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30 Cannon Street, London, EC4M 6XH, United Kingdom.

Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411

Email: info@ifrs.org Web: www.ifrs.org

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IFRS Foundation Publications Department

30 Cannon Street, London, EC4M 6XH, United Kingdom.

Tel: +44 (0)20 7332 2730 Fax: +44 (0)20 7332 2749

Email: publications@ifrs.org Web: www.ifrs.org

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Approval by the Board of IFRS 7 issued in August 2005

International Financial Reporting Standard 7 *Financial Instruments: Disclosures* was approved for issue by the fourteen members of the International Accounting Standards Board.

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Geoffrey Whittington

Tatsumi Yamada

Approval by the Board of *Improving Disclosures about Financial Instruments* (Amendments to IFRS 7) issued in March 2009

Improving Disclosures about Financial Instruments (Amendments to IFRS 7) was approved for issue by the fourteen members of the International Accounting Standards Board.

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Approval by the Board of *Disclosures—Transfers of Financial Assets* (Amendments to IFRS 7) issued in October 2010

Disclosures—Transfers of Financial Assets (Amendments to IFRS 7) was approved for issue by the fourteen members of the International Accounting Standards Board.

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Prabhakar Kalavacherla

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Paul Pacter

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Tatsumi Yamada

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Approval by the Board of *Mandatory Effective Date of IFRS 9 and Transition Disclosures (Amendments to IFRS 9 (2009), IFRS 9 (2010 and IFRS 7) issued in December 2011*

Mandatory Effective Date of IFRS 7 and Transition Disclosures (Amendments to IFRS 9 (2009), IFRS 9 (2010) and IFRS 7) was approved for publication by fourteen of the fifteen members of the International Accounting Standards Board. Ms McConnell dissented from the issue of the amendments. Her dissenting opinion is set out after the Basis for Conclusions.

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Approval by the Board of *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) issued in December 2011

Disclosures—Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7) was approved for issue by the fifteen members of the International Accounting Standards Board.

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Elke Kšniĝ

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Paul Pacter

Darrel Scott

John T Smith

Wei-Guo Zhang

Approval by the Board of IFRS 9 *Financial Instruments* (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) issued in November 2013

IFRS 9 *Financial Instruments* (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) was approved for issue by fifteen of the sixteen members of the International Accounting Standards Board. Mr Finnegan dissented. His dissenting opinion is set out after the Basis for Conclusions.

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Basis for Conclusions on IFRS 7 *Financial Instruments: Disclosures*

This Basis for Conclusions accompanies, but is not part of, IFRS 7.

In this Basis for Conclusions the terminology has not been amended to reflect the changes made by IAS 1 Presentation of Financial Statements (as revised in 2007).

Introduction

- BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in IFRS 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, the International Accounting Standards Committee (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.
- BC4 In 2001 the Board added this project to its agenda. To assist and advise it, the Board retained the IAS 30 steering committee, renamed the Financial Activities Advisory Committee (FAAC), as an expert advisory group. FAAC members had experience and expertise in banks, finance companies and insurance companies and included auditors, financial analysts, preparers and regulators. The FAAC's role was:
- (a) to provide input from the perspective of preparers and auditors of financial statements of entities that have significant 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.
- BC5 The Board published its proposals in July 2004 as ED 7 *Financial Instruments: Disclosures*. The deadline for comments was 27 October 2004. The Board received 105 comment letters. After reviewing the responses, the Board issued IFRS 7 in August 2005.
- BC5A In October 2008 the Board published an exposure draft *Improving Disclosures about Financial Instruments* (proposed amendments to IFRS 7). The aim of the proposed amendments was to enhance disclosures about fair value and liquidity risk. The Board received 89 comment letters. After reviewing the responses, the Board issued amendments to IFRS 7 in March 2009. The Board decided to require application of the amendments for periods beginning on or after 1 January 2009. The Board noted that, although the effective date of IFRSs and amendments to IFRSs is usually 6–18 months after issue, the urgent need for enhanced disclosures about financial instruments demanded earlier application.
- BC5B In January 2011 the IASB and the US national standard-setter, the Financial Accounting Standards Board (FASB), published the exposure draft *Offsetting Financial Assets and Financial Liabilities*. This was in response to requests from users of financial statements and recommendations from the Financial Stability Board to achieve convergence of the boards' requirements for offsetting financial assets and financial liabilities. The different requirements result in a significant difference between amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities. The proposals in the exposure draft would have replaced the requirements for offsetting financial assets and financial liabilities and would have established a common approach with the FASB. After considering the responses to the exposure draft, the boards decided to maintain their respective offsetting models. However, to meet the needs of users of financial statements, the boards agreed jointly on additional disclosures to enable users of financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with an entity's recognised financial assets and recognised financial liabilities, on the entity's financial position. *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) was issued in December 2011 and is effective for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods.

Scope (paragraphs 3–5)

The entities to which the IFRS applies

- BC6 Although IFRS 7 arose from a project to revise IAS 30 (a Standard that applied only to banks and similar financial institutions), it applies to all entities that have financial instruments. The Board observed that the reduction in regulatory barriers in many countries and increasing competition between banks, non-bank financial services firms, and financial conglomerates have resulted in many entities providing financial services that were traditionally provided only by entities regulated and supervised as banks. The Board concluded that this development would make it inappropriate to limit this project to banks and similar financial institutions.
- BC7 The Board considered whether entities that undertake specified activities commonly undertaken by banks and other financial institutions, namely deposit-taking, lending and securities activities, face unique risks that would require a standard specific to them. However, the Board decided that the scope of this project should include disclosures about risks arising from financial instruments in all entities for the following reasons:
- (a) disclosures about risks associated with financial instruments are useful to users of the financial statements of all entities.
 - (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 financial assets for investment and liquidity management purposes.
 - (c) responses to the Exposure Draft of Improvements to IAS 32 *Financial Instruments: Disclosure and Presentation*, published in June 2002, indicated that IAS 32's risk disclosure requirements, applicable to all entities, could be improved.
 - (d) the exclusion of some financial instruments 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 even if that instrument is not held as part of deposit-taking, lending and securities activities.
 - (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 decided that the scope of the IFRS should be the same as that of IAS 32 with one exception. The Board concluded that the IFRS should not apply to derivatives based on interests in subsidiaries, associates or joint ventures if the derivatives meet the definition of an equity instrument in IAS 32. This is because equity instruments are not remeasured and hence:
- (a) they do not expose the issuer to balance sheet and income statement risk; and
 - (b) the disclosures about the significance of financial instruments for financial position and performance are not relevant to equity instruments.

Although these instruments are excluded from the scope of IFRS 7, they are within the scope of IAS 32 for the purpose of determining whether they meet the definition of equity instruments.

Exemptions considered by the Board

Insurers

- BC9 The Board considered whether the IFRS should apply to entities that both have financial instruments and issue insurance contracts. The Board did not exempt these entities because financial instruments expose all entities to risks regardless of what other assets and liabilities they have. Accordingly, an entity that both issues insurance contracts and has financial instruments applies IFRS 4 *Insurance Contracts* to its insurance contracts and IFRS 7 to its financial assets and financial liabilities. However, many of the disclosure requirements in IFRS 4 were applications of, or relatively straightforward analogies with, existing requirements in IAS 32. Therefore, the Board also updated the disclosures required by IFRS 4 to make them consistent with IFRS 7, with modifications that reflect the interim nature of IFRS 4.

