Grant Thornton

Technical Accounting Alert

Improving Disclosures about Financial Instruments (Amendments to IFRS 7)

Introduction

On 5 March 2009, the IASB published *Improving Disclosures about Financial Instruments (Amendments to IFRS 7).* This was issued by the AASB in Australia in April 2009 as AASB 2009 – 02 Amendments to Australian Accounting Standards – Improving Disclosures about Financial Instruments.

The aims of the Amendments to IFRS 7 are to:

- explain more clearly how entities determine the fair value of their financial instruments; and
- improve the disclosure of liquidity risk.

The Amendments to IFRS 7 are part of the IASB's response to the credit crisis.

The purpose of this Alert is to provide details about these amendments.

Relevant standards

References are made to standards issued by the International Accounting Standards Board. The Australian equivalent to each standard included in this alert is shown below:

International Standard reference	Australian equivalent standard
IFRS 7 *Financial instruments: Disclosures*	AASB 7: *Financial Instruments: Disclosures*

Overview

The three-level fair value hierarchy

In order to improve the disclosure of how entities measure the fair value of their financial instruments, the Amendments to IFRS 7 introduce a fair value hierarchy, similar (but not identical) to that which is required under US GAAP.

The fair value hierarchy consists of the following three levels:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie as prices) or indirectly (ie derived from prices);
- Level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The disclosures required

For financial instruments (within the scope of IFRS 7) which are measured at fair value in the statement of financial position an entity shall disclose the following for each class of financial instruments:

- the level in the fair value hierarchy into which the fair value measurements are categorised in their entirety;
- any significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers;
- for fair value measurements in Level 3 of the hierarchy, a reconciliation from the beginning balances to the ending balances. As well as highlighting purchases, sales, and gains and losses, this reconciliation will identify transfers into or out of Level 3 and the reasons for those transfers.

In addition, for any fair value measurements in Level 3 where changing one or more inputs to reasonably possible alternative assumptions would change fair value significantly, entities are required to disclose that fact and the effect of those changes.

The quantitative disclosures are to be provided in a tabular format unless another format is more appropriate. Examples have been added to the Implementation Guidance section of IFRS 7 to illustrate some possible ways of disclosing the additional information required.

Determination of hierarchy level

The determination of which of the levels in the fair value hierarchy into which an asset or liability is categorised is based on the lowest level input that is significant to the fair value measurement of the instrument.

Assessing whether a particular input to the fair value measurement is significant may require judgement. The Amendments to IFRS 7 make clear that when the fair value of an instrument is measured using some observable inputs, but these inputs require significant adjustment based on unobservable inputs, that fair value measurement should be categorised in Level 3 of the hierarchy.

Liquidity risk disclosures

The second part of the Amendments to IFRS 7 improves the liquidity risk disclosures required by IFRS 7.39.

In accordance with the Amendments an entity discloses:

(a) a maturity analysis for non-derivative financial liabilities that shows the remaining contractual maturities

Grant Thornton

(b) a maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows

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

Liquidity risk is defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

The most important change compared to the previous IFRS 7 liquidity risk disclosures relates to derivative financial liabilities. Under the previous version of IFRS 7, entities were required to disclose a quantitative maturity analysis for all derivative financial liabilities according to their remaining contractual maturities. The change is a response to comments that the requirement to provide disclosures based on the remaining contractual maturities was difficult to apply for some derivative financial liabilities and did not always result in information that reflects how many entities manage liquidity risk for such instruments. As a result, the Amendments to IFRS 7 retain the requirement to disclose the remaining contractual maturities of derivative financial liabilities only where the information is essential for an understanding of the timing of the cash flows.

Effective date

The Amendments to IFRS 7 are effective for annual periods beginning on or after 1 January 2009. In the first year of application, however, an entity need not provide comparative information in respect of the new requirements. Earlier application is permitted.

Grant Thornton comment

The new three level fair value hierarchy should help investors and other users to understand more clearly how entities have determined the fair value of their financial instruments, and is to be welcomed. It also increases the comparability of IFRS with US GAAP, which uses a similar hierarchy.

The revised liquidity disclosures should enable entities to explain more clearly how they manage liquidity risk in relation to derivatives they hold, and should also be beneficial.

In our comment letter of December 2008 on the Exposure Draft that preceded the amendments, we expressed concern that full retrospective application of the amendments would be burdensome for entities, given the requirements for additional fair value information. We are therefore pleased that the IASB has given relief from providing comparative information in respect of the amended disclosures in the first year of their application.

Grant Thornton

Further Information

For further information on any of the information included in this TA Alert, please contact your local Grant Thornton Australia contact or a member of the National Audit Support team at NAS@grantthornton.com.au