
STANDARDS
BOARD

FINANCIAL REPORTING
EXPOSURE DRAFT

For the convenience of respondents in compiling their responses, the text of the questions in the Invitation to Comment on which particular comments are invited (see pages 7 to 13) can be downloaded (in Word format) from the 'Financial Instruments' page in the Current Projects section of the ASB Website (www.frc.org.uk/asb).

For ease of handling, we prefer comments to be sent by email (in Word format), to

fred33@frc-asb.org.uk

Comments may also be sent in hard copy form to:

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Comments should be despatched so as to be received no later than 22 October 2004. All replies will be regarded as on the public record, unless confidentiality is requested by the commentator.

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FINANCIAL REPORTING

EXPOSURE DRAFT

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PREFACE

Introduction

1. This Financial Reporting Exposure Draft (FRED) is issued as part of the Accounting Standards Board's (ASB's) programme to bring about convergence between UK Accounting Standards and International Financial Reporting Standards (IFRSs*). It sets out for comment a proposed UK accounting standard, based on a proposed IFRS.

The IASB's proposals

2. Currently the International Accounting Standards Board (IASB) has its main financial instrument disclosures in two standards: IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*. It has recently been reviewing these requirements and concluded that they need to be consolidated, amended and supplemented. It is proposing to:

    - issue a new IFRS that will contain some new disclosure requirements as well as disclosures already required by IAS 32; and

    - require additional capital disclosure requirements in the new IFRS.

    All disclosure requirements (including those not carried forward into the new standard) will be deleted from IAS 32.

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* *The IASB has designated its recent standards as International Financial Reporting Standards or IFRSs. Standards issued prior to 2002 are identified as International Accouting Standards or IASs. In this Preface, the term IFRS is used to refer to both IFRSs and IASs.*

3. The IASB is proposing to implement its new IFRS for accounting periods beginning on or after 1 January 2007, whilst encouraging entities to adopt earlier if they so wish.

The ASB's proposals

Background

4. The ASB's main financial instrument disclosure requirements are currently contained within FRS 13 *Derivatives and Other Financial Instruments: Disclosures*. The disclosure requirements in this standard apply to banks, financial institutions and listed entities.

5. As part of its convergence programme the ASB issued FRED 30 *Financial Instruments: Disclosure and Presentation & Recognition and Measurement* in June 2002. This was followed by supplements to the FRED in August 2003, April and July 2004, reflecting proposed revisions to IAS 32 and 39 from the IASB. FRED 30, as amended by these supplements, proposed inter alia the adoption of IAS 32, including the disclosure requirements, by all entities reporting under UK accounting standards (other than those falling within the scope of the FRSSE).

6. In the Preface to FRED 30 Second Supplement, the Board noted that a further IASB exposure draft was expected and that consequential changes would be incorporated into the equivalent UK standards.

7. The ASB is proposing that the UK Standard in this FRED should be implemented at the same date as the proposed IFRS and that the option for early adoption should also be available to UK entities implementing the UK Standard. This would offer the possibility of a single change to disclosures in 2005 rather than making disclosures based on [draft] FRS ● (IAS 32) *Financial Instruments: Disclosure and Presentation* in 2005 and 2006 and then making a second change to disclosures to those

prescribed in this Standard. Upon implementation of this new Standard, the disclosure requirements of the proposed standards set out in FRED 30 *Financial Instruments: Disclosure and Presentation* will be deleted.

8. In line with the proposals made in the Second Supplement to FRED 30 the ASB is proposing that the disclosure requirements in this FRED should also apply to all entities reporting under UK accounting standards (other than those falling within the scope of the Financial Reporting Standard for Smaller Entities (FRSSE)).

Capital Disclosures

9. The IASB's exposure draft contains certain disclosure requirements in relation to capital which are applicable to all entities (regardless of whether they have significant financial instruments). In the Board's view these proposed amendments represent an improvement in financial reporting. The proposed requirements are set out in paragraphs 46 - 48.

Differences between proposed UK standard and the IASB's exposure draft

10. In line with its objective of convergence the ASB has decided to implement the text of the IASB's exposure draft with as few amendments as possible, making only those changes that are necessary to apply it in a UK context. Deleted text has been struck through and inserted text is underlined.

11. FRED 30 Second Supplement proposed certain disclosure requirements for entities that will not be applying FRS ● (Part of IAS 39) *Financial Instruments: Measurement*. These additional requirements are retained in the proposed Standard and are located at paragraphs 23A and 23B.

12. The ASB has previously decided not to implement those sections of IAS 39 relating to recognition and derecognition in place of the requirements in FRS 5 *Reporting the substance of transactions*. This was based on the ASB's view that FRS 5 plays a critical role in UK financial reporting and should be retained until such a time as its most important requirements have adequate counterparts under IFRS. FRED 30 Second Supplement therefore proposed that the IAS 32 disclosure requirements relating to derecognition should not be implemented in the UK. This FRED adopts the same approach so paragraph 14 of the draft IFRS has been deleted.

Relationship of the draft UK Standard to the Fair Value Directive

13. The Fair Value Directive adopted by the EU in 2001 requires Member States to amend companies' legislation to enable companies to adopt the then current version of IAS 39 and to require them to provide certain disclosures about financial instruments. The Government intends to implement the requirements of this Directive in UK company law effective for accounting periods commencing on or after 1 January 2005.

14. The disclosure requirements of the Government's proposals to implement the Directive would require some disclosures that go beyond the requirements in the proposed Standard. Accordingly, compliance with the new Standard would not necessarily ensure full compliance with the proposed amendments to company legislation. Appendix C compares the disclosure requirements proposed by the Government and by the proposed Standard.

Transitional arrangements and consequential amendments

15. The IASB's exposure draft proposes certain changes to IFRS 1 *First Time Adoption of International Financial*

Reporting Standards setting out transitional provisions for entities that intend to adopt this Standard early. The ASB believes UK entities reporting under UK standards should be able to take advantage of similar transitional provisions and therefore proposes to include them in the UK Standard. The provisions are contained in paragraph 49A.

16. The proposals made within this FRED will supersede the disclosure requirements of the draft FRS ● (IAS 32) *Financial Instruments: Disclosure and Presentation* (set out in FRED 30) which in turn are intended to supersede FRS 13 *Derivatives and Other Financial Instruments: Disclosures*.

17. Given that a number of the disclosure requirements included in this FRED have been taken unamended from draft FRS ● (IAS 32) *Financial Instruments: Disclosure and Presentation* (set out in FRED 30) a table of concordance has been provided in Appendix B to enable readers to track the contents of FRED 30 Second Supplement to the current proposed draft.

Invitation to comment

18. The ASB is requesting comments on any aspect of the FRED by 22 October 2004.

19. The ASB would welcome comments in particular on the following:

ASB(i) The ASB does not propose any exemptions from the disclosure requirements in this Standard other than for entities applying the FRSSE. Do you agree?

ASB(ii) The ASB is proposing to retain the new capital disclosure requirements within this Standard as it believes that these represent an improvement in financial reporting. The effect of this would be that the capital disclosure requirements apply to all entities, including those that do not have any significant financial instruments. Do you agree with this proposal?

20. The IASB have asked commentators to respond to the following questions on the proposed changes:

IASB(i) The draft IFRS incorporates disclosures at present contained in IAS 32 *Financial Instruments: Disclosure and Presentation* so that all disclosures about financial instruments are located in one Standard. It also proposes to add the following disclosure requirements:

(a) financial assets and financial liabilities by classification (see paragraphs 10 and BC13).

(b) information about any allowance account (see paragraphs 17 and BC14).

(c) income statement amounts by classification (see paragraphs 21(a), BC15 and BC16).

(d) fee income and expense (see paragraphs 21(d) and BC17).

Are these proposals appropriate? If not, why not? What alternative disclosures would you propose?

IASB(ii) For an entity's exposure to credit risk, the draft IFRS proposes to require disclosure of the fair value of collateral pledged as security and other credit enhancements unless impracticable (see paragraphs 39, 40, BC27 and BC28).

Is this proposal appropriate? If not, why not? What, if any, alternative disclosures would you propose to meet the stated objective?

IASB(iii) For an entity that has an exposure to market risk arising from financial instruments, the draft IFRS proposes to require disclosure of a sensitivity analysis (see paragraphs 43, 44 and BC36 - BC39).

Is the proposed disclosure of a sensitivity analysis practicable for all entities?

If not, why not and what, if any, alternative disclosures of market risk would you propose to meet the stated objective of enabling users to evaluate the nature and extent of market risk?

IASB(iv) The draft IFRS proposes disclosure of information that enables users of an entity's financial statements to evaluate the nature and extent of its capital. This includes a proposed requirement to disclose qualitative information about the entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether during the period it complied with any capital targets set by management and any externally imposed capital requirements; and if it has not complied, the consequences of such non-compliance (see paragraphs 46-48 and BC45 - BC54).

Is this proposal appropriate? If not, why not? Should it be limited to only externally imposed capital requirements? What, if any, alternative disclosures would you propose?

IASB(v) The proposed effective date is for periods beginning on or after 1 January 2007 with earlier adoption encouraged (see paragraphs 49 and BC62 - BC67).

Entities adopting IFRSs and the draft IFRS for the first time before 1 January 2006 would be exempt from providing comparative disclosures for the draft IFRS in the first year of adoption (see Appendix B, paragraph B9).

Are the proposed effective date and transition requirements appropriate? If not, why not? What alternative would you propose?

IASB(vi) The disclosure of risks arising from financial instruments proposed by the draft IFRS would be part of the financial statements prepared in accordance with International Financial Reporting Standards (see paragraph BC41). Some believe that disclosures about risks should not be part of financial statements prepared in accordance with IFRSs; rather they should be part of the information provided by management outside the financial statements.

Do you agree that the disclosures proposed by the draft IFRS should be part of the financial statements? If not, why not?

IASB(vii) Paragraph B10 of Appendix B proposes amendments to the risk disclosures in IFRS 4 *Insurance Contracts* to make them consistent with the requirements proposed in the draft IFRS. The requirements in IFRS 4 were based on disclosure requirements in IAS 32 that would be amended by the draft IFRS. The Board's reasons for proposing these amendments are set out in paragraphs BC57 - BC61.

Do you agree that the risk disclosures in IFRS 4 should be amended to make them consistent with the requirements proposed in the draft IFRS? If not, why not and what amendments would you make pending the outcome of phase II of the Board's Insurance project?

IASB(viii) The draft Implementation Guidance accompanying the draft IFRS suggests possible ways to apply the risk disclosure requirements in paragraphs 32-45 (see paragraphs BC19, BC20 and BC42 - BC44).

Is the Implementation Guidance sufficient? If not, what additional guidance would you propose?

IASB(ix) The FASB's Proposed Statement of Financial Accounting Standards *Fair Value Measurements*, which is open for public comment at the same time as this Exposure Draft, proposes guidance on how to measure fair value that would apply broadly to financial and non-financial assets and liabilities that are measured at fair value in accordance with other FASB pronouncements. That Exposure Draft proposes disclosure of information about the use of fair value in measuring assets and liabilities as follows:

(a) For assets and liabilities that are remeasured at fair value on a recurring (or ongoing) basis during the period (for example, trading securities)

(i) the fair value amounts at the end of the period, in total and as a percentage of total assets and liabilities,

(ii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and

(iii) the effect of the remeasurements on earnings for the period (unrealised gains or losses) relating to those assets and liabilities still held at the reporting date.

(b) For assets and liabilities that are remeasured at fair value on a non-recurring (or periodic) basis during the period (for example, impaired assets), a description of

(i) the reason for remeasurements,

(ii) the fair value amounts,

(iii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and

(iv) the effect of the remeasurements on earnings for the period relating to those assets and liabilities still held at the reporting date.

Disclosures similar to (a)(ii) above are proposed in paragraph 31 of the draft IFRS (and are currently required by paragraph 92 of IAS 32) and disclosures similar to (a)(iii) are proposed in paragraph 21(a).

Do you agree that the requirements in the draft IFRS provide adequate disclosure of fair value compared with those proposed in the FASB's Exposure Draft? If not, why not, and what changes to the draft IFRS would you propose?

IASB(x) Do you have any other comments on the draft IFRS, Implementation Guidance and Illustrative Examples?

[DRAFT] FRS ● 'FINANCIAL INSTRUMENTS: DISCLOSURES'

[Draft] Financial Reporting Standard ● embodies [draft] IFRS ●'Financial Instruments: Disclosure' and some amendments to that standard adopted for entities subject to UK accounting standards.

The [draft] Statement of Standard Accounting Practice in [draft] FRS ● is set out in paragraphs 1–50 and Appendix A. All paragraphs have equal authority. Paragraphs in bold type state the main principles. Terms defined in Appendix A are in italics the first time they appear.

Accompanying the [draft] Statement of Standard Accounting Practice is the basis for the conclusions reached in the Statement and some implementation guidance, neither of which forms part of the Statement.

The [draft] Statement of Standard Accounting Practice should be read in the context of its objectives as stated in paragraph 1, the Basis for Conclusions set out in paragraphs BC1–BC69, and the Accounting Standard Board's 'Foreword to Accounting Standards' and 'Statement of Principles for Financial Reporting'.

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INTRODUCTION*

REASONS FOR ISSUING THE [DRAFT] IFRS†

IN1 In recent years, the techniques used by entities for measuring and managing exposure to risks arising from financial instruments have evolved and new risk management concepts and approaches have gained acceptance. In addition, many public and private sector initiatives have proposed improvements to the disclosure framework for risks arising from financial instruments.

IN2 The International Accounting Standards Board believes that users of financial statements need information about an entity's exposure to risks and how those risks are managed. Such information can influence a user's assessment of the financial position and financial performance of an entity or of the amount, timing and uncertainty of its future cash flows. Greater transparency regarding those risks allows users to make more informed judgements about risk and return.