Small and medium-sized entities

- BC10 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. The IFRS requires entities with few financial instruments and few risks to give few disclosures. Also, many of the requirements in the IFRS are based on information provided internally to the entity's key management personnel. This helps to avoid unduly onerous requirements that would not be appropriate for smaller entities. Accordingly, the Board decided not to exempt such entities from the scope of IFRS 7. However, it will keep this decision under review in its project on financial reporting for small and medium-sized entities.

Subsidiaries

- BC11 Some respondents to ED 7 stated that there is little public interest in the financial statements of some entities, such as a wholly-owned subsidiary whose parent issues publicly available financial statements. These respondents stated that such subsidiaries should be exempt from some of the requirements of IFRS 7 in their individual financial statements. However, deciding whether such an entity should prepare general purpose financial statements is a matter for the entity and local legislators and regulators. If such an entity prepares financial statements in accordance with IFRSs, users of those statements should receive information of the same quality as users of any general purpose financial statements prepared in accordance with IFRSs. The Board confirmed its view that no exemptions from the general requirements of any Standard should be given for the financial statements of subsidiaries.

Disclosures about the significance of financial instruments for financial position and performance (paragraphs 7–30, B4 and B5)

- BC12 The Board relocated disclosures from IAS 32 to IFRS 7, so that all disclosure requirements for financial instruments are in one Standard. Many of the disclosure requirements about the significance of financial instruments for an entity's financial position and performance were previously in IAS 32. For these disclosures, the relevant paragraphs from the Basis for Conclusions on IAS 32 have been incorporated into this Basis for Conclusions. This Basis for Conclusions does not discuss requirements that the Board did not reconsider either in revising IAS 32 in 2003 or in developing IFRS 7.

The principle (paragraph 7)

- BC13 The Board decided that the disclosure requirements of IFRS 7 should result from the explicit disclosure principle in paragraph 7. The Board also decided to specify disclosures to satisfy this principle. In the Board's view, entities could not satisfy the principle in paragraph 7 unless they disclose the information required by paragraphs 8–30.

Balance sheet disclosures (paragraphs 8–19 and B4)

Categories of financial assets and financial liabilities (paragraph 8)

- BC14 Paragraph 8 requires entities to disclose financial assets and financial liabilities by the measurement categories in IAS 39 *Financial Instruments: Recognition and Measurement*. The Board concluded that the disclosure for each measurement category would assist users in understanding the extent to which accounting policies affect the amounts at which financial assets and financial liabilities are recognised.
- BC15 The Board also concluded that separate disclosure of the carrying amounts of financial assets and financial liabilities that are classified as held for trading and those designated upon initial recognition as financial assets and financial liabilities at fair value through profit or loss is useful because such designation is at the discretion of the entity.

Financial assets or financial liabilities at fair value through profit or loss (paragraphs 9–11, B4 and B5)

- BC16 IAS 39 permits entities to designate a non-derivative financial liability as at fair value through profit or loss, if specified conditions are met. If entities do so, they are required to provide the disclosures in paragraphs 10 and 11. The Board's reasons for these disclosures are set out in the Basis for Conclusions on IAS 39, paragraphs BC87–BC92.

- BC17 The requirements in paragraphs 9, 11 and B5(a) are related to the Amendments to IAS 39 Financial Instruments: Recognition and Measurement—*The Fair Value Option*, issued in June 2005.¹ The reasons for those requirements are discussed in the Basis for Conclusions on those Amendments.
- BC18 Paragraph 10(a) requires disclosure of the change in fair value of a financial liability designated as at fair value through profit or loss that is attributable to changes in the liability's credit risk. The Board previously considered this disclosure in its deliberations on the fair value measurement of financial liabilities in IAS 39.
- BC19 Although quantifying such changes might be difficult in practice, the Board concluded that disclosure of such information would be useful to users of financial statements and would help alleviate concerns that users may misinterpret the profit or loss effects of changes in credit risk, especially in the absence of disclosures. Therefore, in finalising the revisions to IAS 32 in 2003, it decided to require disclosure of the change in fair value of the financial liability that is not attributable to changes in a benchmark interest rate. The Board believed that this is often a reasonable proxy for the change in fair value that is attributable to changes in the liability's credit risk, in particular when such changes are large, and would provide users with information with which to understand the profit or loss effect of such a change in credit risk.
- BC20 However, some respondents to ED 7 stated that they did not agree that the IAS 32 disclosure provided a reasonable proxy, except for straightforward debt instruments. In particular, there could be other factors involved in the change in an instrument's fair value unrelated to the benchmark interest rate, such as the effect of an embedded derivative. Respondents also cited difficulties for unit-linked insurance contracts, for which the amount of the liability reflects the performance of a defined pool of assets. The Board noted that the proxy that was developed in IAS 32 assumed that it is not practicable for entities to determine directly the change in fair value arising from changes in credit risk. However, the Board acknowledged and shared these concerns.
- BC21 As a result, the Board amended this requirement to focus directly on the objective of providing information about the effects of changes in credit risk:
- (a) by permitting entities to provide a more faithful representation of the amount of change in fair value that is attributable to changes in credit risk if they could do so. However, such entities are also required to disclose the methods used and provide their justification for concluding that those methods give a more faithful representation than the proxy in paragraph 10(a)(i).
 - (b) by amending the proxy disclosure to be the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk. For example, some entities may be able to identify part of the change in the fair value of the liability as attributable to a change in an index. In these cases, the proxy disclosure would exclude the amount of change attributable to a change in an index. Similarly, excluding the amount attributable to a change in an internal or external investment fund makes the proxy more suitable for unit-linked insurance contracts.
- BC22 The Board decided that when an entity has designated a financial liability as at fair value through profit or loss, it should disclose the difference between the carrying amount and the amount the entity would contractually be required to pay at maturity to the holders of the liability (see paragraph 10(b)). The fair value may differ significantly from the settlement amount, in particular for financial liabilities with a long duration when an entity has experienced a significant deterioration in creditworthiness since their issue. The Board concluded that knowledge of this difference would be useful to users of financial statements. Also, the settlement amount is important to some financial statement users, particularly creditors.

Reclassification (paragraphs 12 and 12A)

- BC23 IAS 32 required disclosure of the reason for reclassification of financial assets at cost or amortised cost rather than at fair value. The Board extended this requirement to include disclosure of the reason for reclassifications and of the amount reclassified into and out of each category. As noted in paragraph BC14, the Board regards such information as useful because the categorisation of financial instruments has a significant effect on their measurement.
- BC23A In October and November 2008 the Board amended IAS 39² to permit reclassification of particular financial assets in some circumstances. The Board decided to require additional disclosures about the situations in which any such reclassification is made, and the effects on the financial statements. The Board regards such information as useful because the reclassification of a financial asset can have a significant effect on the financial statements.

¹ In November 2009 and October 2010, the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. This paragraph refers to matters relevant when IFRS 7 was issued.

² In November 2009 and October 2010, the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. This paragraph refers to matters relevant when IFRS 7 was issued.

BC24 [Deleted]

Offsetting financial assets and financial liabilities

Background

- BC24A Following requests from users of financial statements and recommendations from the Financial Stability Board, in June 2010 the IASB and the FASB added a project to their respective agendas to improve and potentially achieve convergence of the requirements for offsetting financial assets and financial liabilities. The different requirements result in a significant difference between amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities.
- BC24B Consequently, in January 2011 the IASB and the FASB published the exposure draft *Offsetting Financial Assets and Financial Liabilities*. The exposure draft proposed common offsetting requirements for IFRSs and US GAAP and proposed disclosures about financial assets and financial liabilities that are subject to rights of set-off and related arrangements.
- BC24C Most respondents to the exposure draft supported the boards' efforts towards achieving convergence, but their responses to the proposals varied. Many IFRS preparers agreed with the proposals, stating that the underlying principle and proposed criteria were similar to those in IAS 32 and reflect an entity's credit and liquidity exposure to such instruments. Some US GAAP preparers indicated that offsetting in the statement of financial position in accordance with the proposed criteria provided more relevant information than the current model, except for derivatives and repurchase or reverse repurchase agreements.
- BC24D There was no consensus among users of financial statements regarding if, or when, to present gross or net information in the statement of financial position. However, there was consensus that both gross and net information are useful and necessary for analysing financial statements. Users of financial statements supported achieving convergence of the IFRS and US GAAP requirements, and also supported improving disclosures so that financial statements prepared in accordance with IFRSs and US GAAP would be more comparable. Comparable information is important to investors for calculating their ratios and performing their analyses.
- BC24E As a result of the feedback received on the exposure draft, the IASB and the FASB decided to maintain their respective offsetting models. However, the boards noted that requiring common disclosures of gross and net amounts of recognised financial instruments that are (a) set off in the statement of financial position and (b) subject to enforceable master netting arrangements and similar agreements, even if not set off in the statement of financial position, would be helpful for users of financial statements. Accordingly, the boards agreed on common disclosure requirements by amending and finalising the disclosures initially proposed in the exposure draft.

Scope (paragraph 13A)

- BC24F The disclosures in the exposure draft would have applied to all recognised financial assets and recognised financial liabilities subject to a right of set-off, and/or for which an entity had either received or pledged cash or other financial instruments as collateral.
- BC24G Respondents to the exposure draft noted that paragraphs 14, 15 and 36(b) of IFRS 7 already require disclosures of financial instrument collateral received and pledged and other credit enhancements. US GAAP has similar disclosure requirements. Consequently, if an entity has no financial assets or financial liabilities subject to a right of set-off (other than collateral agreements or credit enhancements), the boards concluded that there would be no incremental value in providing additional disclosure information for such instruments.
- BC24H For example, some respondents were concerned that providing disclosure of conditional rights to set off loans and customer deposits at the same financial institution would be a significant operational burden. Such rights are often a result of statute, and entities do not typically manage their credit risk related to such amounts based on these rights of set-off. In addition, entities that have contractual rights to set off customer deposits with loans only in situations such as events of default see these rights as a credit enhancement and not as the primary source of credit mitigation. Respondents argued that the cost of including these amounts in the amended disclosures would outweigh the benefit because users of financial statements did not request information related to these instruments when discussing the offsetting disclosure requirements.
- BC24I The boards agreed and decided to limit the scope of the disclosures to all financial instruments that meet the boards' respective offsetting models and recognised financial assets and recognised financial liabilities that are subject to an enforceable master netting arrangement or a similar agreement. The boards specifically

excluded loans and customer deposits with the same financial institution from the scope of these requirements (except in the limited cases when the respective offsetting model is satisfied). This reduced scope still responds to the needs of users of financial statements for information about amounts that have been set off in accordance with IFRSs and amounts that have been set off in accordance with US GAAP. The types of instruments that fall within the scope of these disclosures include the instruments that cause significant differences between amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP.

- BC24J If there is an associated collateral agreement for such instruments, an entity would disclose amounts subject to such agreements in order to provide full information about its exposure in the normal course of business, as well as in the events of default and insolvency or bankruptcy.
- BC24K Other respondents requested that the scope of the proposed disclosures be further amended to exclude financial instruments for which the lender has the right to set off the related non-financial collateral in the event of default. Although non-financial collateral agreements may exist for some financial instruments, those preparers do not necessarily manage the credit risk related to such financial instruments on the basis of the non-financial collateral held.
- BC24L The disclosures focus on the effects of recognised financial instruments and financial instrument set-off agreements on an entity's financial position. The boards also noted that a comprehensive reconsideration of credit risk disclosures was not within the scope of this project. They therefore restricted the scope of the disclosures to exclude financial instruments with rights of set-off only for non-financial collateral.
- BC24M A few respondents were concerned that the proposals seem to be designed for financial institutions and would impose requirements on non-financial institutions. They questioned the benefit that such disclosures would provide to investors in non-financial entities.
- BC24N Although the boards acknowledged that financial institutions would be among those most affected, they did not agree that the disclosures are only relevant for financial institutions. Other industries have similar financial instrument activities and use enforceable master netting arrangements and similar agreements to mitigate exposure to credit risks. Consequently, the boards concluded that the required disclosures provide useful information about an entity's arrangements, irrespective of the nature of the entity's business.

Disclosure of quantitative information for recognised financial assets and recognised financial liabilities within the scope of paragraph 13A (paragraph 13C)

- BC24O The boards understood that recognised financial instruments included in the disclosure requirements in paragraph 13C of IFRS 7 may be subject to different measurement requirements. For example, a payable related to a repurchase agreement may be measured at amortised cost, while a derivative asset or derivative liability subject to the same disclosure requirements (for example, in paragraph 13C(a) of IFRS 7) will be measured at fair value. In addition, the fair value amount of any financial instrument collateral received or pledged and subject to paragraph 13C(d)(ii) of IFRS 7 should be included in the disclosures to provide users of financial statements with the best information about an entity's exposure. Consequently, a financial asset or financial liability disclosure table may include financial instruments measured at different amounts. To provide users of financial statements with the information they need to evaluate the amounts disclosed in accordance with paragraph 13C of IFRS 7, the boards decided that an entity should describe any resulting measurement differences in the related disclosures.

Disclosure of the net amounts presented in the statement of financial position (paragraph 13C(c))

- BC24P When providing feedback on the proposals in the exposure draft, users of financial statements emphasised that information in the notes should be clearly reconciled back to the amounts in the statement of financial position. The boards therefore decided that if an entity determines that the aggregation or disaggregation of individual financial statement line item amounts provides more relevant information when disclosing amounts in accordance with paragraph 13C of IFRS 7, the entity must still reconcile the amounts disclosed in paragraph 13C(c) of IFRS 7 back to the individual line item amounts in the statement of financial position.

Disclosure of the amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in paragraph 13C(b) (paragraph 13C(d))

- BC24Q Paragraph 13C(d)(i) of IFRS 7 requires disclosure of amounts related to recognised financial instruments that do not meet some or all of the offsetting criteria in paragraph 42 of IAS 32. This may include current rights of set-off that do not meet the criterion in paragraph 42(b) of IAS 32, or conditional rights of set-off that are enforceable and exercisable only in the event of default, or only in the event of insolvency or bankruptcy of any of the counterparties. Although such rights do not qualify for set-off in accordance with IAS 32, users of financial statements are interested in arrangements that an entity has entered into that mitigate the entity's exposure to such financial instruments in the normal course of business and/or in the events of default and insolvency or bankruptcy.
- BC24R Paragraph 13C(d)(ii) of IFRS 7 requires disclosure of amounts of cash and financial instrument collateral (whether recognised or unrecognised) that do not meet the criteria for offsetting in the statement of financial position but that relate to financial instruments within the scope of these disclosure requirements. Depending on the terms of the collateral arrangement, collateral will often reduce an entity's exposure in the events of default and insolvency or bankruptcy of a counterparty to the contract. Collateral received or pledged against financial assets and financial liabilities may often be liquidated immediately upon an event of default. Consequently, the boards concluded that the amounts of collateral that are not set off in the statement of financial position but that are associated with other netting arrangements should be included in the amounts disclosed as required by paragraph 13C(d)(ii) of IFRS 7.