IN3 Consequently, the Board concluded that there was a need to revise and enhance the disclosures in IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* and IAS 32 *Financial Instruments: Disclosure and Presentation*. As part of this revision, the Board:

(a) reviewed existing disclosures in IAS 30 and IAS 32 and proposes to remove unnecessarily onerous or duplicative disclosures. This includes simplifications to the disclosures about concentrations of risk, credit risk, liquidity risk and market risk in IAS 32 and the deletion of disclosures about contingencies and commitments and general banking risks in IAS 30.

(b) proposes to locate in one place all disclosures relating to financial instruments. Consequently, paragraphs 9-31 of the [draft] IFRS are

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* *ASB Footnote:* This introduction has been prepared by the IASB and is included in this FRED in full and unamended. References here to the "Board" are references to the IASB.

† *ASB Footnote:* Although references to specific IFRSs have been amended so that the [draft] standard can be applied in a UK context, the standard's references to itself as an 'IFRS' and its references to other extant accounting standards as 'other IFRS' have been left unchanged. They should though be taken to be references to this [draft] FRS and to extant standards issued in the UK and the Republic of Ireland.

generally unamended from IAS 32. The Table of Concordance accompanying the [draft] IFRS indicates how the contents of IAS 30 and IAS 32 (revised in December 2003) and the [draft] IFRS correspond.

MAIN FEATURES OF THIS [DRAFT] IFRS

IN4 [Draft] IFRS X applies to all risks arising from all financial instruments, except for those instruments listed in paragraph 3. The [draft] IFRS applies to all entities, including entities that have few financial instruments (eg a manufacturer whose only financial instruments are accounts receivable and accounts payable) and those that have many financial instruments (eg a financial institution most of whose assets and liabilities are financial instruments). However, the extent of disclosure required depends on the extent of the entity's use of financial instruments and of its exposure to risk.

IN5 The [draft] IFRS requires disclosure of the significance of financial instruments for an entity's financial position and performance. The [draft] IFRS incorporates many of the requirements previously in IAS 32.

IN6 The [draft] IFRS adds to the requirements previously in IAS 32 by requiring:

(a) enhanced balance sheet and income statement disclosures; and

(b) disclosures about an allowance account when one is used to reduce the carrying amount of impaired financial assets.

IN7 The [draft] IFRS requires qualitative and quantitative disclosures about exposure to risks arising from financial instruments. The qualitative disclosures describe management's objectives, policies and processes for managing those risks. The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel. Together, these disclosures provide an overview of the entity's use of financial instruments and the exposures to risks they create.

IN8 The [draft] IFRS requires specified minimum disclosures about credit risk, liquidity risk and market risk (including interest rate risk).

IN9 The [draft] IFRS requires disclosure of qualitative information about the entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether during the period it complied with any capital targets set by management and any externally imposed capital requirements; and if it has not complied, the consequences of such non-compliance.

IN10 The [draft] IFRS is accompanied by Implementation Guidance that describes how the disclosures required by the [draft] IFRS might be provided and Illustrative Examples that illustrate the application of the capital disclosure requirements.

[DRAFT] FINANCIAL REPORTING STANDARD X

FINANCIAL INSTRUMENTS: DISCLOSURES

OBJECTIVE

1 The objective of this [draft] IFRS is to require entities to provide disclosures in their financial statements that enable users to evaluate:

(a) the significance of financial instruments for the entity's financial position and performance;

(b) the nature and extent of risks arising from financial instruments to which the entity was exposed during the period and at the reporting date; and

(c) the entity's capital.

2 The principles in this IFRS complement the principles for recognising, measuring and presenting financial assets and financial liabilities in [draft] FRS ● (IAS 32) *Financial Instruments: Presentation* and [draft] FRS ● (Part of IAS 39) *Financial Instruments: ~~Recognition and~~ Measurement*.

SCOPE

2A This Standard applies to all financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income or expenditure). Reporting entities applying the Financial Reporting Standard for Smaller Entities (FRSSE) are exempt from this Standard.

2B An entity that is not applying [draft] FRS ● (Part of IAS 39) *Financial Instruments: Measurement* shall adapt the disclosures required by this Standard in line with its accounting policies for the relevant transactions, and describe those accounting policies as required by paragraph 23. Such entities should apply the definitions of [draft] FRS ● (Part of IAS 39) in determining the scope of this Standard.

3 This [draft] IFRS shall be applied ~~by all entities~~ to all types of financial instruments, except:

(a) those interests in ~~subsidiaries, associates and joint ventures that are accounted for in accordance with IAS 27~~ ~~*Consolidated and Separate*~~

~~*Financial Statements,* IAS 28 *Investments in Associates* or IAS 31 *Interests in Joint Ventures*~~ subsidiary, quasi-subsidiary and associated undertakings, partnerships and joint ventures that are accounted for under FRS 2 *Accounting for Subsidiary Undertakings*; FRS 5 *Reporting the Substance of Transactions*; and FRS 9 *Associates and Joint Ventures*. However, entities shall apply this [draft] IFRS to an interest in a ~~subsidiary, associate or joint venture that according to IAS 27, IAS 28 or IAS 31~~ subsidiary, quasi-subsidiary and associated undertaking, partnership and joint venture that is accounted for in accordance with [draft] FRS ● (Part of IAS 39) *Financial Instruments:* ~~*Recognition and*~~ *Measurement* or is otherwise accounted for as held for resale. In these cases, entities shall apply the disclosure requirements in ~~IAS 27, IAS 28 and IAS 31~~ FRSs 2, 5 and 9 in addition to those in this [draft] IFRS. Entities shall also apply the [draft] IFRS to all derivatives on interests in subsidiaries, associates or joint ventures unless the derivative meets the definition of an equity instrument in [draft] FRS ● (IAS 32).

(b) employers' rights and obligations arising from employee benefit plans, to which ~~IAS 19 *Employee*~~ FRS 17 *Retirement Benefits* applies.

(c) contracts for contingent consideration in a business combination (see ~~IFRS 3 *Business Combinations*~~ paragraphs 81-84 of FRS 7 *Fair Values in Acquisition Accounting*). This exemption applies only to the acquirer.

(d) insurance contracts ~~as defined in IFRS 4 *Insurance Contracts*~~. However, the [draft] IFRS applies to derivatives that are embedded in insurance contracts if [draft] FRS ● (Part of IAS 39) requires the entity to account for them separately.

(e) financial instruments, contracts and obligations under share-based payment transactions to which FRS 20 (IFRS 2) *Share-based Payment* applies, except for contracts within the scope of paragraphs 5-7 of [draft] FRS ● (Part of IAS 39), to which the [draft] IFRS applies.

4 The [draft] IFRS applies to recognised and unrecognised financial instruments. ~~Recognised financial instruments include financial assets and financial liabilities that are within the scope of IAS 39. Unrecognised financial instruments include some financial instruments that, although outside the scope of IAS 39, are within the scope of the [draft] IFRS (such as some loan commitments).~~

5 The [draft] IFRS shall be applied to contracts to buy or sell a non-financial item that are within the scope of [draft] FRS ● (Part of IAS 39) (see paragraphs 5-7 of [draft] FRS ● (Part of IAS 39)).

6 Paragraphs 46-48 require disclosures about capital. Capital may include items other than financial instruments.

CLASSES OF FINANCIAL INSTRUMENTS AND LEVEL OF DISCLOSURE

7 Some of the disclosures in this [draft] IFRS are required by class of financial instrument. Entities shall group financial instruments into classes that are appropriate to the nature of the information disclosed and take into account the characteristics of the financial instruments. In general, classes are determined on a basis that distinguishes instruments measured at amortised cost from those measured at fair value. Entities shall provide sufficient information to permit reconciliation to the relevant items presented in the balance sheet. If an entity chooses to provide information about financial instruments not within the scope of this [draft] IFRS, these instruments constitute a class or classes of financial instruments separate from those within the scope of this [draft] IFRS.

8 An entity decides in the light of its circumstances how much detail it provides to satisfy the requirements of this [draft] IFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. For example, an entity would not disclose information that is so detailed that it would obscure a financial statement users' understanding.

SIGNIFICANCE OF FINANCIAL INSTRUMENTS FOR FINANCIAL POSITION AND PERFORMANCE

9 An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.

Minimum disclosures

Balance sheet

Classification

10 The carrying amounts of each of the following classifications, as defined in [draft] FRS ● (Part of IAS 39), shall be disclosed:

(a) financial assets at fair value through profit or loss, showing separately those classified as held for trading and those designated by the entity as at fair value through profit or loss;

(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 those classified as held for trading and those designated by the entity as at fair value through profit or loss; and

(e) financial liabilities measured at amortised cost.

Financial assets and financial liabilities at fair value through profit or loss

11 If the entity has designated a financial liability as at fair value through profit or loss, it shall disclose:

(a) the amount of change in its fair value that is not attributable to changes in a benchmark interest rate; and

(b) the difference between its carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

12 For a financial liability whose fair value is determined on the basis of an observed market price, the amount of change in the fair value of the financial

liability that is not attributable to changes in a benchmark interest rate can be estimated as follows:

(a) First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the benchmark interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.

(b) Next, the entity calculates the present value of the liability using the liability's contractual cash flows at the start of the period and a discount rate equal to the sum of the benchmark interest rate at the end of the period and the instrument-specific component of the internal rate of return at the start of the period as determined in (a).

(c) The amount determined in (b) is then decreased for any cash paid on the liability during the period and increased to reflect the increase in fair value that arises because the contractual cash flows are one period closer to their due date.

(d) The difference between the observed market price of the liability at the end of the period and the amount determined in (c) is the change in fair value that is not attributable to changes in the benchmark interest rate. This is the amount to be disclosed.

Reclassification

13 If the entity has reclassified a financial asset as one measured at cost or amortised cost rather than at fair value ~~(see paragraph 54 of IAS 39)~~, it shall disclose the reason for that reclassification.

~~Derecognition~~

~~14 An entity may have either transferred a financial asset (see paragraph 18 of IAS 39) or entered into the type of arrangement described in paragraph 19 of IAS 39 in such a way that the arrangement does not qualify as a transfer of a financial asset. If the entity either continues to recognise all of the asset or continues to recognise the asset to the extent of the entity's continuing involvement (see paragraphs 29 and 30 of IAS 39) it shall disclose for each class of financial asset:~~

~~(a) the nature of the asset;~~

~~(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 asset, the carrying amounts of the asset and of the associated liability; and~~

~~(d) when the entity continues to recognise the asset to the extent of its continuing involvement, the total amount of the asset, the amount of the asset that the entity continues to recognise and the carrying amount of the associated liability.~~

Collateral

15 An entity shall disclose the carrying amount of financial assets pledged as collateral for liabilities, the carrying amount of financial assets pledged as collateral for contingent liabilities, and terms and conditions relating to assets pledged as collateral.

16 When an entity has accepted collateral that it is permitted to sell or repledge in the absence of default by the owner of the collateral, it shall disclose:

(a) the fair value of the collateral accepted (financial and non-financial assets);

(b) the fair value of any such collateral sold or repledged and whether the entity has an obligation to return it; and

(c) terms and conditions associated with its use of this collateral.

Allowance account for credit losses

17 When an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses an entity shall disclose a reconciliation of changes in the allowance account during the period for each class of financial assets.

Compound financial instruments with multiple embedded derivatives

18 If an entity has issued an instrument that contains both a liability and an equity component (see paragraph 28 of [draft] FRS ● (IAS 32)) and the instrument has multiple embedded derivative features whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features.

Defaults and breaches

19 With respect to any defaults during the period of principal, interest, sinking fund, or redemption provisions on loans payable recognised at the reporting date, an entity shall disclose:

(a) details of those defaults;

(b) the amount recognised as at the reporting date in respect of the loans payable on which the defaults occurred; and

(c) with respect to amounts disclosed under (b), whether the default has been remedied or the terms of the loans payable renegotiated before the date the financial statements were authorised for issue.

An entity shall disclose the same information for any other breaches of loan agreements during the period when those breaches permit the lender to demand repayment (except for breaches that are remedied, or in response to which the terms of the loan are renegotiated, on or before the reporting date).

20 For the purpose of disclosing information on breaches of loan agreements in accordance with paragraph 19, loans payable include issued debt instruments and other financial liabilities other than short-term trade payables on normal credit terms. When such a breach occurred during the period, and the breach has not been remedied or the terms of the loan payable have not been renegotiated by the reporting date, the effect of the breach on the classification of the liability as current or non-current is determined in accordance with ~~IAS 1 *Presentation of Financial Statements*~~[draft] FRS ● (IAS 32) *Financial Instruments: Presentation*.

Income statement and equity

Items of income, expense, gains and losses

21 An entity shall disclose the following items of income, expense, gains and losses:

(a) net gains or net losses on:

(i) financial assets and financial liabilities at fair value through profit or loss, showing separately those on financial assets and financial liabilities classified as held for trading and those designated by the entity as at fair value through profit or loss;

(ii) available-for-sale financial assets, showing separately the amount of gain (loss) recognised directly in equity during the period and the amount that was 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) how the income statement amounts in (a) are determined, for example, whether the net gains or net losses include interest and dividend income;

(c) total interest income and total interest expense (calculated using the effective interest method) for financial assets and financial liabilities that are not at fair value through profit or loss;

(d) fee income and expense (other than amounts included in determining the effective interest rate) arising on financial assets and financial liabilities, and from 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; and

(e) interest income accrued on impaired financial assets ~~accrued in accordance with paragraph AG93 of IAS 39~~.

Impairment

22 An entity shall disclose the amount of any impairment loss by class of financial asset.

Other disclosures

Accounting policies

23 ~~In accordance with IAS 1, an~~ An entity discloses 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:

(a) the criteria for designating, on initial recognition, financial assets or financial liabilities as at fair value through profit or loss;

(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 paragraph 38 of [draft] FRS ● (Part of IAS 39));

(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 directly reduced (or, in the case of a reversal of a write-down, directly increased) 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 paragraph 17);

(e) the criteria for determining that an impairment loss has occurred (see paragraph 22); and

(f) the policy for determining when financial assets are no longer *past due* (see paragraph 40).