Limits on the amounts disclosed in paragraph 13C(d) (paragraph 13D)

- BC24S The boards concluded that an aggregate disclosure of the amount of cash collateral and/or the fair value of collateral in the form of other financial instruments would be misleading when some financial assets and financial liabilities are over-collateralised and others have insufficient collateral. To prevent an entity from inappropriately obscuring under-collateralised financial instruments with others that are over-collateralised, paragraph 13D of IFRS 7 restricts the amounts of cash and/or financial instrument collateral to be disclosed in respect of a recognised financial instrument to more accurately reflect an entity's exposure. However, if rights to collateral can be enforced across financial instruments, such rights can be included in the disclosure provided in accordance with paragraph 13D of IFRS 7. At no point in time should under-collateralisation be obscured.

Disclosure by type of financial instrument or by counterparty

- BC24T The exposure draft proposed disclosures by class of financial instrument. An entity would have been required to group financial assets and financial liabilities separately into classes that were appropriate to the nature of the information disclosed, taking into account the characteristics of those financial instruments and the applicable rights of set-off. Many preparers were concerned that the cost of disclosing amounts related to rights of set-off in the events of default and insolvency or bankruptcy by class of financial instrument would outweigh the benefit. They also indicated that they often manage credit exposure by counterparty and not necessarily by class of financial instrument.
- BC24U Many users of financial statements indicated that disclosure of recognised amounts subject to enforceable master netting arrangements and similar agreements (including financial collateral) that were not set off in the statement of financial position would be useful irrespective of whether the amounts are disclosed by counterparty or by type or by class of financial instrument, as long as they can reconcile these amounts back to the statement of financial position. In evaluating whether the disclosures should be provided by type or by class of financial instrument or by counterparty, the boards noted that the objective of these disclosures (paragraph 13B of IFRS 7) is that an entity should disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on the entity's financial position.
- BC24V The boards decided to reduce the burden on preparers by requiring disclosure by type of financial instrument rather than by class. Disclosure by type of financial instrument may (or may not) differ from the class of financial instrument used for other disclosures in IFRS 7, but is appropriate in circumstances where a difference would better achieve the objective of the disclosures required by these amendments. The boards also decided to provide flexibility as to whether the information required by paragraph 13C(c)–(e) of IFRS 7 is presented by type of financial instrument or by counterparty. This would allow preparers to present the disclosures in the same way that they manage their credit exposure.
- BC24W The Board also noted that paragraph 31 of IFRS 7 requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments

to which the entity is exposed at the end of the reporting period. In addition, paragraph 34 of IFRS 7 requires the disclosure of concentrations of risk for each type of risk. Consequently, the Board noted that, irrespective of whether the disclosures were required to be provided by type or by class of financial instrument or by counterparty, entities are already required to disclose information about risks and how they are managed, including information about concentrations of credit risk.

Other considerations

Reconciliation between IFRSs and US GAAP

- BC24X Some users of financial statements asked for information to help them reconcile between the amounts set off in accordance with IFRSs and the amounts set off in accordance with US GAAP. The boards recognised that the amounts disclosed in accordance with paragraph 13C(b), (c) and (d) of IFRS 7 will probably be different for financial statements prepared in accordance with IFRSs and those prepared in accordance with US GAAP. However, the amounts disclosed in accordance with paragraph 13C(a) and (e) of IFRS 7 are generally not affected by the offsetting criteria applied in the statement of financial position. These amounts are important for users of financial statements to understand the effects of netting arrangements on an entity's financial position in the normal course of business and in the events of default and insolvency or bankruptcy.
- BC24Y Consequently, while the amended disclosure requirements do not directly reconcile the IFRS and US GAAP amounts, they provide both gross and net information on a comparable basis. The boards considered that requiring a full reconciliation between IFRSs and US GAAP was unnecessary, particularly given the relative costs and benefits. Such reconciliation would have required preparers to apply two sets of accounting requirements and to track any changes to the related accounting standards and to contracts in the related jurisdictions.

Tabular information

- BC24Z The disclosures require amounts to be presented in a tabular format (ie a table) unless another format is more appropriate. The boards believe that a tabular format best conveys an overall understanding of the effect of any rights of set-off and other related arrangements on an entity's financial position and improves the transparency of such information.

Transition and effective date

- BC24AA The boards identified two transition approaches in the exposure draft—prospective and retrospective.
- BC24AB Prospective transition is generally appropriate only in situations where it is not practicable to apply a standard to all prior periods. The boards did not believe that this was the case with the proposed disclosure requirements. Retrospective transition would require an entity to apply the new requirements to all periods presented. This would maximise consistency of financial information between periods. Retrospective transition would enable analysis and understanding of comparative accounting information among entities. In addition, the scope of the disclosures was reduced and the disclosures amended to require less detailed information than originally proposed, which would make them less burdensome for preparers to apply retrospectively.
- BC24AC The exposure draft did not propose an effective date, but instead asked respondents for information about the time and effort that would be involved in implementing the proposed requirements. The boards indicated that they would use such feedback, as well as the responses in their *Request for Views on Effective Dates and Transition Methods*, and the timing of other planned accounting and reporting standards, to determine an appropriate effective date for the proposals in the exposure draft.
- BC24AD Some respondents suggested that the offsetting proposals should have the same effective date as the other components of the IASB's project to replace IAS 39 with IFRS 9 *Financial Instruments*. If an earlier date was required, it was suggested that application should be restricted only to the accounting period being presented, rather than providing comparative information, because of the potential burden of applying the proposed disclosure requirements.
- BC24AE At the time the amended disclosure requirements were issued (December 2011), IFRS 9 was not yet mandatorily effective. However, the Board did not believe that the IFRS 9 project would change the offsetting disclosures. Aligning the effective date of these amendments with the effective date of the financial instruments project could result in postponing the effective date of the common disclosure requirements, which would mean a delay in providing users of financial statements the information that they need. For users of financial statements to benefit from the increased comparability, and because the

offsetting and IFRS 9 projects are independent of one another, the boards decided that common disclosures should be effective as early as possible.

- BC24AF In addition, the boards did not think that a long transition period was needed, because the amended disclosures had a reduced scope and less detailed information than originally proposed in the exposure draft and were related to the presentation of instruments that entities have already recognised and measured. The boards therefore decided that the effective date for the amended disclosures should be for annual periods beginning on or after 1 January 2013, and interim periods within those annual periods.
- BC24AG As described in greater detail in other sections of this Basis for Conclusions, the disclosures required by paragraphs 13B–13E of IFRS 7 are a result of requests from users of financial statements for information to enable them to compare statements of financial position prepared in accordance with IFRSs with statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities.
- BC24AH The information required in paragraphs 13B–13E of IFRS 7 will enable users of financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with an entity's recognised financial assets and recognised financial liabilities, on the entity's financial position for financial statements presented in accordance with IFRSs and those presented in accordance with US GAAP.
- BC24AI The Board noted that paragraph 10(f) of IAS 1 *Presentation of Financial Statements* requires an entity to provide a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements. In the case of *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7), because the change relates only to disclosures and there is no associated change in accounting policy, or a resulting restatement or reclassification, it was noted that paragraph 10(f) of IAS 1 does not apply for these amendments to IFRS 7.

Cost-benefit considerations

- BC24AJ Before issuing an IFRS or an amendment to an IFRS, the Board seeks to ensure that it will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. As described in greater detail in other sections of this Basis for Conclusions on *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7), the Board considered that there is significant benefit to market participants in providing these disclosures. The disclosures address a significant difference between the amounts presented in statements of financial position prepared in accordance with IFRSs and amounts presented in statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities. The disclosures therefore make the amounts presented in accordance with both sets of standards more comparable.
- BC24AK During redeliberations, the Board considered feedback related to the costs of providing the disclosures proposed in the exposure draft. As described in greater detail in other sections of this Basis for Conclusions, the Board decided to limit the scope of the disclosures because these changes would reduce the cost to preparers while still providing the information that users of financial statements had requested.
- BC24AL On the basis of the considerations described in the Basis for Conclusions on these amendments, and summarised in paragraphs BC24AJ and BC24AK, the Board concluded that the benefits of *Disclosures—Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) outweigh the costs to preparers of applying these amendments.

Collateral (paragraphs 14 and 15)

- BC25 Paragraph 15 requires disclosures about collateral that the entity holds if it is permitted to sell or repledge the collateral in the absence of default by the owner. Some respondents to ED 7 argued for an exemption from this disclosure if it is impracticable to obtain the fair value of the collateral held. However, the Board concluded that it is reasonable to expect an entity to know the fair value of collateral that it holds and can sell even if there is no default.

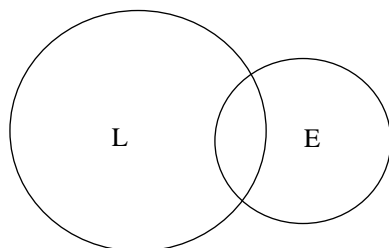
Allowance account for credit losses (paragraph 16)

- BC26 When a separate account is used to record impairment losses (such as an allowance account or similar account used to record a collective impairment of assets), paragraph 16 requires a reconciliation of that account to be disclosed. 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. However, the Board decided not to specify the components of the reconciliation. This allows entities flexibility in determining the most appropriate format for their needs.

- BC27 Respondents to ED 7 asked the Board to require entities to provide equivalent information if they do not use an allowance account. The Board decided not to add this disclosure in finalising the IFRS. It concluded that, for virtually all entities, IAS 39's requirement to consider impairment on a group basis would necessitate the use of an allowance or similar account. The accounting policy disclosures required by paragraph B5(d) also include information about the use of direct adjustments to carrying amounts of financial assets.

Compound financial instruments with multiple embedded derivatives (paragraph 17)

- BC28 IAS 32 requires the separation of the liability and equity components of a compound financial instrument. The Board notes that this is more complicated for compound financial instruments with multiple embedded derivative features whose values are interdependent (for example, a convertible debt instrument that gives the issuer a right to call the instrument back from the holder, or the holder a right to put the instrument back to the issuer) than for those without such features. If the embedded equity and non-equity derivative features are interdependent, the sum of the separately determined values of the liability and equity components will not equal the value of the compound financial instrument as a whole.
- BC29 For example, the values of an embedded call option feature and an equity conversion option feature in a callable convertible debt instrument depend in part on each other if the holder's equity conversion option is extinguished when the entity exercises the call option or vice versa. The following diagram illustrates the joint value arising from the interaction between a call option and an equity conversion option in a callable convertible bond. Circle L represents the value of the liability component, ie the value of the straight debt and the embedded call option on the straight debt, and Circle E represents the value of the equity component, ie the equity conversion option on the straight debt. The total area of the two circles represents the value of the callable convertible bond. The difference between the value of the callable convertible bond as a whole and the sum of the separately determined values for the liability and equity components is the joint value attributable to the interdependence between the call option feature and the equity conversion feature. It is represented by the intersection between the two circles.



- BC30 Under the approach in IAS 32, the joint value attributable to the interdependence between multiple embedded derivative features is included in the liability component. A numerical example is set out as Illustrative Example 10 accompanying IAS 32.
- BC31 Even though this approach is consistent with the definition of equity as a residual interest, the Board recognises that the allocation of the joint value to either the liability component or the equity component is arbitrary because it is, by its nature, joint. Therefore, the Board concluded that it is important to disclose the existence of issued compound financial instruments with multiple embedded derivative features that have interdependent values. Such disclosure highlights the effect of multiple embedded derivative features on the amounts recognised as liabilities and equity.

Defaults and breaches (paragraphs 18 and 19)

- BC32 Paragraphs 18 and 19 require disclosures about defaults and breaches of loans payable and other loan agreements. The Board concluded that such disclosures provide relevant information about the entity's creditworthiness and its prospects of obtaining future loans.

Income statement and equity (paragraph 20)

Items of income, expenses, gains or losses (paragraph 20(a))

- BC33 Paragraph 20(a) requires disclosure of income statement gains and losses by the measurement categories in IAS 39 (which complement the balance sheet disclosure requirement described in paragraph BC14).

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.

- BC34 Some entities include interest and dividend income in gains and losses on financial assets and financial liabilities held for trading and others do not. To assist users in comparing income arising from financial instruments across different entities, 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 or financial liabilities held for trading include interest and dividend income (see Appendix B, paragraph B5(e)).

Fee income and expense (paragraph 20(c))

- BC35 Paragraph 20(c) requires disclosure of fee income and expense (other than amounts included in determining the effective interest rate) arising from financial assets or 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. This information indicates the level of such activities and helps users to estimate possible future income of the entity.

Other disclosures—fair value (paragraphs 25–30)³

- BC36 Many entities use fair value information internally in determining their 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. The Board decided that when an entity does not measure a financial asset or financial liability in its balance sheet at fair value, it should provide fair value information through supplementary disclosures to assist users to compare entities on a consistent basis.
- BC37 Disclosure of fair value is not required for investments in unquoted equity instruments⁴ and derivatives linked to such equity instruments if their fair value cannot be measured reliably⁵. Similarly, IFRS 4 does not specify the accounting required for contracts containing a discretionary participation feature pending phase II of the Board's project on insurance contracts. Accordingly, disclosure of fair value is not required for contracts containing a discretionary participation feature, if the fair value of that feature cannot be measured reliably. For all other financial assets and financial liabilities, it is reasonable to expect that fair value can be determined with sufficient reliability within constraints of timeliness and cost. Therefore, the Board concluded that there should be no other exception from the requirement to disclose fair value information for financial assets or financial liabilities.
- BC38 To provide users of financial statements with a sense of the potential variability of fair value estimates, the Board decided that information about the use of valuation techniques should be disclosed, in particular the sensitivities of fair value estimates to the main valuation assumptions.⁶ In forming this conclusion, the Board considered the view that disclosure of sensitivities could be difficult, particularly when there are many assumptions to which the disclosure would apply and these assumptions are interdependent. However, the Board noted that a detailed quantitative disclosure of sensitivity to all assumptions is not required (only those that could result in a significantly different estimate of fair value are required) and that the disclosure does not require the entity to reflect interdependencies between assumptions when making the disclosure. Additionally, the Board considered whether this disclosure might imply that a fair value established by a valuation technique is less reliable than one established by other means. However, the Board noted that fair values estimated by valuation techniques are more subjective than those established from an observable market price, and concluded that users need information to help them assess the extent of this subjectivity.

³ IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains requirements for measuring fair value and for disclosing information about fair value measurements. As a consequence, paragraphs 27–27B of IFRS 7 have been deleted.

⁴ IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IAS 39 and IFRS 9 refer to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

⁵ IFRS 9, issued in November 2009, amended the measurement requirements for investments in equity instruments.

⁶ IFRS 13, issued in May 2011, resulted in paragraph 27B(e) of IFRS 7 being deleted.