23A* If [draft] FRS ● (Part of IAS 39) *Financial Instruments: Measurement*) is not being applied, it will be particularly important to provide adequate information for users of financial statements to understand the basis on which financial assets and financial liabilities have been measured. Therefore, disclosures of accounting policies indicate not only whether cost, fair value or some other basis of measurement has been applied to a specific class of asset or liability but also the method of applying that basis. For example, for financial instruments carried on the cost basis, an entity may be required to disclose how it accounts for:

(a) costs of acquisition or issuance;

(b) premiums and discounts on monetary financial assets and financial liabilities;

(c) changes in the estimated amount of determinable future cash flows associated with a monetary financial instrument such as a bond indexed to a commodity price;

(d) changes in circumstances that result in significant uncertainty about the timely collection of all contractual amounts due from monetary financial assets;

(e) declines in the fair value of financial assets below their carrying amount; and

(f) restructured financial liabilities.

---

* *ASB footnote*: This paragraph is identical (apart from a necessary but cosmetic change to the introductory text) to paragraph 54 of the 1998 version of IAS 32, which the IASB has subsequently deleted. The ASB is proposing it be reinstated because compliance with the UK equivalent of IAS 39 will not be mandatory for all companies initially. Similarly, paragraph 23B is identical to paragraph 55 of the 1998 version of IAS 32, which the IASB has subsequently deleted but the ASB is proposing to reinstate.

For financial assets and financial liabilities carried at fair value, an entity indicates whether carrying amounts are determined from quoted market prices, independent appraisals, discounted cash flow analysis or another appropriate method, and discloses any significant assumptions made in applying those methods.

23B An entity discloses the basis for reporting in the income statement realised and unrealised gains and losses, interest and other items of income and expense associated with financial assets and financial liabilities. The disclosure includes information about the basis on which income and expense arising from financial instruments held for hedging purposes are recognised. When an entity presents income and expense items on a net basis even though the corresponding financial asset and financial liabilities on the balance sheet have not been offset, the reason for that presentation is disclosed if the effect is significant.

Hedge accounting

24 An entity shall disclose the following separately for designated fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation (as defined in [draft] FRS ● (Part of IAS 39)):

(a) a description of the hedge;

(b) a description of the financial instruments designated as hedging instruments and their fair values at the reporting date;

(c) the nature of the risks being hedged; and

(d) for cash flow hedges, the periods in which the cash flows are expected to occur, when they are expected to enter into the determination of profit or loss and a description of any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur.

25 When a gain or loss on a hedging instrument in a cash flow hedge has been recognised directly in equity, through the statement of changes in equity, an entity shall disclose:

(a) the amount that was recognised in equity during the period;

(b) the amount that was removed from equity and included in profit or loss for the period; and

(c) 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 that was a hedged highly probable forecast transaction.

Fair value

26 Except as set out in paragraphs 29 and 30, for each class of financial assets and financial liabilities, an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with the corresponding carrying amount in the balance sheet. ([draft] FRS ● (Part of IAS 39) provides guidance for determining fair value.)

27 For financial instruments such as short-term trade receivables and payables, no disclosure of fair value is required when the carrying amount is a reasonable approximation of fair value.

28 In disclosing fair values, an entity shall group financial assets and financial liabilities into classes and offset them only to the extent that their related carrying amounts are offset in the balance sheet.

29 The information about fair value in paragraphs 26 and 31 is not required to be disclosed for:

(a) an investment in unquoted equity instruments or a derivative linked to such equity instruments that is measured at cost in accordance with [draft] FRS ● (Part of IAS 39) because its fair value cannot be measured reliably; or

(b) a discretionary participation feature ~~(as described in IFRS 4 *Insurance Contracts*)~~ contained in a financial asset or financial liability if the fair values of that feature cannot be measured reliably.

30 If the information about fair value required in paragraphs 26 and 31 is not disclosed in accordance with paragraph 29, information shall be provided to help users of the financial statements in making their own judgements about the extent of possible differences between the carrying amount of such financial assets and financial liabilities and their fair value, including:

(a) the fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;

(b) a description of the financial instruments, their carrying amount and an explanation of why fair value cannot be measured reliably;

(c) information about the market for the instruments;

(d) information about whether and how the entity intends to dispose of the financial instruments; and

(e) if financial assets whose fair value previously could not be reliably measured are sold, that fact, the carrying amount of such financial assets at the time of sale and the amount of gain or loss recognised.

31 An entity shall disclose:

(a) the methods and assumptions applied in determining fair values of financial assets and financial liabilities separately for classes of financial assets and financial liabilities. For example, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses and interest or discount rates.

(b) whether fair values of financial assets and financial liabilities are determined directly, in full or in part, by reference to published price quotations in an active market or are estimated using a valuation technique (see paragraphs AG71-AG79 of [draft] FRS • (Part of IAS 39)).

(c) whether its financial statements include financial instruments measured at fair values that are determined in full or in part using a valuation technique based on assumptions that are not supported by observable market prices or rates. If changing any such assumption to a reasonably possible alternative would result in a significantly different fair value, the entity shall state this fact and disclose the effect on the fair value of those reasonably possible alternative assumptions. For this purpose, significance shall be judged with respect to profit or loss and total assets or total liabilities.

(d) if (c) applies, the total amount of the change in fair value estimated using such a valuation technique that was recognised in profit or loss during the period.

NATURE AND EXTENT OF RISK ARISING FROM FINANCIAL INSTRUMENTS

32 An entity shall 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 was exposed during the period and at the reporting date.

33 The disclosures required by paragraphs 34-45 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*.

Qualitative disclosures

34 For each risk arising from financial instruments, an entity shall disclose:

(a) the exposure to risk and how it arose;

(b) its 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.

Quantitative disclosures

35 For each risk arising from financial instruments, an entity shall disclose:

(a) summary quantitative data about the extent to which it is exposed to that risk as at the reporting date. This disclosure shall be based on the information provided internally to the entity's *key management personnel* ~~(as defined in IAS 24 *Related Party Disclosures* (as revised in 2003))~~, for example the entity's board of directors and chief executive officer.

(b) the minimum disclosures required by paragraphs 39-45 of this [draft] IFRS, to the extent not provided in (a).

(c) concentrations of risk if not apparent from (a) and (b).

36 If the quantitative data disclosed as at the reporting date are unrepresentative of an entity's exposure to risk during the period, further information shall be provided that is representative.

37 When an entity uses several methodologies in managing a risk exposure, the entity shall disclose information using the method(s) that provide the most relevant and reliable information.

38 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 by management taking into account the circumstances of the entity. Disclosure of concentrations of risk shall include:

(a) a description of how management determines concentrations;

(b) a description of the shared characteristic that identifies each concentration (eg counterparty, geographical area, currency and market); and

(c) the amount of the risk exposure associated with all financial instruments sharing that characteristic.

Minimum disclosures

Credit risk

39 An entity shall disclose by class of financial instrument with credit risk:

(a) the amount that best represents its maximum exposure to credit risk at the reporting date without taking account of any collateral pledged or other credit enhancements;

(b) in respect of the amount disclosed in (a), a description of collateral pledged as security and other credit enhancements and, unless impracticable, their fair value; and

(c) information about the credit quality of financial assets with credit risk that are neither past due nor impaired.

Financial assets that are either past due or impaired

40 An entity shall 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 impaired as at the reporting date, including the factors the entity considered in determining that the financial assets are impaired; and

(c) in respect of the amounts disclosed in (a) and (b), a description of collateral pledged as security and other credit enhancements and, unless impracticable, their fair value.

Collateral and other credit enhancements obtained

41 When an entity obtains assets during the period by taking control of collateral pledged as security or calling on other credit enhancements (eg guarantees), an entity shall disclose:

(a) the nature of the assets obtained;

(b) the fair value of the assets obtained less the cost of obtaining them; and

(c) when the assets are not readily convertible into cash and the entity does not plan to use them in its operations, its policies for disposing of such assets.

Liquidity risk

42 An entity shall disclose:

(a) a maturity analysis for financial liabilities that shows the remaining contractual maturities; and

(b) a description of how it manages the liquidity risk inherent in (a).

Market risk

Sensitivity analysis

43 An entity shall disclose:

(a) a sensitivity analysis for each type of market risk at the reporting date, showing the effect of reasonably possible changes in the relevant risk variable (such as interest rates or exchange rates) on profit and loss and, when changes in fair value are recognised in equity, on equity;

(b) the methods and assumptions used in preparing the sensitivity analysis; and

(c) changes from the previous period in the methods and assumptions used.

44 An entity is required to disclose the effect of a change in only the relevant risk variable. However, if management prepares a sensitivity analysis that reflects interdependencies between risk variables (eg interest rates and exchange rates typically vary with each other) and uses it to manage financial risks, it can use that sensitivity analysis to meet the minimum requirement.

Other market risk disclosures

45 When the sensitivity analysis disclosure is unrepresentative of a risk inherent in a financial instrument, additional information shall be disclosed. The additional information shall include:

(a) a description of the risk; and

(b) the effect of changes in the relevant risk variable on profit and loss and, when changes in fair value are recognised in equity, on equity.

CAPITAL

46 An entity shall disclose information that enables users of its financial statements to evaluate the entity's capital.

47 An entity shall 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 regards 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 regards as capital and any capital targets set by management.

(c) any changes in (a) and (b) from the previous period.

(d) whether during the period it complied with the capital targets set by management and any externally imposed capital requirements to which it is subject.

(e) when the entity has not complied with the capital targets set by management or the externally imposed capital requirements to which it is subject, the consequences of such non-compliance.

These disclosures shall be based on the information provided internally to the entity's key management personnel.

48 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 geographical areas. 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 shall disclose the information separately.

EFFECTIVE DATE

49 An entity shall apply this [draft] IFRS for ~~annual~~ accounting periods beginning on or after 1 January 2007. Earlier application is encouraged. If an entity applies this [draft] IFRS for an earlier period, it shall disclose that fact.

49A* An entity that adopts ~~IFRSs~~ this Standard before 1 January ~~2006~~ 2007 ~~and chooses to adopt [draft] IFRS X *Financial Instruments: Disclosures* before 1 January 2006~~ need not present the comparative disclosures required by this [draft] ~~IFRS X~~ Standard in its first ~~IFRS~~ financial statements prepared in accordance with this [draft] Standard.

~~WITHDRAWAL OF IAS 30~~

~~50 The [draft] IFRS supersedes IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions.*~~

WITHDRAWAL OF, AND AMENDMENTS TO, EXISTING UK STANDARDS AND UITF ABSTRACTS

50 This [draft] Standard amends the [draft] FRS • (IAS 32) *Financial Instruments: Disclosure and Presentation* as set out in Appendix B.

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* *ASB Footnote:* This paragraph is inserted from paragraph 36B of IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

APPENDIX A

DEFINED TERMS

This appendix is an integral part of the [draft] IFRS.

credit risk	The risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.
currency risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.
interest rate risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.
liquidity risk	The risk that an entity will encounter difficulty in meeting commitments associated with financial liabilities.
market risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. The term "market risk" embodies both the potential for loss and the potential for gain. Market risk includes three types of risk: **currency risk, interest rate risk** and **other price risk**
other price risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate as a result 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.
past due	A financial asset is past due when a counterparty has failed to make a payment when contractually due.

prepayment risk	The risk that the counterparty to a financial asset will repay other than when expected.
residual value risk	The risk that the fair value of a non-financial asset that underlies a financial instrument will be more or less than expected.
key management personnel	Those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including director (whether executive or otherwise) of that entity.*

* *ASB Footnote*: This definition is that provided by IAS 24 *Related Party Disclosures* paragraph 9.

The following terms are defined in paragraph 11 of [draft] FRS ● (IAS 32) or paragraph 9 of [draft] FRS ● (Part of IAS 39) and are used in the [draft] IFRS with the meaning specified in [draft] FRS ● (IAS 32) and [draft] FRS ● (Part of IAS 39).

- amortised cost of a financial asset or financial liability
- available-for-sale financial assets
- derecognition
- derivative
- effective interest method
- equity instrument
- fair value
- financial asset
- financial instrument
- financial liability
- financial asset or financial liability at fair value through profit or loss
- financial asset or financial liability held for trading
- forecast transaction
- hedging instrument
- held-to-maturity investments
- loans and receivables
- regular way purchase or sale

APPENDIX B

AMENDMENTS TO OTHER ~~IFRSS~~ STANDARDS

The amendments in this [draft] appendix shall be applied for annual periods beginning on or after 1 January 2007. If an entity adopts this [draft] IFRS for an earlier period, these amendments shall be applied for that earlier period. In the amendments, new text is underlined and deleted text is struck through.

B1 In ~~International~~ Financial Reporting Standards~~, including International Accounting Standards and Interpretations,~~ and UITF Abstracts references to [draft] FRS ● (IAS 32) *Financial Instruments: Disclosure and Presentation* ~~(as revised in December 2003)~~ are amended to [draft] FRS ● (IAS 32) *Financial Instruments: Presentation*, unless otherwise stated below.

B2 [draft] FRS ● (IAS 32) *Financial Instruments: Disclosure and Presentation* ~~(as revised in 2003)~~ is amended as described below.

The title is amended to [draft] FRS ● (IAS 32) *Financial Instruments: Presentation*.

Paragraphs IN16 - IN19 are deleted. A new paragraph IN16 is added as follows:

IN16. In [date], the Board revised and enhanced the disclosure requirements for risks arising from financial instruments, and relocated all disclosures about financial instruments in [draft] IFRS X.

Paragraph 1 is deleted and paragraphs 2 and 3 are amended as follows:

2. ~~This Standard contains requirements for the presentation of financial instruments and identifies the information that should be disclosed about them. The presentation requirements apply~~ The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset. ~~The Standard requires disclosure of~~

~~information about factors that affect the amount, timing and certainty of an entity's future cash flows relating to financial instruments and the accounting policies applied to those instruments. This Standard also requires disclosure of information about the nature and extent of an entity's use of financial instruments, the business purposes they serve, the risks associated with them, and management's policies for controlling those risks.~~

3. The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in [draft] FRS ● (Part of IAS 39) *Financial Instruments: ~~Recognition and~~ Measurement* and for disclosing information about them in [draft] IFRS X *Financial Instruments: Disclosures*.

Paragraphs 5 and 7 are deleted.

Paragraph 47 is amended as follows:

47. An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with paragraph ~~76~~39 of [draft] IFRS X.

Paragraph 50 is amended as follows:

50. An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a 'master netting arrangement' with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of bankruptcy or other circumstances that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realisation or settlement of individual financial assets and financial liabilities only

following a specified event of default or in other circumstances not expected to arise in the normal course of business. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 42 are satisfied. When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity's exposure to credit risk is disclosed in accordance with paragraph ~~76~~39 of IFRS X.

Paragraphs 51-95 are deleted.

Paragraphs 96-100 are renumbered as paragraphs 51-55.

In the Application Guidance, paragraph AG40 is deleted.

In the Basis for Conclusions, the heading above paragraph BC34 ("Disclosure") is footnoted as follows:

In [date], the IASB relocated all disclosures relating to financial instruments to [draft] IFRS X.

In the Basis for Conclusions, a new paragraph BC34A is added after the heading "Fair Value (paragraphs 86-93)".

BC34A. Fair value information is widely used for business purposes in determining an entity's overall financial position and in making decisions about individual financial instruments. It is also relevant to many decisions made by users of financial statements because, in many circumstances, it reflects the judgement of the financial markets about the present value of expected future cash flows relating to an instrument. Fair value information permits comparisons of financial instruments having substantially the same economic characteristics, regardless of why they are held and when and by whom they were issued or acquired. Fair values provide a neutral basis for assessing management's stewardship by indicating the effects of its decisions to buy, sell or hold financial assets and to incur, maintain or discharge financial liabilities. When an entity does not measure a financial asset or financial liability in its balance sheet at fair value, it provides fair value information through supplementary disclosures.

~~B3~~ ~~IAS 1 *Presentation of Financial Statements* (as revised in 2003) is amended as described below~~.*

~~B4~~ ~~IAS 14 *Segmental Reporting* is amended as described below~~.†

~~B5~~ ~~In paragraphs 31, 35, 47 and 56 of IAS 17 *Leases* (as revised in 2003), the reference to IAS 32 is replaced with [draft] IFRS X.~~

~~B6~~ ~~In paragraph 72 of IAS 33 *Earnings per Share* (as revised in 2003), the reference to IAS 32 is replaced with [draft] IFRS X.~~

B7 [Draft] FRS ● (Part of IAS 39) *Financial Instruments:* ~~*Recognition and Measurement* (as revised in 2003)~~ is amended as described below.

In the Introduction, the following footnote is added to the end of paragraph IN25:

> In [date], the IASB relocated all disclosures relating to financial instruments to [draft] IFRS X.

Paragraph 1 is amended as follows:

1. The objective of this Standard is to establish principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting ~~and disclosing~~ information about financial instruments are ~~set out~~ in [draft] FRS ● (IAS 32) *Financial Instruments:* ~~*Disclosure and*~~ *Presentation*. Requirements for disclosing information about financial instruments are in [draft] IFRS X *Financial Instruments: Disclosures.*

In paragraph 45, the reference to [draft] FRS ● (IAS 32) is replaced with [draft] IFRS X.

Paragraph 48 is amended as follows:

* *ASB Footnote:* IAS 1 *Presentation of Financial Instruments* has not been implemented in the UK, therefore, the amendments to IAS 1 proposed by the IASB have been omitted.

† *ASB Footnote:* IAS 14 *Segmental Reporting* has not been implemented in the UK, therefore, the amendments to IAS 14 proposed by the IASB have been omitted.

48. ***In determining the fair value of a financial asset or a financial liability for the purpose of applying this Standard, ~~or~~ [draft] FRS • (IAS 32) or [draft] IFRS X, an entity shall apply paragraphs AG69 - AG82 of Appendix A.***

In the Basis for Conclusions, the references to [draft] FRS • (IAS 32) in paragraphs BC90 and BC222(s) are footnoted as follows:

> In [date], the IASB relocated all disclosures relating to financial instruments to [draft] IFRS X.

In the Guidance on Implementing [draft] FRS • (Part of IAS 39) Q&A F.1.12, both references to [draft] FRS • (IAS 32).58 are replaced by [draft] IFRS X.24.

In the Guidance on Implementing [draft] FRS • (Part of IAS 39) Q&A G.1, the answer is amended as follows:

> ~~IAS 32.94(h)~~ [Draft] IFRS X.21 requires items of income, expense and gains and losses to be disclosed ~~whether included in profit or loss or in equity~~. This disclosure requirement encompasses ~~material~~ items of income, expense and gains and losses that arise on remeasurement to fair value. Therefore, an entity provides disclosures of ~~material~~ fair value changes, distinguishing between changes that are recognised in profit or loss and changes that are recognised in equity. Further breakdown is provided of changes that relate to:
>
> (a) AFS assets, showing separately the amount of gain (loss) recognised directly in equity during the period and the amount that was removed from equity and recognised in profit or loss for the period;
>
> (b) financial assets and financial liabilities at fair value through profit or loss, showing separately those on financial assets and financial liabilities classified as held for trading and those that were designated by the entity as at fair value through profit or loss; and
>
> (c) hedging instruments.
>
> ~~IAS 32~~ [Draft] IFRS X neither requires nor prohibits disclosure of components of the change in fair value by the way items are classified

for internal purposes. For example, an entity may choose to disclose separately the change in fair value of those derivatives that [draft] FRS ● (Part of IAS 39) classifies as held for trading but the entity classifies as part of risk management activities outside the trading portfolio.

In addition, ~~IAS 32.94(e)~~ [draft] IFRS X.10 requires disclosure of the carrying amounts of financial assets and financial liabilities that: (i) are classified as held for trading and (ii) were, upon initial recognition, designated by the entity as financial assets and financial liabilities at fair value through profit or loss (ie those not financial instruments classified as held for trading).

~~B8 In the Basis for Conclusions on IAS 41 *Agriculture*, the second sentence of paragraph B3 is amended as follows:~~*

~~B9 In IFRS 1 *First-time Adoption of International Financial Reporting Standards*, a heading and paragraph 36B are added as follows~~:†

~~B10 IFRS 4 *Insurance Contracts* is amended as described below.~~‡

~~B11 The Guidance on Implementing IFRS 4 is amended as described below.~~‡

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* *ASB Footnote:* IAS 41 *Agriculture* has not been implemented in the UK, therefore, the amendments to IAS 41 proposed by the IASB have been omitted.
† *ASB Footnote:* The additions to IFRS1 proposed by the IASB have been incorporated into the main text of the [draft] Standrd at paragraph 49A.
‡ *ASB Footnote:* IAS 4 *Insurance Contracts* has not been implemented in the UK, therefore, the amendments to IAS 4 and the Guidance on Implementation proposed by the IASB have been omitted.

TABLE OF CONCORDANCE

This table accompanies, but is not part of, the draft IFRS.

This table shows how the contents of ~~IAS 30 and~~ [draft] FRS ● (IAS 32) ~~(as revised in 2003)~~ and draft IFRS X correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ. Paragraphs 1-50 of [draft] FRS ● (IAS 32) are not amended, except as set out in Appendix B.

[draft] FRS ● (IAS 32) paragraph	**Draft IFRS X paragraph**	**[draft] FRS ● (IAS 32) paragraph**	**Draft IFRS X paragraph**
51	1(a), 9, 32	88	27*
52	1(b), 32, Appendix A*	89	28*
53	None	90	30
54	8, IG2	91	29(a), 30
55	7	91A	29(b), 30
56, 57	34(b), IG7	92	31*
58	24*	93	31(a)*
59	25*	94(a)	14*
60	23	94(b)	15*
61	23(c)	94(c)	16*
62-65	None	94(d)	18
66	23	94(e)	10
66A	23A	94(f)	11*
66B	23B	94(g)	13*
67-75	43-45, IG36, IG37	94(h)	21
76	35(c), 39(a)	94(i)	22
77, 78	None	94(j)	19*
79	IG13, IG14	95	20*

[draft] FRS ● (IAS 32) paragraph	Draft IFRS X paragraph	[draft] FRS ● (IAS 32) paragraph	Draft IFRS X paragraph
80, 81	39(b)	96	renumbered as IAS 32.51*
82	IG14(c)	97	renumbered as IAS 32.52*
83, 84	35(c), 38, IG9, IG10	97A	renumbered as IAS 32.52A*
85	38(b), (c)	98	renumbered as IAS 32.53*
86	26*	99	renumbered as IAS 32.54*
87	IAS 32.BC34A*	100	renumbered as IAS 32.55*

* indicates paragraphs taken from IAS 32 with no significant amendment.

APPENDIX C

NOTE ON LEGAL REQUIREMENTS

ASB note: This Appendix has been prepared by the ASB to enable users to compare the disclosure requirements in the Government's proposals and the proposed Standard.

1. The disclosure requirements contained within the FRED as currently proposed are consistent with the Fair Value Directive. However, some of the requirements of the Directive, and the resulting proposal for implementation in the UK by the Government, go beyond that of the FRED.

2. The table below provides an overview of the disclosure requirements contained in the Government's proposals and their relationship to the FRED.

Government Proposals*	**FRED**
Sch 4 Para 45A (2) (a) (1) This paragraph applies where financial instruments have been included at fair value by virtue of paragraph 34A or 34C. (2) There shall be stated- (a) the significant assumptions underlying the valuation models and techniques used where the fair value of the instruments has been determined in accordance with paragraph 34B(4);	Para 31(a) An entity shall disclose: (a) the methods and assumptions applied in determining fair values of financial assets and financial liabilities separately for classes of financial assets and financial liabilities.
Sch 4 Para 45A (2) (b) (1) This paragraph applies where financial instruments have been included at fair value by virtue of paragraph 34A or 34C. (2) There shall be stated- (b) for each category of financial instrument, the fair value of the instruments in that category and the amounts – (i) included in the profit and loss account, and (ii) credited to or (as the case may be) debited from the fair value reserve,	Para 21 An entity shall disclose the following items of income, expense, gains and losses: (a) net gains or net losses on: (i) financial assets and financial liabilities at fair value through profit or loss, showing separately those on financial assets and financial liabilities classified as held for trading and those designated by the entity as at fair value through profit or loss;

* *ASB Footnote:* The numbering provided here follows those contained in the proposed amendments to Schedules 4 and 7 of the Companies Act 1985 as described in the Government's consultation document *Fair Value Accounting* published on 12 June 2003. Similar amendments to Schedules 8, 9 and 9A are also proposed. Amendments to Section 246, relating to exemptions for small companies from disclosures in directors' report, are also proposed by the same document.

Government Proposals	FRED
	(ii) available-for-sale financial assets, showing separately the amount of gain (loss) recognised directly in equity during the period and the amount that was 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.
Sch 4 Para 45A (2) (c) (2) There shall be stated- (c) for each class of derivative financial instruments, the extent and nature of the instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows.	the FRED does not specifically require these disclosures
Sch 4 Para 45A (3) (3) Where any amount is transferred to or from the fair value reserve during the financial year, there shall be stated in tabular form: (i) the amount of the reserve as at the date of the beginning of the financial year and as at the balance sheet date respectively;	the FRED does not specifically require these disclosures

Government Proposals	FRED
(ii) the amount transferred to or from the reserve during that year; and (iii) the source and application respectively of the amounts so transferred.	
Sch 4 Para 45B Where the company has financial instruments which it has not included at fair value, there shall be stated for each class of derivative financial instrument- (a) the fair value of the instruments in that class, if such a value can be determined in accordance with paragraph 34B; and (b) the extent and nature of the instruments	Para 26 Except as set out in paragraph 29 and 30, for each class of financial assets and financial liabilities, an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with the corresponding carrying amount in the balance sheet. (~~IAS 39~~ [Draft] FRS ● (Part of IAS 39) provides guidance for determining fair value.)
Sch 4 Para 45C (1) Sub-paragraph (2) applies if – (a) The company has financial fixed assets which could be included at fair value by virtue of paragraph 34A; (b) The amount at which those assets are included under any item in the company's accounts is in excess of their fair value; and (c) The company has not made provision for diminution in value of those assets in accordance with paragraph 19(1) of this Schedule.	the FRED does not specifically require these disclosures

Government Proposals	FRED
(2) There shall be stated- (a) The amount at which either the individual assets or appropriate groupings of those individual assets is stated in the company's accounts, and fair value of those assets or groupings; and (b) the reasons for not making a provision for diminution in value of those assets, including the nature of the evidence that provides the basis for the belief that the amount at which they are stated in the accounts will be recoverable.	
Sch 7 Para 6A (1) (i) (1) The directors' report shall also contain, in relation to the use of financial instruments by the company and by its subsidiary undertakings, and where material for the assessment of the company's and (as the case may be) group's assets, liabilities, financial position and profit or loss: (i) the financial risk management objectives and policies of the company and (where applicable) the group, including its policy for hedging each major type of forecasted transaction for which hedge accounting is used;	See Paragraphs 24, 32 and 34 **Para 32**: An entity shall 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 was exposed during the period and at the reporting date. **Para 34**: For each risk arising from financial instruments, an entity shall disclose: (a) the exposure to risk and how it arose; (b) its 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.

Government Proposals	FRED
	Para 24: An entity shall disclose the following separately for designated fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation (as defined in ~~IAS 39~~ [draft] FRS ● (Part of IAS 39)): (a) a description of the hedge; (b) a description of the financial instruments designated as hedging instruments and their fair values at the reporting date; (c) the nature of the risks being hedged; and (d) for cash flow hedges, the periods in which the cash flows are expected to occur, when they are expected to enter into the determination of profit or loss and a description of any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur.
Sch 7 Para 6A (1) (i) (1) The directors' report shall also contain, in relation to the use of financial instruments by the company and by its subsidiary undertakings, and where material for the assessment of the company's and (as the case may be) group's assets, liabilities, financial position and profit or loss: (ii) the exposure of the company and (where applicable) of the group to price risk, credit risk, liquidity risk and cash flow risk.	See paragraphs 35 to 45 of the FRED.