- BC39 Paragraph 28 requires disclosure about the difference that arises if the transaction price differs from the fair value of a financial instrument that is determined in accordance with paragraph AG76 of IAS 39. Those disclosures relate to matters addressed in the December 2004 amendment to IAS 39 *Transition and Initial Recognition of Financial Assets and Financial Liabilities*. That amendment does not specify how entities should account for those initial differences in subsequent periods. The disclosures required by paragraph 28 inform users about the amount of gain or loss that will be recognised in profit or loss in future periods. The Board noted that the information required to provide these disclosures would be readily available to the entities affected.
- BC39A Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157) issued by the US Financial Accounting Standards Board requires disclosures that are based on a three-level fair value hierarchy for the inputs used in valuation techniques to measure fair value. The Board was asked by some users of financial statements to include similar disclosure requirements in IFRS 7 to provide more information about the relative reliability of the inputs to fair value measurements. The Board concluded that such a hierarchy would improve comparability between entities about the effects of fair value measurements as well as increase the convergence of IFRSs and US generally accepted accounting principles (GAAP). Therefore, the Board decided to require disclosures for financial instruments on the basis of a fair value hierarchy.⁷
- BC39B Because its own fair value measurement project was not yet completed, the Board decided not to propose a fair value hierarchy for measurement, but only for disclosures. The fair value hierarchy for disclosures is the same as that in SFAS 157 but uses IFRS language pending completion of the fair value measurement project. Although the implicit fair value hierarchy for measurement in IAS 39 is different from the fair value hierarchy in SFAS 157, the Board recognised the importance of using a three-level hierarchy for disclosures that is the same as that in SFAS 157.⁸
- BC39C The Board noted the following three-level measurement hierarchy implicit in IAS 39⁹:
- (a) financial instruments quoted in an active market;
 - (b) financial instruments whose fair value is evidenced by comparison with other observable current market transactions in the same instrument (ie without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets; and
 - (c) financial instruments whose fair value is determined in whole or in part using a valuation technique based on assumptions that are not supported by prices from observable current market transactions in the same instrument (ie without modification or repackaging) and not based on available observable market data.
- BC39D For example, the Board acknowledged that some financial instruments that for measurement purposes are considered to have an active market in accordance with paragraphs AG71–AG73 of IAS 39 might be in Level 2 for disclosure purposes. Also, the application of paragraph AG76A of IAS 39 might result in no gain or loss being recognised on the initial recognition of a financial instrument that is in Level 2 for disclosure purposes.¹⁰
- BC39E The introduction of the fair value disclosure hierarchy does not affect any measurement or recognition requirements of other standards. In particular, the Board noted that the recognition of gains or losses at inception of a financial instrument (as required by paragraph AG76 of IAS 39) would not change as a result of the fair value disclosure hierarchy.
- BC39F The Board decided to require additional disclosures for instruments with fair value measurements that are in Level 3 of the fair value hierarchy.¹¹ These disclosures inform users of financial statements about the effects of those fair value measurements that use the most subjective inputs.
- BC39G After reviewing comments received on the exposure draft, the Board decided not to require disclosure by level of the fair value hierarchy for financial instruments that are not measured at fair value in the statement

⁷ IFRS 13, issued in May 2011, contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value and for the related disclosures.

⁸ IFRS 13, issued in May 2011, contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value and for the related disclosures. That hierarchy is identical to the hierarchy in Topic 820 *Fair Value Measurement* in the *FASB Accounting Standards Codification*[®], which codified SFAS 157.

⁹ IFRS 13, issued in May 2011, contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value and for the related disclosures.

¹⁰ IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a result paragraphs AG71–AG73 and paragraph AG76A of IAS 39 have been deleted. In addition, the requirements in paragraph AG76A have been relocated to paragraph AG76(b).

¹¹ IFRS 13, issued in May 2011, requires disclosures about fair value measurements. As a consequence paragraphs 27–27B of IFRS 7 have been deleted.

of financial position. The Board noted that paragraphs 25 and 27 of IFRS 7, which require the disclosure of the fair value of each class of assets and liabilities in a way that permits it to be compared with its carrying amount, and the methods and assumptions applied in determining fair values, were retained.¹²

Disclosures about the nature and extent of risks arising from financial instruments (paragraphs 31–42 and B6–B28)

- BC40 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 to balance two objectives:
- (a) consistent requirements should apply to all entities so that users receive comparable information about the risks to which entities are exposed.
 - (b) the disclosures provided should depend on the extent of an 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 more disclosure to communicate those risks to users of financial statements. Conversely, entities with few financial instruments and related risks may provide less extensive disclosure.
- BC41 The Board decided to balance these two objectives by developing an IFRS that sets out principles and minimum requirements applicable to all entities, supported by guidance on implementing the IFRS. The requirements in paragraphs 33–42 combine qualitative disclosures of the entity's exposure to risks arising from financial instruments, and the way in which management views and manages these risks, with quantitative disclosures about material risks arising from financial instruments. The extent of disclosure depends on the extent of the entity's exposure to risks arising from financial instruments. The guidance on implementing the IFRS illustrates how an entity might apply the IFRS. This guidance is consistent with the disclosure requirements 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.
- BC42 The Board noted that because entities view and manage risk in different ways, disclosures based on how an entity manages risk are unlikely to be comparable between entities. In addition, for an entity that undertakes limited management of risks arising from financial instruments, such disclosures would convey little or no information about the risks the entity has assumed. To overcome these limitations, the Board decided to specify disclosures about risk exposures applicable to all entities. These disclosures provide a common benchmark for financial statement users when comparing risk exposures across different entities and are expected to be relatively easy for entities to prepare. Entities with more developed risk management systems would provide more detailed information.

Interaction between qualitative and quantitative disclosures (paragraph 32A)

- BC42A In *Improvements to IFRSs* issued in May 2010, the Board addressed a perceived lack of clarity in the intended interaction between the qualitative and quantitative disclosures of the nature and extent of risks arising from financial instruments. The Board emphasised the interaction between qualitative and quantitative disclosures about the nature and extent of risks arising from financial instruments. This enables users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments. The Board concluded that an explicit emphasis on the interaction between qualitative and quantitative disclosures will contribute to disclosure of information in a way that better enables users to evaluate an entity's exposure.

Location of disclosures of risks arising from financial instruments (paragraph B6)

- BC43 Many respondents to ED 7 argued that disclosures about risks in paragraphs 31–42 should not be part of the financial statements for the following reasons:
- (a) the information would be difficult and costly to audit.

¹² IFRS 13, issued in May 2011, resulted in paragraph 27 of IFRS 7 being deleted.

- (b) the information is different from information generally included in financial statements because it is subjective, forward-looking and based on management's judgement. Thus, the information does not meet the criteria of comparability, faithful representation and completeness.
 - (c) inclusion of such information in a management commentary section outside the financial statements would be consistent with practice in other jurisdictions, including the US. Having this information in the financial statements would put IFRS preparers at a disadvantage relative to their US peers.
- BC44 Respondents raised concerns that the disclosure of sensitivity analysis in particular should not be part of the financial statements. Respondents stated that sensitivity analysis cannot be prepared with the degree of reliability expected of information in the financial statements, and that the subjectivity in the sensitivity analysis and the hypothetical alternative values could undermine the credibility of the fair values recognised in the financial statements.
- BC45 The Board considered whether the disclosures should be part of the information provided by management outside the financial statements. The Board noted that respondents generally regarded the disclosures proposed in ED 7 as useful, even if they did not agree that they should be located in the financial statements. The Board's view is that 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. The Board rejected the argument that increased transparency puts an entity at a disadvantage; greater certainty on the part of investors can provide a significant advantage by lowering the entity's cost of capital.
- BC46 The Board also noted that some entities might prefer to present the information required by the IFRS together with material such as a management commentary or risk report that is not part of the financial statements. Some entities might be required by regulatory authorities to provide in a separate report information similar to that required by the IFRS. Accordingly, the Board decided these disclosures should be given in the financial statements or incorporated by cross-reference from the financial statements to some other statement that is available to users of the financial statements on the same terms as the financial statements and at the same time.