BASIS FOR CONCLUSIONS

Contents

BASIS FOR CONCLUSIONS

This Basis for Conclusions accompanies, but is not part of, the draft IFRS.

ASB note: The Basis for Conclusions material that the IASB prepared to accompany its exposure draft is set out below in full. It should be noted though that some of the discussion it contains concerns IASB requirements that have no equivalent in the UK or Republic of Ireland. Footnotes have been used to highlight those parts of the discussion.

All references in this section to 'the Board' and 'Board members' are references to the IASB Board and IASB Board members.

INTRODUCTION

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in ED 7 *Financial Instruments: Disclosures*. Individual Board members gave greater weight to some factors than to others.

BC2 During the late 1990s, the need for a comprehensive review of IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*[*] became apparent. The Board's predecessor, IASC, issued a number of Standards that addressed, more comprehensively, some of the topics previously addressed only for banks in IAS 30. Also, fundamental changes were taking place in the financial services industry and in the way in which financial institutions manage their activities and risk exposures. This made it increasingly difficult for users of banks' financial statements to assess and compare their financial position and performance, their associated risk exposures and their processes for measuring and managing those risks.

BC3 In 1999, IASC added a project to its agenda to revise IAS 30 and in 2000 it appointed a steering committee.

[*] *ASB Footnote:* IAS 30 has not been implemented in the UK; however, FRS 13 *Derivatives and Other Financial Instruments: Disclosures* addresses the same issues.

BC4 In 2001, the Board added this project to its own agenda. To assist and advise it, the Board retained the IAS 30 steering committee, now renamed the Financial Activities Advisory Committee (FAAC), as an expert advisory group. FAAC members have experience and expertise in banks, finance companies and insurance companies and include auditors, financial analysts, preparers and regulators. The FAAC's role was:

(a) to provide input from the perspective of users, preparers and auditors of financial statements of entities that have large exposures to financial instruments; and

(b) to assist the Board in developing a Standard and Implementation Guidance for risk disclosures arising from financial instruments and for other related disclosures.

SCOPE

The entities to which the IFRS would apply

BC5 As noted above, ED 7 arose from a project to revise IAS 30 and hence at the start was intended to apply only to banks and similar financial institutions.

BC6 However, when the Board adopted this project in 2001, it made a fundamental change to its scope. The Board decided that an IFRS arising from the project should address disclosure and presentation issues that arise for all types of entities that engage in financial activities, irrespective of whether they are regulated and supervised as banks. The Board concluded that the reduction in regulatory barriers in many countries, and increasing competition between banks, non-bank financial services firms and financial conglomerates in providing the same types of financial services make it inappropriate to limit the scope to banks and similar financial institutions. Thus, the scope was revised to cover entities that undertake specified activities commonly undertaken by banks and other financial institutions, namely deposit-taking, lending and securities activities.

BC7 In 2002, the Board decided to widen the scope of the project again to cover risk arising from financial instruments in all entities. It made this decision for the following reasons:

(a) disclosures about risks associated with financial instruments are useful to users of the financial statements of all entities that hold financial instruments, not only to banks and similar financial institutions or only entities with deposit-taking, lending and securities activities.

(b) the Board found it could not satisfactorily define deposit-taking, lending and securities activities. In particular, it could not satisfactorily differentiate an entity with securities activities from an entity holding a portfolio of available-for-sale assets for investment and liquidity management purposes.

(c) comments received in response to the Exposure Draft of Improvements to IAS 32 *Financial Instruments: Disclosure and Presentation*★ indicated that improvements could be made to its risk disclosure requirements that were applicable to entities that do not have deposit-taking, lending and securities activities.

(d) the exclusion of some financial instruments from the disclosures proposed would increase the danger that risk disclosures could be incomplete and possibly misleading. For example, a debt instrument issued by an entity could significantly affect its exposures to liquidity risk, interest rate risk and currency risk, but no disclosure would be required for the instrument.

(e) users of financial statements need to be able to compare similar activities, transactions and events of different entities on a consistent basis. Hence, the disclosure principles that apply to regulated entities should not differ from those that apply to non-regulated, but otherwise similar, entities.

BC8 The Board concluded that the most straightforward way to implement its decision that the IFRS should apply to all types of entities that have financial instruments was for the scope to be the same as that of IAS 32.

★ *ASB Footnote:* Currently, there is no equivalent UK standard to IAS 32, although the issues that some parts of this standard address are also addressed in UK standards. However, in June 2002 when the IASB published its proposals to amend IAS 32, the ASB proposed that a UK standard based on this international standard should be issued. This is set out in FRED 30 and its Supplements and is yet to be issued in its final form.

BC9 In addition, the Board decided that it would be more helpful to constituents to have all required disclosures relating to financial instruments contained in one Standard. Accordingly, the Board proposes to move all such disclosure requirements from IAS 32 to the proposed IFRS. As a result, ED 7 contains disclosures about:

(a) the significance of financial instruments for an entity's financial position and performance. Many of these proposed requirements are in IAS 32 and would be relocated into the IFRS without change. When the Board develops its Basis for Conclusions on the IFRS arising from this Exposure Draft, it intends to include in it relevant paragraphs from the Basis for Conclusions on IAS 32. The reasons for the proposed changes are given in paragraphs BC12 - BC18.

(b) the risks arising from financial instruments. These proposed requirements are new and replace requirements in IAS 32. The reasons for them are given in paragraphs BC19 - BC40.

(c) capital. These proposed requirements are new and the reasons for them are given in paragraphs BC45 - BC54.

Should the IFRS exempt insurers from its scope?

BC10 The Board also considered whether it would be appropriate for the IFRS to apply to entities that both have financial instruments and issue insurance contracts. The Board could not justify an exemption for entities that issue insurance contracts. It noted that an entity that has financial instruments is subject to risks arising from those financial instruments regardless of what other assets and liabilities it has. Accordingly, an entity that both issues insurance contracts and has other financial instruments should apply the proposed IFRS to its financial instruments in addition to IFRS 4 *Insurance Contracts*[*] However, the Board also decided to propose to amend the disclosures required by IFRS 4 to make them consistent with the proposed disclosures (see paragraphs BC57 - BC61).

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[*] *ASB Footnote:* Currently, there is no equivalent UK standards to IFRS 4. In July 2004, the Board proposed that some of the requirements of IFRS 4 be included within the UK equivalents of IASs 32 and 39. Details of this are provided in the Third Supplement to FRED 30.

Should the IFRS exempt small and medium-sized entities from its scope?*

BC11 The Board considered whether it should exempt small and medium-sized entities from the scope of the IFRS. The Board noted that the extent of disclosures required by the IFRS will depend on the extent to which the entity uses financial instruments and the extent to which it has assumed associated risks. An entity with few financial instruments and few risks will be required to give few disclosures. Also, many of the proposed disclosures are based on information provided internally to the entity's key management personnel. This also helps to avoid unduly onerous requirements that would not be appropriate for smaller entities. Accordingly, the Board decided not to propose a scope exemption for small and medium-sized entities. However, it also decided to keep this decision under review in its project on financial reporting for small and medium-sized entities.

DISCLOSURES ABOUT THE SIGNIFICANCE OF FINANCIAL INSTRUMENTS FOR AN ENTITY'S FINANCIAL POSITION AND PERFORMANCE

The principle

BC12 In deciding to amend non-risk disclosures in IAS 32, the Board concluded that it was important that any additional disclosure requirements should result from the application of an explicit disclosure principle. As a result, the Board decided to include the principle that an entity should disclose information that enables users of its financial statements to evaluate the significance of financial instruments to an entity's financial position and performance.

Balance sheet disclosures

Classification

BC13 In paragraph 10 the Board proposes a new requirement to disclose financial assets and financial liabilities by the measurement classifications

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* *ASB Footnote:* In line with its usual practice, the Board has decided not to extend the scope in the UK to entities complying with the FRSSE.

in IAS 39 *Financial Instruments: Recognition and Measurement**. This is because the Board concluded that such disclosure by classification is needed in order for users to understand the financial position of an entity's financial instruments, given the different measurement bases in IAS 39.

Allowance account for credit losses

BC14 In paragraph 17 the Board proposes to require disclosure of a reconciliation of the allowance account. An allowance account is used by some entities instead of recognising a credit loss on a financial asset directly against that financial asset. The Board was informed that analysts and other users find this information useful in assessing the adequacy of the allowance for impairment losses for such entities and when comparing one entity with another. The Board also noted that information about the allowance account is at present required by IAS 30.

INCOME STATEMENT DISCLOSURES

Income, expenses, gains and losses

BC15 In paragraph 21(a) the Board proposes to add a requirement to disclose income statement gains and losses by the measurement classifications in IAS 39 (which complement the balance sheet disclosure requirement described in paragraph BC13). The Board concluded that the disclosure is needed for users to understand the financial performance of an entity's financial instruments, given the different measurement bases in IAS 39.

BC16 In conjunction with this requirement, the Board decided that an entity should disclose how the income statement amounts are determined. For example, an entity should disclose whether net gains and losses on financial assets and financial liabilities held for trading include interest and dividend income. The Board noted that in practice some entities include interest and dividend income in gains and losses on financial assets and

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* *ASB Footnote:* Currently, there is no equivalent UK standard to IAS 39, although the issues that some parts of this standard address are also addressed in UK standards. However, in June 2002 when the IASB published its proposals to amend IAS 39, the ASB proposed that a UK standard based on this international standard should be issued. This is set out in FRED 30 and its Supplements and is yet to be issued in its final form.

financial liabilities held for trading and others do not. The Board decided that requiring information of this type would assist users of financial statements in comparing income arising from financial instruments across different entities.

Fee income and expense

BC17 In paragraph 21(d), the Board has added to the requirement to disclose items of income, expenses, gains and losses a proposed requirement to disclose fee income and expense (other than amounts included in determining the effective interest rate) arising from financial assets and financial liabilities and from trust and other fiduciary activities that result in the entity holding or placing assets on behalf of individuals, trusts, retirement benefit plans and other institutions. The Board decided that this information indicates the level of such activities and helps users to estimate possible future income of the entity.

Accounting policies

BC18 The Board noted that the accounting policies disclosure at present in paragraph 66 of IAS 32 requires the disclosure of policies that were subsequently specified in IAS 39. This paragraph would be retained as paragraph 23 in the IFRS, but the examples of accounting policy disclosures required have been updated to reflect the policy choices permitted in the improved IAS 39.

DISCLOSURES ABOUT THE NATURE AND EXTENT OF RISK ARISING FROM FINANCIAL INSTRUMENTS

BC19 The Board was informed that users of financial statements value information about the risks arising from financial instruments, such as credit risk, liquidity risk and market risk, to which entities are exposed and the techniques used to identify, measure, monitor and control those risks. Therefore, the Board decided to require disclosure of this information. The Board also decided that, in requiring disclosure of this information, it should balance two objectives:

(a) consistent requirements should apply to all entities so that users receive comparable information about the risks they incur.

(b) the disclosures provided should depend on the extent of the entity's use of financial instruments and the extent to which it assumes associated risks. Entities with many financial instruments and related risks should provide a greater amount of disclosure to communicate those risks to users of financial statements. Conversely, entities with few financial instruments and related risks should provide less extensive disclosure.

BC20 The Board decided to balance these two objectives by developing a concise IFRS that sets out high level requirements applicable to all entities, supported by guidance on implementing the IFRS. The high level requirements balance qualitative disclosures based on how management views and manages its risks and minimum quantitative disclosures. The guidance on implementing the IFRS would illustrate how an entity might apply the IFRS; its relevance depends on the extent of the entity's use of financial instruments and its resulting exposure to risk. This guidance is consistent with the disclosure proposals for banks developed by the Basel Committee (known as Pillar 3), so that banks can prepare, and users receive, a single co-ordinated set of disclosures about financial risk. However, the overall volume of disclosures has been reduced compared with those in IAS 30 and IAS 32.

Qualitative disclosures

BC21 Paragraph 34 requires qualitative disclosure of the entity's exposure to risks, how the exposure arose, the entity's objectives, policies and processes for managing the risk and the methods used to measure it. The Board believes that the way in which and the extent to which entities manage their financial risk exposures conveys useful information. However, the way in which entities manage risks also varies between entities and, accordingly, the extent of qualitative disclosures depends on the circumstances of the entity and requires the exercise of judgement.

Quantitative disclosures

Information based on how the entity manages risk

BC22 The Board concluded that disclosures about an entity's exposure to risks arising from financial instruments should be required, and should be based on how the entity views and manages its risks, ie using the information provided to the entity's key management personnel (for example, its board of directors or chief executive officer). The Board noted that this approach:

(a) provides a useful insight into how the entity views and manages risk;

(b) results in information that has more predictive value than information based on assumptions and methods that management does not use, for instance, in considering the entity's ability to react to adverse situations;

(c) is more effective in adapting to changes in risk measurement and management techniques and developments in the external environment;

(d) has practical advantages for preparers of financial statements, because it allows them to use the data they use in managing risk; and

(e) is consistent with the approach used in IAS 14 *Segment Reporting*★.

Information on averages and concentrations of risk

BC23 The Board considered whether it should require quantitative information about average risk exposures during the period. It noted that information about averages is more informative, in particular if the risk exposure at the reporting date is not typical of the exposure during the period. However, information about averages is also more onerous to prepare. On balance, the Board decided to require disclosure of the exposures at the reporting date in all cases and to require additional information (eg the highest, lowest and average amount of risk the entity was exposed to during the period) only if the information provided at the reporting date is unrepresentative of the entity's exposure to risk during the period.

BC24 The Board also decided to require disclosure of concentrations of risk as at the reporting date. This is because such information helps a user to assess the effect on the entity of an adverse change in a particular risk factor.

★ *ASB Footnote:* IAS 14 has not been implemented in the UK, although the issues that some parts of this standard address are also addressed in SSAP 25 *Segmental Reporting*.

Minimum disclosures

BC25 The Board noted that because entities view and manage risk in different ways, the disclosures based on how the entity manages risk are unlikely to be comparable between entities. In addition, for entities that have little or no management of risks arising from financial instruments, the disclosures would convey little or no information about the risks the entity has assumed. To overcome these limitations, the Board decided to specify minimum disclosures about risk exposures. These disclosures would provide a common benchmark for financial statement users when they are comparing risk exposures across different entities and would be relatively easy for entities to prepare.

Credit risk

Maximum exposure to credit risk

BC26 Paragraph 39(a) requires disclosure of an entity's maximum exposure to credit risk at the reporting date, ie without taking account of any collateral pledged or other credit enhancements. Such information:

(a) provides users of financial statements with a consistent measure of an entity's exposure to credit risk; and

(b) takes into account the possibility that the maximum exposure to loss may differ from the amount recognised in the balance sheet.

Collateral pledged as security and other credit enhancements

BC27 Paragraphs 39(b) and 40(c) require that, unless impracticable, the entity should disclose the fair value of collateral pledged as security and other credit enhancements. The Board decided to require this disclosure because it provides information about the loss the entity expects to incur in the event of default.

BC28 The Board noted arguments that quantitative data are onerous to prepare and that qualitative information about collateral pledged would be sufficient information for users about the loss that entities might incur in the future. The Board acknowledged that the fair value of collateral is not always readily available (for example, when mortgage loans are collateralised by residential property that is not appraised every year or when corporate loans are secured by a floating charge over all of the assets of a borrower). Therefore, the Board concluded that disclosure of the fair value of collateral pledged should not be required when impracticable.

Credit quality of assets that are neither past due nor impaired

BC29 The Board noted that information about credit quality gives a greater insight into the credit risk of assets and helps users assess whether such assets are more or less likely to become impaired in the future. The Board decided not to specify a particular method for giving this information, but rather to allow each entity to devise a method that is appropriate to its circumstances and the assets it has because this information will vary between entities.

Financial assets that are either past due or impaired

BC30 The Board decided to require separate disclosure of financial assets that are past due or impaired to provide users with information about financial assets with the greatest credit risk (paragraph 40).

BC31 The Board decided to require disclosure of an analysis of the age of financial assets that are past due as at the reporting date, but not impaired, to provide users with information about those financial assets that are more likely to become impaired and help users to estimate the level of future impairment losses (paragraph 40(a)).

BC32 The Board decided to require disclosure of an analysis of financial assets that are impaired as at the reporting date, including the factors the entity considered in determining that the financial assets are impaired (paragraph 40(b)). The Board concluded that an analysis of the age of financial assets that are impaired would not be useful information, because it does not help the user to understand why the impairment occurred. Rather, it concluded that this information would be better conveyed by requiring an analysis by other factors (eg nature of the counterparty, or geographical analysis of impaired assets). The Board also concluded that disclosure of the factors the entity considered in determining that financial assets are impaired is useful because estimating whether an asset is impaired involves judgement. Hence, this disclosure helps a user to compare one entity with another.

Collateral and other credit enhancements obtained

BC33 Paragraph 41 requires the entity to disclose the nature and fair value of assets obtained as collateral and other credit enhancements and its policy for disposing of such assets. The Board concluded that this information is useful because it provides information about the frequency of such activities and the entity's ability to obtain and dispose of the collateral obtained.

Liquidity risk

BC34 The Board decided to require disclosure of a maturity analysis for financial liabilities that shows the remaining earliest contractual maturities (paragraph 42). The Board concluded that liquidity risk, ie the risk that the entity will encounter difficulty in meeting commitments associated with financial liabilities, arises because of the possibility (which may often be remote) that the entity could be required to pay its liabilities on their earliest contractual maturity date. Therefore, this disclosure shows a worst case scenario.

BC35 However, the Board also noted concerns that such a contractual maturity analysis does not reveal the expected maturity of liabilities that, for some entities, eg banks with many demand deposits, may be different. As such, it does not reveal the risk expected in normal circumstances or how the entity manages liquidity risk. Therefore, the Board decided to require a description of how the liquidity risk portrayed by contractual maturity analysis is managed. This description would include disclosure of factors such as the expected maturity dates of liabilities and how assets held by the entity mitigate liquidity risk.

Market risk—sensitivity analysis

BC36 The Board decided to require disclosure of a sensitivity analysis for each type of market risk (paragraph 43) because:

(a) users have consistently requested disclosure of sensitivity analysis;

(b) a sensitivity analysis can be disclosed for all types of market risk and by all entities, and is relatively easy to understand and calculate; and

(c) as with all the minimum disclosures, it is a minimum requirement suitable for all entities—including non-financial entities—that have financial instruments. It is supported by disclosures of how the entity manages the risk. Thus, it is a simpler and more suitable disclosure than other approaches, including the disclosures of terms and conditions and the gap analysis of interest rate risk currently required by IAS 32.

BC37 The Board acknowledged that a simple sensitivity analysis that shows a change in one variable has limitations. For example, the analysis may not reveal non-linearities in sensitivities or disclose the effects of interdependencies between variables. The Board decided to meet the first concern by requiring additional disclosure when the sensitivity analysis is unrepresentative of a risk inherent in a financial instrument. On the second concern, the Board noted that it could require a more complex sensitivity analysis that takes into account the interdependencies between risks. However, such an analysis, although more informative, is also more complex and costly to prepare. Accordingly, the Board decided not to require such an analysis, but to permit its disclosure when it is used by management to manage risk.

BC38 Additionally, the Board noted that information provided by a simple sensitivity analysis would not be comparable across entities. More comparable information would be obtained if the Board imposed specific requirements about the inputs, process and methodology of the analysis, for example disclosure of the effects of a parallel shift of the yield curve by 100 basis points. However, the Board decided against such a specific requirement because a reasonably possible change in a relevant risk variable (such as interest rates) in one economic environment may not be reasonably possible in another (such as an economy with high inflation). Therefore, the Board decided that it was preferable to require entities to disclose the effect of reasonably possible changes in the relevant risk variable, and leave entities to judge what those reasonably possible changes are.

BC39 The Board decided that the proposed sensitivity analysis provided more useful information than the following requirements currently in IAS 32 that are intended to satisfy the same user needs:

(a) disclosures of terms and conditions of financial instruments; and

(b) disclosures about exposure to interest rate risk including contractual repricing or maturity dates.

Accordingly, the Board decided to delete these requirements.

Disclosures of operational risk

BC40 The Board discussed whether it should require disclosure of information about operational risk. However, the Board noted that definition and measurement of operational risk is in its infancy. It also decided that such disclosures would be more appropriately disclosed outside the financial statements. Therefore, the Board decided to address the issue in its research project on management commentary.

Location of disclosures of risks arising from financial instruments

BC41 The Board discussed the location of disclosures about risks arising from financial instruments. One possibility would be that the disclosures should not be part of the financial statements. Rather they should be part of the information provided by management outside the financial statements. However, the Board noted that there is no present requirement in IFRSs for material accompanying the financial statements, such as a management commentary, so the Board has no other mechanism for ensuring that the necessary information is provided. In addition, the Board decided that the financial statements would be incomplete and potentially misleading without disclosures about risks arising from financial instruments. Hence, it concluded that such disclosures should be part of the financial statements (either directly or by being included in accompanying material and cross-referenced from the financial statements). Also, IAS 32 previously required similar disclosures to be part of the financial statements.

Implementation guidance

BC42 The Board discussed the status of the proposed implementation guidance. The Board concluded that the guidance would be appropriate in its entirety only for an entity with many financial instruments (including many financial institutions). Accordingly, the Board concluded that it should not make the guidance mandatory for all entities because doing so would be excessive and burdensome for entities that do not have large holdings of financial instruments.

BC43 The Board also decided to add an introduction to its implementation guidance, to explain the objective and status of the guidance, and what entities would be expected to do to comply with the IFRS. In particular, the implementation guidance emphasises that it does not create additional requirements; rather it suggests possible ways to apply the proposed disclosures.

BC44 The Board considered whether it should prepare separate implementation guidance for entities with only a few financial instruments and little associated risk. It decided that this was not necessary because for such an entity, the IFRS on its own would provide sufficient guidance. The Board also noted that all entities could apply only the parts of the implementation guidance that are relevant to their circumstances.

DISCLOSURES ABOUT CAPITAL

BC45 As part of this project, the Board considered whether it should require disclosures about capital. The Board noted that the Insurance Advisory Steering Committee had also proposed in its draft statement of principles that capital disclosure requirements should be introduced for insurers.

BC46 The Board concluded that information about capital should be disclosed. This is because the level of an entity's capital and how it manages capital is an important factor in assessing the risk profile of an entity and its ability to withstand unexpected adverse events. It might also affect the entity's ability to pay dividends.

BC47 The Board considered whether only entities that are subject to external capital requirements (eg regulatory capital requirements established by legislation or other regulation) should be required to disclose information about capital or whether the information should be required for all entities. The Board believes that information about capital is useful for all entities, as is evidenced by the fact that some entities set internal capital requirements, and industry norms have been established for some industries. Therefore, the Board concluded that the information about capital should be disclosed by all entities.

BC48 The Board decided that disclosure about capital should be set in the context of a discussion of the entity's objectives, policies and processes for managing capital. This is because the Board believes that such a discussion both communicates important information about the entity's capital strategy and provides the context for other disclosures.

BC49 The Board considered whether it should require disclosure of any externally imposed capital requirements. Such a capital requirement could be:

(a) an industry-wide requirement that all entities in the industry must comply with; or

(b) an entity-specific requirement imposed on a particular entity by its prudential supervisor or other regulator.

BC50 The Board concluded that there was no need for disclosure of industry-wide requirements because information about the existence and level of such requirements is widely available outside the financial statements. It also noted that whereas some industries and countries have industry-wide capital requirements, others do not. Thus, using industry-wide requirements would not lead to comparability across different entities or across similar entities in different countries.

BC51 As regards externally imposed entity-specific requirements, the Board noted that some view the disclosure of the existence and level of entity-specific capital requirements as important information for users, because it informs them about the risk assessment of the regulator. Such disclosure would improve transparency and market discipline.

BC52 However, the Board noted the following arguments against requiring disclosure of externally imposed entity-specific capital requirements:

(a) users of financial statements might rely primarily on the regulator's assessment of solvency risk without making their own risk assessment.

(b) the focus of a regulator's risk assessment is for those whose interests the regulations are intended to protect (eg depositors or policyholders). This emphasis is different from that of a shareholder. Thus, it could be misleading to suggest that the supervisor's risk assessment could, or should, be a substitute for independent analysis by investors.

(c) the disclosure of entity-specific capital requirements imposed by a regulator might undermine that regulator's ability to impose such requirements. For example, the information could cause depositors to withdraw funds. Hence, this might discourage regulators from imposing requirements. Furthermore, an entity's supervisory dialogue would become public, which might not be appropriate in all circumstances.

(d) because regulators have different tools available, for example formal requirements and moral suasion, a requirement to disclose entity-specific capital requirements could not be framed in a way that would lead to the provision of information that is comparable across entities.

(e) a requirement to disclose capital requirements (and, hence, supervisory judgements) could hamper clear communication to the entity of the regulator's assessment by creating incentives to use moral suasion and other informal mechanisms.

(f) disclosure requirements should not focus on entity-specific capital requirements in isolation, but should focus on how entity-specific capital requirements affect how an entity manages, and hence determines the adequacy of, its capital resources.

(g) a requirement to disclose entity-specific capital requirements imposed by a regulator is not part of the Basel Committee's Pillar 3 requirements.

BC53 Taking into account all of the above arguments, the Board decided not to require disclosure of externally imposed capital requirements, but to require disclosures about whether the entity complied with any externally imposed capital requirements during the period and, if not, the consequences of non-compliance. This retains confidentiality between regulators and the entity, but alerts users to breaches of capital requirements and the consequences.

BC54 The Board also decided that the requirement to disclose information about breaches of capital requirements should apply equally to breaches of internally imposed requirements, because the information is also useful to a user of the financial statements.

WITHDRAWAL OF IAS 30*

BC55 The Board noted that the IFRS would replace the disclosure requirements about risks arising from financial instruments in IAS 32 and IAS 30.

BC56 The Board concluded that the requirements in IAS 30 that do not relate to risk disclosures would either be superseded by the proposed requirements, are no longer relevant or are covered by other Standards. As an example the disclosures of categories of assets, liabilities, income and expenses would be superseded by the requirements of IAS 1 *Presentation of Financial Statements*† and the IFRS. As another example, the requirements in IAS 30 about related party transactions are covered by IAS 24 *Related Party Disclosures*‡.

AMENDMENTS TO IFRS 4§

BC57 The Board noted that the disclosure requirements in IFRS 4 were based on requirements in other Standards, particularly IAS 32, or were applications of those requirements. The IFRS would replace many of the requirements in IAS 32 on which the IFRS 4 disclosures were based, resulting in the need for consequential amendments to IFRS 4.

BC58 The Board noted that there were two approaches it could take to amending those disclosure requirements in IFRS 4 that had been based on IAS 32:

(a) it could make only the minimum essential changes to IFRS 4 (such as amending cross-references to IAS 32) and conduct a fuller review of the disclosures in IFRS 4 as part of phase II of the Insurance project; or

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* *ASB Footnote:* As IAS 30 has not been implemented in the UK this section has no relevance for entities in the UK.
† *ASB Footnote:* Currently, there is no equivalent UK standard to IAS 1.
‡ *ASB Footnote:* In May 2002 the ASB proposed that a UK standard based on IAS 24 should be issued. This is set out in FRED 25 and is yet to be issued in its final form. Some of the issues covered in IAS 24 are covered by the UK standard FRS 8 *Related Party Disclosures.*
§ *ASB Footnote:* As IFRS 4 has not been implemented in the UK this section has no relevance in the UK.