Quantitative disclosures (paragraphs 34–42 and B7–B28)

Information based on how the entity manages risk (paragraphs 34 and B7)

- BC47 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 key management personnel (for example, its board of directors or chief executive officer). 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*.¹³
- BC47A In *Improvements to IFRSs* issued in May 2010, the Board removed the reference to materiality from paragraph 34(b) of IFRS 7. The Board noted that the reference could imply that disclosures in IFRS 7 are required even if those disclosures are not material, which was not the Board's intention.

Information on averages

- BC48 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 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

¹³ In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments*.

reporting date in all cases and to require additional information only if the information provided at the reporting date is unrepresentative of the entity's exposure to risk during the period.

Credit risk (paragraphs 36–38, B9 and B10)

Maximum exposure to credit risk (paragraphs 36(a), B9 and B10)

- BC49 Paragraph 36(a) requires disclosure of an entity's maximum exposure to credit risk at the reporting date. Some respondents to ED 7 stated that these disclosures would not provide useful information when there are no identified problems in a loan portfolio, and it is not likely that collateral would be called on. However, the Board disagreed because it believes that 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.
- BC49A In *Improvements to IFRSs* issued in May 2010, the Board enhanced consistency within IFRS 7 by clarifying that the disclosure requirement in paragraph 36(a) applies only to financial assets whose carrying amounts do not show the reporting entity's maximum exposure to credit risk. Such an approach is consistent with the approach taken in paragraph 29(a), which states that disclosure of fair value is not required when the carrying amount is a reasonable approximation of fair value. Moreover, the Board concluded that the requirement might be duplicative for assets that are presented in the statement of financial position because the carrying amount of these assets often represents the maximum exposure to credit risk. In the Board's view, the disclosure requirement should focus on the entity's exposure to credit risk that is not already reflected in the statement of financial position.
- BC50 Some respondents to ED 7 questioned whether the maximum exposure to credit risk for a derivative contract is its carrying amount because fair value does not always reflect potential future exposure to credit risk (see paragraph B10(b)). However, the Board noted that paragraph 36(a) requires disclosure of the amount that best represents the maximum exposure to credit risk *at the reporting date*, which is the carrying amount.

Collateral held as security and other credit enhancements (paragraphs 36(b) and 37(c))

- BC51 ED 7 proposed that, unless impracticable, the entity should disclose the fair value of collateral held as security and other credit enhancements, to provide information about the loss the entity might incur in the event of default. However, many respondents to ED 7 disagreed with this proposal on cost/benefit grounds. Respondents indicated that fair value information might not be available for:
- (a) small entities and entities other than banks, which may find it onerous to acquire information about collateral;
 - (b) banks that collect precise information on the value of collateral only on origination, for loans whose payments are made on time and in full (for example a mortgage portfolio secured by properties, for which valuations are not kept up to date on an asset-by-asset basis);
 - (c) particular types of collateral, such as a floating charge on all the assets of an entity; and
 - (d) insurers that hold collateral for which fair value information is not readily available.
- BC52 The Board also noted respondents' concerns that an aggregate disclosure of the fair value of collateral held would be misleading when some loans in a portfolio are over-collateralised, and other loans have insufficient collateral. In these circumstances, netting the fair value of the two types of collateral would under-report the amount of credit risk. The Board agreed with respondents that the information useful to users is not the total amount of credit exposure less the total amount of collateral, but rather is the amount of credit exposure that is left after available collateral is taken into account.
- BC53 Therefore, the Board decided not to require disclosure of the fair value of collateral held, but to require disclosure of only a description of collateral held as security and other credit enhancements. The Board noted that such disclosure does not require an entity to establish fair values for all its collateral (in particular when the entity has determined that the fair value of some collateral exceeds the carrying amount of the loan) and, thus, would be less onerous for entities to provide than fair values.

Credit quality of financial assets that are neither past due nor impaired (paragraph 36(c))

- BC54 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. Because this information will vary between entities, 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.

Financial assets with renegotiated terms (paragraph 36(d))

- BC54A In *Improvements to IFRSs* issued in May 2010, the Board addressed a practical concern relating to the disclosure requirements for renegotiated financial assets. The Board deleted the requirement in paragraph 36(d) to disclose the carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated. The Board considered the difficulty in identifying financial assets whose terms have been renegotiated to avoid becoming past due or impaired (rather than for other commercial reasons). The Board noted that the original requirement was unclear about whether the requirement applies only to financial assets that were renegotiated in the current reporting period or whether past negotiations of those assets should be considered. Moreover, the Board was informed that commercial terms of loans are often renegotiated regularly for reasons that are not related to impairment. In practice it is difficult, especially for a large portfolio of loans, to ascertain which loans were renegotiated to avoid becoming past due or impaired.

Financial assets that are either past due or impaired (paragraph 37)

- BC55 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 37). This includes:
- (a) an analysis of the age of financial assets, including trade receivables, that are past due at the reporting date, but not impaired (paragraph 37(a)). This information provides users with information about those financial assets that are more likely to become impaired and helps users to estimate the level of future impairment losses.
 - (b) an analysis of financial assets that are individually determined to be impaired at the reporting date, including the factors the entity considered in determining that the financial assets are impaired (paragraph 37(b)). The Board concluded that an analysis of impaired financial assets by factors other than age (eg nature of the counterparty, or geographical analysis of impaired assets) would be useful because it helps users to understand why the impairment occurred.
- BC55A In *Improvements to IFRSs* issued in May 2010, the Board addressed a concern that the disclosure of the fair value of collateral was potentially misleading. Within a class of assets some might be over-collateralised while others might be under-collateralised. Hence, aggregate disclosure of the fair value might be misleading. Therefore, the Board removed from paragraph 37(c) the requirement to disclose the fair value of collateral and other credit enhancements. However, the Board believes that information on the financial effect of such assets is useful to users. Hence, the Board included in paragraph 36(b) a requirement to disclose a description of collateral held as security and of other credit enhancements and to disclose their financial effect.

Collateral and other credit enhancements obtained (paragraph 38)

- BC56 Paragraph 38 requires the entity to disclose the nature and carrying amount of assets obtained by taking possession of collateral held as security or calling on 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 realise the value of the collateral. ED 7 had proposed that the entity should disclose the fair value of the assets obtained less the cost of selling them, rather than the carrying amount. The Board noted that this amount might be more relevant in the case of collateral obtained that is expected to be sold. However, it also noted that such an amount would be included in the impairment calculation that is reflected in the amount recognised in the balance sheet and the purpose of the disclosure is to indicate the amount recognised in the balance sheet for such assets.
- BC56A In *Improvements to IFRSs* issued in May 2010, the Board enhanced consistency within IFRS 7 by clarifying that paragraph 38 requires entities to disclose the amount of foreclosed collateral held at the reporting date. This is consistent with the objective in IFRS 7 to disclose information that enables users to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.