(b) it could make the disclosure requirements of IFRS 4 fully consistent with those in the proposed IFRS.

BC59 The Board noted that IFRS 4 had been issued only a few months before the Exposure Draft and some might consider that it was too soon to make changes to it. The Board acknowledged that insurers that had begun to collect the information necessary to comply with the disclosure requirements in IFRS 4 might not welcome another change in a short period (particularly because further changes may occur in a few years as a result of phase II of the Insurance project).

BC60 However, the Board noted that:

(a) insurers will have both insurance contracts and financial instruments. In particular, some of the investment products issued by insurers are financial instruments, not insurance contracts under IFRSs. It is more useful for users and easier for preparers if the risk disclosures for insurance contracts and financial instruments are the same.

(b) making the disclosure requirements of IFRS 4 fully consistent with the IFRS would result in disclosures that are easier to prepare. In particular, the IFRS would remove the 'terms and conditions' disclosure in paragraph 39(b) of IFRS 4. Some commentators on ED 5 (the Exposure Draft that preceded IFRS 4) objected to this disclosure requirement, believing it to be onerous and not provide the most useful information. The Board decided to consider these objections in this project.

(c) the disclosures proposed in the IFRS were designed to be implemented as a package, and if implemented piecemeal would result in less useful information for users. For example, the proposed risk disclosures are intended to replace the 'terms and conditions' disclosure at present in paragraph 60(a) of IAS 32 and paragraph 39(b) of IFRS 4. Merely updating the reference in paragraph 39(d) of IFRS 4 would result in some, but not all, of the proposed risk disclosures being applicable to insurance contracts and the 'terms and conditions' disclosure being retained.

(d) it is likely that no further significant changes will be required to the risk disclosures as a result of phase II of the Insurance project (although changes are expected to the accounting-related disclosures). However, the guidance to support the disclosures in IFRS 4 may need refinement when phase II is completed, as discussed in paragraph BC207 of the Basis for Conclusions on IFRS 4.

BC61 The Board concluded that the arguments in paragraph BC60 were persuasive. Therefore, the Board proposes to amend IFRS 4 to be fully consistent with the IFRS. However, the Board also acknowledged the concerns described in paragraph BC59 and therefore decided to ask for constituents' views on this matter.

EFFECTIVE DATE AND TRANSITION

BC62 The Board considered what the effective date of the IFRS and related amendments to IFRS 4 should be. The Board is committed to maintaining a 'stable platform' of unchanged Standards during the period to 2005 when many entities will adopt IFRSs for the first time. In addition, some preparers will need time to make the system changes necessary to comply with the IFRS.

BC63 However, the Board was informed that a number of entities that will be adopting IFRSs from 2005 would like to apply the disclosures proposed in ED 7 from when they first adopt IFRSs, on the grounds that:

(a) the proposals in the IFRS, in particular the proposed risk disclosures, would be more up-to-date than the present requirements in IAS 32 and IAS 30, more relevant to users of financial statements and easier to prepare.

(b) it would be unhelpful to both preparers and users for an entity to change from local GAAP to IAS 32 and IAS 30 and then change again only one or two years later to the proposed new risk disclosures.

BC64 Taking into account the points in paragraphs BC62 and BC63, the Board decided that the effective date of the IFRS and related amendments to IFRS 4 should be annual periods beginning on or after 1 January 2007, with earlier application encouraged.

BC65 As regards transition, the main issue that arises is whether an entity that chooses to apply the IFRS early should be required to provide comparative disclosure in the first year of adoption of IFRSs. The Board believes that entities that apply the requirements only when they become mandatory should be required to provide comparative disclosures because such entities will have enough time to prepare the information. The Board noted the following arguments for giving an exemption for entities that apply the IFRS early:

(a) The Board gave an exemption in IAS 32 to entities that adopt IFRSs for the first time before 1 January 2006. This exemption allows such entities not to provide comparative disclosures that comply with IAS 32 in the first year of adoption. Some may argue that entities that choose to apply the IFRS early should be given a similar exemption. Otherwise, such entities may choose to apply the older, less relevant, Standard in order to avoid having to provide disclosures for 2004.

(b) Some entities that would like to apply the proposed new risk disclosures early may not have all the information needed to provide comparative disclosures. For example, although the risk disclosures mainly focus on the position at the reporting date, they require additional information if that position is unrepresentative. This requires the entity to have some information throughout the period. If the entity applies the IFRS early, the comparative period may include time before ED 7 was published.

(c) Some entities that would like to apply the proposed new risk disclosures early may be discouraged from doing so if they have to provide comparative disclosures. For example, a group that in 2004 did not manage risk consistently across the group, but moved to consistent methods in 2005, may choose not to apply the proposed requirements early if doing so would require it to disclose the variety of methods used in 2004.

BC66 The Board also noted the following arguments for requiring all entities to provide comparative disclosures in the first year of application:

(a) the proposed disclosures will be more useful if they are accompanied by comparatives.

(b) most of the proposed requirements are relatively easy to comply with because:

   (i) many of them are based on information used internally to manage risk;

   (ii) the proposed minimum risk disclosures are based on the position at the reporting date unless that position is unrepresentative; and

   (iii) the proposed minimum risk disclosures are fairly minimal and, hence, should not be onerous to prepare.

BC67 On balance, the Board decided to propose that an entity that both (a) adopts IFRSs for the first time before 1 January 2006 and (b) applies the IFRS before that date should be exempt from the requirement to produce comparative information in the first year of application. The Board noted that such an exemption exists for IAS 32 and IFRS 4 and that this exemption would apply equally to the amendments proposed by ED 7.

[DRAFT] IMPLEMENTATION GUIDANCE WITH ILLUSTRATIVE EXAMPLES

Contents

[DRAFT] IMPLEMENTATION GUIDANCE

This [draft] guidance accompanies, but is not part of, the [draft] IFRS.

ASB note: This Implementation Guidance was prepared by the IASB.

INTRODUCTION

IG1 The guidance in paragraphs IG7-IG47 suggests possible ways to apply the disclosure requirements in paragraphs 32-45. The guidance in paragraphs IE1 and IE2 illustrates the application of the disclosure requirement in paragraph 47 for (a) an entity that is not a financial institution and is not subject to an externally imposed capital requirement and (b) an entity that has not complied with externally imposed capital requirements.

IG2 Paragraph 8 states that "an entity decides in the light of its circumstances how much detail it provides to satisfy the requirements of this [draft] IFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics." To satisfy the requirements, an entity may not need to disclose all the information suggested in paragraphs IG7- IG47. This guidance does not create additional requirements.

~~IG3 IAS 1 *Presentation of Financial Statements* (as revised in 2003) requires an entity to "provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance."~~

IG4 For convenience, this Implementation Guidance discusses each disclosure requirement in the [draft] IFRS separately. In practice, disclosures would normally be presented as an integrated package and individual disclosures may satisfy more than one requirement. For example, information about concentrations of risk may also convey information about exposure to credit or other risk.

MATERIALITY*

~~IG5 IAS 1 notes that a specific disclosure requirement in a Standard or an Interpretation need not be satisfied if the information is not material. IAS 1 defines materiality as follows:~~

> ~~Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.~~

~~IG6 IAS 1 also explains that definition as follows:~~

> ~~Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. The *Framework for the Preparation and Presentation of Financial Statements* states in paragraph 25 that "users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence." Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.~~

NATURE AND EXTENT OF RISK ARISING FROM FINANCIAL INSTRUMENTS (PARAGRAPHS 32-45)

Qualitative disclosures (paragraph 34)

IG7 The type of qualitative information an entity might disclose to meet the disclosure requirements in paragraph 34 includes, but is not limited to, a narrative description of:

(a) the entity's exposures to risk and the activities that generated them;

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* *ASB Footnote:* There is no equivalent to IAS 1 in the UK. The guidance on materiality is set out in the ASB's Statement of Principles and the Foreword to Accounting Standards.

(b) the entity's policies and processes for accepting, measuring, monitoring and controlling risk, which might include:

  (i) the structure and organisation of the entity's risk management function(s), including a discussion of independence and accountability;

  (ii) the scope and nature of the entity's risk reporting or measurement systems;

  (iii) the entity's policies for hedging or mitigating risk; and

  (iv) the entity's processes for monitoring the continuing effectiveness of such hedges or mitigating devices.

(c) the entity's policies and procedures for avoiding excessive concentrations of risk and for taking collateral to mitigate risk.

IG8 In accordance with paragraph 34, entities disclose if there has been any change in the qualitative information from the previous period and explain the reasons for the change. Such changes may result from changes in exposure to risk or from changes in the way those exposures are managed.

Quantitative disclosures (paragraphs 35-45)

IG9 Paragraph 35 requires disclosure of quantitative data about concentrations of risk. Concentrations of credit risk may arise from:

(a) industry sectors of counterparties. Thus, if an entity's counterparties are concentrated in one or more industry sectors (such as retail or wholesale), it would disclose separately exposure to risks arising from each concentration of counterparties.

(b) credit rating or other measure of credit quality. Thus, if an entity's counterparties are concentrated in one or more credit qualities (such as secured loans or unsecured loans) or in one or more credit ratings (such as investment grade or speculative grade), it would disclose separately exposure to risks arising from each concentration of counterparties.

(c) geographical distribution of counterparties. Thus, if an entity's counterparties are concentrated in one or more geographical markets (such as Europe or the Far East), it would disclose separately exposure to risks arising from each concentration of counterparties.

Similar principles apply to identifying concentrations of other risks, including liquidity risk and market risk. For example, in the context of liquidity risk, concentrations may arise from the repayment terms of financial liabilities, sources of borrowing facilities or reliance on a particular market in which to realise liquid assets.

IG10 In accordance with paragraph 38, disclosure of concentrations of risk includes a description of the shared characteristic that identifies each concentration. For example, a geographical distribution of counterparties may comprise individual countries, groups of countries or regions within countries.

IG11 When quantitative information at the reporting date is unrepresentative of the entity's exposure to risk during the period, paragraph 36 requires further information to be provided. To meet this requirement, an entity might disclose the highest, lowest and average amount of risk to which it was exposed during the period. For example, if an entity typically has a large exposure to a particular currency, but at year-end unwinds the position, the entity might disclose a graph that shows the exposure at various times during the period, including the highest, lowest and average exposures.

Minimum disclosures (paragraphs 39-45)

Credit risk (paragraphs 39-41)

IG12 Paragraph 39 requires an entity to disclose information about its exposure to credit risk by class of financial instrument. Financial instruments in the same class share economic characteristics with respect to the risk being disclosed (in this case, credit risk). For example, an entity might determine that residential mortgages, unsecured consumer loans and commercial loans each have different economic characteristics.

Maximum credit risk exposure (paragraph 39(a))

IG13 Paragraph 39(a) requires disclosure of the amount that best represents the entity's maximum exposure to credit risk. For a financial asset, this amount is typically the gross carrying amount, net of:

(a) any amounts offset in accordance with IAS 32; and

(b) any impairment losses recognised in accordance with IAS 39 (whether the carrying amount is reduced directly or through the use of an allowance account).

IG14 Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:

(a) granting loans and receivables to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the related financial assets.

(b) entering into derivatives and similar contracts, eg foreign exchange contracts, interest rate swaps and credit derivatives. When the resulting asset is measured at fair value, the maximum exposure to credit risk will equal the carrying amount.

(c) the granting of financial guarantees. In this case, the maximum exposure to credit risk is the maximum amount the entity could have to pay if the guarantee is called on, which may be significantly greater than the amount recognised as a liability.

(d) making a loan commitment that is irrevocable over the life of the facility. If the loan commitment cannot be settled net in cash or another financial instrument, the maximum credit exposure is the full amount of the commitment, because it is uncertain whether the amount of any undrawn portion may be drawn upon in the future. This may be significantly greater than the amount recognised as a liability.

Collateral and other credit enhancements pledged (paragraph 39(b))

IG15 Paragraph 39(b) requires an entity to describe collateral pledged as security for assets it holds and other credit enhancements obtained and, unless impracticable, the fair value. An entity might meet this requirement by disclosing:

(a) the policies and processes for valuing and managing collateral and other credit enhancements obtained;

(b) a description of the main types of collateral and other credit enhancements (examples of the latter being guarantees, credit derivatives and netting agreements that do not qualify for offset in accordance with IAS 32);

(c) the main types of counterparties to collateral and other credit enhancements and their creditworthiness; and

(d) information about risk concentrations within the collateral or other credit enhancements.

IG16 In determining whether disclosure of the fair value of collateral pledged as security or any other credit enhancement is practicable, the entity considers the nature of the collateral or other credit enhancement. For example, an entity may lend to financial intermediaries who provide actively traded financial instruments as collateral. The entity may also monitor the value of collateral daily. If so, the disclosure of the fair value of collateral pledged is practicable. In contrast, collateral pledged may consist of a floating charge over all the assets of an entity that has many non-financial assets. If so, the disclosure of the fair value of collateral pledged may not be practicable.

Credit quality (paragraph 39(c))

IG17 Paragraph 39(c) requires an entity to disclose information about the credit quality of financial assets with credit risk that are neither past due nor impaired. In doing so, an entity might disclose the following information:

(a) an analysis of credit exposures using an external or internal credit grading system;

(b) the nature of the counterparty (see paragraph IG9(b));

(c) historical information about counterparty default rates; and

(d) any other information used to assess credit quality.

IG18 When the entity considers external ratings when managing and monitoring credit quality, the entity might disclose information about:

(a) the amounts of credit exposures for each external credit grade;

(b) the rating agencies used;

(c) the amount of an entity's rated and unrated credit exposures; and

(d) the relationship between internal and external ratings.

IG19 When the entity considers internal credit ratings when managing and monitoring credit quality, the entity might disclose information about:

(a) the internal credit ratings process;

(b) the amounts of credit exposures for each internal credit grade; and

(c) the relationship between internal and external ratings.

Financial assets that are past due or impaired (paragraph 40)

IG20 A financial asset is past due when the counterparty has failed to make a payment when contractually due. As an example, an entity enters into a lending agreement that requires interest to be paid every thirty days. On the thirty-first day, if interest has not been paid, the loan is past due. Past due does not mean that a counterparty will never pay, but it can trigger various actions such as renegotiation, enforcement of covenants or legal proceedings.

IG21 Paragraph 40(a) requires the disclosure by class of an analysis of the age of financial assets that are past due but not impaired. In preparing this analysis, an entity uses its judgement to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:

(a) not more than three months;

(b) more than three months and not more than six months;

(c) more than six months and not more than one year; and

(d) more than one year.

IG22 Paragraph 23(f) requires disclosure of an entity's policy for determining when financial assets are no longer past due because, for example, the terms and conditions have been renegotiated. This could be immediately after a new contractual arrangement is signed or only after the counterparty has made payments when due in accordance with the new terms and conditions for a specified period.

IG23 Paragraph 40(b) requires an analysis of impaired financial assets by class. This analysis might include:

(a) the carrying amount, before deducting any impairment loss;

(b) the amount of any related impairment loss; and

(c) the nature and fair value of collateral pledged and other credit enhancements obtained.

Liquidity risk (paragraph 42)

Contractual maturity analysis (paragraph 42(a))

IG24 In preparing the contractual maturity analysis for financial liabilities required by paragraph 42(a), an entity uses its judgement to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:

(a) not later than one month;

(b) later than one month and not later than three months;

(c) later than three months and not later than one year; and

(d) later than one year and not later than five years.

IG25 When an entity or a counterparty has a choice over when to pay an amount, the liability is included on the basis of the earliest date on which the entity can be required to pay. For example, financial liabilities that an entity can be required to repay on demand (eg demand deposits) would be included in the earliest time band.

IG26 When an entity is committed to make amounts available in instalments, each instalment is allocated to the earliest period in which the entity can be required to pay. For example, an undrawn loan commitment would be included in the contractual maturity analysis in the time band containing the earliest date it can be drawn down.

IG27 The amounts disclosed in the maturity analysis are the contractual undiscounted cash flows, for example:

(a) gross finance lease obligations (before deducting finance charges) to be paid;

(b) prices specified in forward agreements to purchase financial assets which will be settled by delivering cash in exchange for financial assets;

(c) net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged; and

(d) the stream of floating rate interest payments for pay-floating/receive-fixed interest rate swaps for which gross cash flows are exchanged.

IG28 When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the reporting date. For example, when the amount payable varies with changes in an index, the amount disclosed is determined on the basis of the level of the index at the reporting date.

Liquidity management (paragraph 42(b))

IG29 Paragraph 42(b) requires the entity to describe how it manages liquidity risk inherent in the maturity analysis of financial liabilities required in paragraph 42(a). The factors that the entity may consider in providing this disclosure include, but are not limited to, whether the entity:

(a) expects some of its liabilities to be repaid later than the earliest date on which the entity can be required to pay (as may be the case for customer deposits placed with a bank);

(b) holds financial assets for which there is a liquid market and that are readily saleable to meet liquidity needs;

(c) has committed borrowing facilities (eg commercial paper facilities) or other lines of credit (eg stand-by credit facilities) that it can access to meet liquidity needs;

(d) holds financial assets for which there is not a liquid market, but which are expected to generate cash inflows (principal or interest) that will be available to meet cash outflows on liabilities;

(e) holds deposits at central banks to meet liquidity needs;

(f) has very diverse funding sources; or

(g) has significant concentrations of liquidity risk in either its assets or its funding sources.

IG30 An entity that manages liquidity risk on the basis of expected maturity dates might disclose a maturity analysis of the expected maturity dates of both financial liabilities and financial assets. If an entity discloses such an expected maturity analysis, it might clarify that expected dates are based on estimates made by management, and explain how the estimates are determined and the principal reasons for differences from the contractual maturity analysis that is required by paragraph 42(a).

Market risk (paragraphs 43-45)

IG31 There are various types of market risk, including currency risk, equity price risk, commodity price risk, interest rate risk, prepayment risk and residual value risk. Risk variables that are relevant to disclosing market risk include, but are not limited to:

(a) in the context of interest rate risk, a parallel or non-parallel shift in the yield curve of market interest rates;

(b) in the context of currency risk, a change in foreign currency exchange rates;

(c) in the context of equity price risk, a change in market prices of equity instruments; and

(d) in the context of commodity price risk, a change in market prices of commodities.

Sensitivity analysis (paragraphs 43 and 44)

IG32 Paragraph 43(a) requires a sensitivity analysis to be disclosed for each type of market risk to which the entity is exposed. An entity that trades financial instruments might disclose this information separately for financial instruments held for trading and those not held for trading.

IG33 Paragraph 43(a) requires the sensitivity analysis to show the effect on profit or loss or equity of reasonably possible changes in the relevant risk variable (eg prevailing market interest rates, currency rates, equity prices or commodity prices). For example, relevant risk variables might include:

(a) prevailing market interest rates, for interest-sensitive financial instruments such as a variable-rate loan.

(b) currency rates and interest rates, for foreign currency financial instruments such as foreign currency bonds.

The effect on profit or loss shown in the sensitivity analysis includes the effect on interest income or expense, impairment and (in the case of foreign currency monetary items) currency gain or loss. For available-for-sale financial assets, the entity also shows the effect on equity of other changes in fair value.

IG34 The sensitivity analysis disclosed by an entity includes the effect of hedging activities. For example, if an entity has an interest-bearing financial asset that is hedged with an interest rate swap, the sensitivity analysis would reflect the effect of a reasonably possible change in interest rates after taking into account the interest rate swap.

IG35 Paragraph 44 permits an entity to use a sensitivity analysis that reflects the interdependencies between risk variables, such as a value-at-risk methodology, if it uses this analysis to manage its exposure to financial risks. Such an entity might comply with paragraph 43(b) by disclosing the type of value-at-risk model used (eg whether the model relies on Monte Carlo simulations) and the main assumptions (eg the holding period and confidence level).

Interest rate risk

IG36 Interest rate risk arises on interest-bearing financial instruments recognised in the balance sheet (eg loans and receivables and debt instruments issued) and on some financial instruments not recognised in the balance sheet (eg loan commitments).

IG37 For interest rate risk, the sensitivity analysis might show separately the effect of a change in interest rates on:

(a) interest income and expense;

(b) other line items of profit and loss (such as trading gains and losses); and

(c) when applicable, equity.

A sensitivity analysis for interest rate risk might be disclosed for each major currency in which financial instruments are denominated.

Currency risk

IG38 Currency (or foreign exchange) risk arises on financial instruments that are denominated in a foreign currency, ie in a currency other than the functional currency of the entity. For the purpose of the [draft] IFRS, currency risk does not arise from non-monetary items, or from monetary items that are denominated in an entity's functional currency.

IG39 A sensitivity analysis might be disclosed for each major currency to which an entity is exposed.

Other price risk

IG40 Other price risk includes commodity price risk, equity price risk and other market price risk arising from financial instruments. To comply with paragraph 43, an entity might disclose the effect of a decrease in a specified stock market index, commodity price, or other risk variable (eg if an entity gives residual value guarantees that are financial instruments, the entity discloses a decrease in the value of the assets whose values are guaranteed).

IG41 For the purpose of the [draft] IFRS, an entity cannot be exposed to equity price risk from financial instruments classified as equity. Two examples of financial instruments that give rise to equity price risk are a holding of equities in another entity, and an investment in a trust, which in turn holds investments in equity instruments. Other examples include forward contracts and options to buy or sell specified quantities of an equity instrument and swaps that are indexed to equity prices. The fair values of such financial instruments are affected by changes in the market price of the underlying equity instruments.IG42

When disclosing the effect of a change in equity prices, the effect on profit or loss (that arises, for example, from instruments classified as at fair value through profit or loss and impairments of available-for-sale financial assets) is disclosed separately from the effect on equity (that arises, for example, from instruments classified as available for sale).

IG43 Other types of market risk to which an entity may be exposed include, but are not limited to:

(a) *residual value risk*. For example, a lessor of motor cars that writes residual value guarantees is exposed to residual value risk.

(b) *prepayment risk*. For example, an entity that has fixed rate prepayable loan assets may find that if interest rates decrease, loan prepayments increase because borrowers take advantage of the opportunity to refinance at a lower rate of interest.

Other market risk disclosures (paragraph 45)

IG44 Paragraph 45 requires the disclosure of additional information, when the sensitivity analysis disclosed is unrepresentative of a risk inherent in a financial instrument. For example, this can occur when:

(a) a financial instrument contains terms and conditions whose effects are not apparent from the sensitivity analysis, eg options that remain out of (or in) the money for the chosen change in the risk variable;

(b) financial assets are illiquid, eg where there is a low volume of transactions in similar assets and an entity may find it difficult to find a counterparty; or

(c) an entity has a large holding of a financial asset that, if sold in its entirety, would be sold at a discount to the quoted market price for a smaller holding.

IG45 In the situation in paragraph IG44(a) additional information might take the form of disclosing:

(a) the terms and conditions (eg the options);

(b) the effect on profit or loss if the term or condition were met (ie if the options were exercised); and

(c) the ways in which the risk is hedged.

For example, an entity may acquire a zero-cost interest rate collar that includes an out-of-the-money leveraged written option (eg the entity pays ten times the amount of the difference between a specified interest rate floor and the current market interest rate). The entity may regard the collar as an inexpensive economic hedge against a reasonably possible increase in interest rates. However, an unexpectedly large decrease in interest rates may trigger negative cash outflows under the written option which, because of the leverage, may be significantly larger than the benefit of lower interest rates. Neither the fair value of the collar nor a sensitivity analysis based on reasonably possible changes in market variables would indicate this exposure. In this case, the entity might provide the additional information described above.

IG46 In the situation in paragraph IG44(b) additional information might take the form of disclosing the reasons for the lack of liquidity and the ways in which the risk is hedged.

IG47 In the situation in paragraph IG44(c), additional information might take the form of disclosing:

(a) the nature of the security (eg entity name);

(b) the extent of holding (eg 15 per cent of the issued shares);

(c) the effect on current period profit and loss; and

(d) the ways in which the risk is hedged.

[DRAFT] ILLUSTRATIVE EXAMPLES

CAPITAL (PARAGRAPHS 46-48)

Illustrative example for an entity that is not a regulated financial institution

IE1 The following example illustrates the application of the disclosure requirement in paragraph 47 for an entity that is not a financial institution and is not subject to an externally imposed capital requirement. In this example, the entity monitors capital using a debt-to-adjusted capital ratio. Other entities may use different methods to monitor capital. The example is also relatively simple. An entity should decide, in the light of its circumstances, how much detail it provides to satisfy the requirements of the [draft] IFRS.

Facts

Group A manufactures and sells motor cars. Group A includes a finance subsidiary that provides finance to customers, primarily in the form of leases. Group A is not subject to an externally imposed capital requirement.

Example disclosure

The Group's objectives when managing capital are to ensure that the level of capital:

- allows creditors to be repaid in the event of unexpected losses, and
- provides adequate returns to shareholders by pricing our products and services commensurately with the level of risk.

The Group sets the amount of capital in proportion to our risk. We manage our capital structure and make adjustments to it in the light of changes in economic conditions and the risk characteristics of our underlying assets. In order to maintain or adjust our capital structure we may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

In common with others in the industry, the Group monitors capital based on the debt-to-adjusted capital ratio. This ratio is calculated as net debt ÷ adjusted capital. Net debt is calculated as total debt (as shown in the balance sheet) less cash and cash equivalents. Adjusted capital comprises share capital, share premium, minority interest, retained earnings and revaluation reserve, but excludes the cash flow hedge reserve.

During 20X4, our strategy, which was unchanged from 20X3, was to maintain the debt-to-adjusted capital ratio at the lower end of the 9-10 to 1 range, in order to secure access to finance at a reasonable cost by maintaining a BB credit rating. The debt-to-adjusted capital ratio at 31 December 20X4 and 31 December 20X3 was as follows:

	31 December 20X4 CU million	**31 December 20X3 CU million**
Total debt	1,000	1,100
Less: cash and cash equivalents	(90)	(150)
Net debt	910	950
Total equity	110	105
Less: cash flow hedge reserve	(10)	(5)
Adjusted capital	100	100
Debt-to-adjusted capital ratio	9.1	9.5

The decrease in the debt-to-adjusted capital ratio during 20X4 resulted primarily from the reduction in net debt that occurred on the sale of subsidiary Z. As a result of this reduction in net debt, improved profitability and lower levels of managed receivables, we increased our dividend payment for 20X4 to CU2.8 million (from CU2.5 million for 20X3).

Illustrative example for an entity that has not complied with externally imposed capital requirements

IE2 The following example illustrates the application of the disclosure requirement in paragraph 47(e) when an entity has not complied with externally imposed capital requirements during the period. Other disclosures would be provided to comply with the other requirements of paragraph 47.

Facts

Entity A provides financial services to its customers and is subject to capital requirements imposed by a prudential supervisor. During the year ended 31 December 2007, Entity A did not comply with the capital requirements imposed by its supervisor. In its financial statements for the year ended 31 December 2007, Entity A provides the following disclosure relating to its non-compliance.

Disclosure

Entity A filed its quarterly regulatory capital return on 30 September 2007. At that date, the amount of Entity A's regulatory capital was below the capital requirement imposed by its prudential supervisor by CU1 million. As a result, Entity A was required to submit a plan to the supervisor indicating how the amount of its regulatory capital would increase to the amount required. To comply with this requirement, Entity A submitted a plan that entailed selling its fixed interest investment portfolio with a carrying amount of CU11.5 million in the fourth quarter of 2007. In the fourth quarter of 2007, Entity A sold its fixed interest investment portfolio for CU12.6 million and met its regulatory capital requirement.

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