Liquidity risk (paragraphs 34(a), 39, B10A and B11–B11F)

- BC57 The Board decided to require disclosure of a maturity analysis for financial liabilities showing the remaining earliest contractual maturities (paragraph 39(a) and paragraphs B11–B16 of Appendix B)¹⁴. 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 earlier than expected. The Board decided to require disclosure based on the earliest contractual maturity date because this disclosure shows a worst case scenario.
- BC58 Some respondents expressed concerns that such a contractual maturity analysis does not reveal the expected maturity of liabilities, which, for some entities—eg banks with many demand deposits—may be very different. They suggested that a contractual maturity analysis alone does not provide information about the conditions expected in normal circumstances or how the entity manages deviations from expected maturity. Therefore, the Board decided to require a description of how the entity manages the liquidity risk portrayed by the contractual maturity analysis.
- BC58A In March 2009 the Board amended the disclosure requirements on the nature and extent of liquidity risk by:
- (a) amending the definition of liquidity risk to clarify that paragraph 39 applies only to financial liabilities that will result in the outflow of cash or another financial asset. This clarifies that the disclosure requirements would not apply to financial liabilities that will be settled in the entity's own equity instruments and to liabilities within the scope of IFRS 7 that are settled with non-financial assets.
 - (b) emphasising that an entity must provide summary quantitative data about its exposure to liquidity risk based on information provided internally to key management personnel of the entity as required by paragraph 34(a). This reinforces the principles of IFRS 7.
 - (c) amending the requirement in paragraph 39 to disclose a contractual maturity analysis.
- BC58B The requirements in paragraph 39(a) and (b) relate to minimum benchmark disclosures as set out in paragraph 34(b) and are expected to be relatively easy to apply. However, the Board noted 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. Hence, for some circumstances the Board eliminated the previous requirement to disclose contractual maturity information for derivative financial liabilities. However, the Board retained minimum contractual maturity disclosures for non-derivative financial liabilities (including issued financial guarantee contracts within the scope of the IFRS) and for some derivative financial liabilities.
- BC58C The Board noted that for non-derivative financial liabilities (including issued financial guarantee contracts within the scope of the IFRS) and some derivative financial liabilities, contractual maturities are essential for an understanding of the timing of cash flows associated with the liabilities. Therefore, this information is useful to users of financial statements. The Board concluded that disclosures based on the remaining contractual maturities of these financial liabilities should continue to be required.
- BC58D The Board also emphasised the existing requirement to disclose a maturity analysis for financial assets held for managing liquidity risk, if that information is required to enable users of its financial statements to evaluate the nature and extent of liquidity risk. The Board also emphasised that an entity must explain the relationship between qualitative and quantitative disclosures about liquidity risk so that users of financial statements can evaluate the nature and extent of liquidity risk.

Market risk (paragraphs 40–42 and B17–B28)

- BC59 The Board decided to require disclosure of a sensitivity analysis for each type of market risk (paragraph 40) because:
- (a) users have consistently emphasised the fundamental importance 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) it is 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 previously required by IAS 32.

¹⁴ Amendments to IFRS 7 issued in March 2009 amended paragraph 39 and paragraphs B11–B16. The paragraph references in paragraph BC57 have not been amended as a result of these amendments.

The Board noted that information provided by a simple sensitivity analysis would not be comparable across entities. This is because the methodologies used to prepare the sensitivity analysis and the resulting disclosures would vary according to the nature of the entity and the complexity of its risk management systems.

- BC60 The Board acknowledged that a simple sensitivity analysis that shows a change in only one variable has limitations. For example, the analysis may not reveal non-linearities in sensitivities or 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 (paragraph 42). The Board noted that it could meet the second concern by requiring a more complex sensitivity analysis that takes into account the interdependencies between risks. Although more informative, such an analysis is also more complex and costly to prepare. Accordingly, the Board decided not to require such an analysis, but to permit its disclosure as an alternative to the minimum requirement when it is used by management to manage risk.
- BC61 Respondents to ED 7 noted that a value-at-risk amount would not show the effect on profit or loss or equity. However, entities that manage on the basis of value at risk would not want to prepare a separate sensitivity analysis solely for the purpose of this disclosure. The Board's objective was to require disclosures about sensitivity, not to mandate a particular form of sensitivity disclosure. Therefore, the Board decided not to require disclosure of the effects on profit or loss and equity if an alternative disclosure of sensitivity is made.
- BC62 Respondents to ED 7 requested the Board to provide more guidance and clarification about the sensitivity analysis, in particular:
- (a) what is a reasonably possible change in the relevant risk variable?
 - (b) what is the appropriate level of aggregation in the disclosures?
 - (c) what methodology should be used in preparing the sensitivity analysis?
- BC63 The Board concluded that it would not be possible to provide comprehensive guidance on the methodology to be used in preparing the sensitivity analysis. The Board noted that more comparable information would be obtained if it 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 higher inflation). Moreover, the effect of a reasonably possible change will vary depending on the entity's risk exposures. As a result, entities are required to judge what those reasonably possible changes are.
- BC64 However, the Board decided that it would provide high level application guidance about how the entity should assess what is a reasonably possible change and on the appropriate level of aggregation in the disclosures. In response to comments received on ED 7, the Board also decided to clarify that:
- (a) an entity should not aggregate information about material exposures to risk from significantly different economic environments. However, if it has exposure to only one type of market risk in only one economic environment, it might not show disaggregated information.
 - (b) the sensitivity analysis does not require entities to determine what the profit or loss for the period would have been had the relevant risk variable been different. The sensitivity analysis shows the effect on current period profit or loss and equity if a reasonably possible change in the relevant risk variable had been applied to the risk exposures in existence at the balance sheet date.
 - (c) a reasonably possible change is judged relative to the economic environments in which the entity operates, and does not include remote or 'worst case' scenarios or 'stress tests'.
 - (d) entities are required to disclose only the effects of the changes at the limits of the reasonably possible range of the relevant risk variable, rather than all reasonably possible changes.
 - (e) the time frame for which entities should make an assessment about what is reasonably possible is the period until the entity next presents these disclosures, usually its next annual reporting period.

The Board also decided to add a simple example of what a sensitivity analysis might look like.

Operational risk

- BC65 The Board discussed whether it should require disclosure of information about operational risk. However, the Board noted that the definition and measurement of operational risk are in their infancy and are not necessarily related to financial instruments. It also decided that such disclosures would be more appropriately located outside the financial statements. Therefore, the Board decided to defer this issue to its research project on management commentary.

Disclosures relating to transfers of financial assets

Background

- BC65A In March 2009, in conjunction with the Memorandum of Understanding between the IASB and the US Financial Accounting Standards Board (FASB) to improve and achieve convergence of IFRS and US standards for derecognition, the IASB published an exposure draft to replace the derecognition requirements of IAS 39 and to improve the disclosure requirements in IFRS 7 relating to the transfer of financial assets and liabilities. In response to feedback received on the exposure draft the IASB developed more fully the alternative model described in the exposure draft and the boards discussed the alternative model.
- BC65B In May 2010 the boards reconsidered their strategies and plans for the derecognition project in the light of:
- their joint discussions of the alternative derecognition model described in the exposure draft;
 - the June 2009 amendments to the US GAAP derecognition guidance by the FASB, which reduced the differences between IFRSs and US GAAP by improving requirements relating to derecognition of financial assets and liabilities; and
 - the feedback the IASB received from national standard-setters on the largely favourable effects of the IFRS derecognition requirements during the financial crisis.
- BC65C As a result, in June 2010 the IASB and the FASB agreed that their near-term priority was on increasing the transparency and comparability of their standards by improving and aligning the disclosure requirements in IFRSs and US GAAP for financial assets transferred to another entity. The boards also decided to conduct additional research and analysis, including a post-implementation review of some of the FASB's recently amended requirements, as a basis for assessing the nature and direction of any further efforts to improve or align IFRSs and US GAAP.
- BC65D As a result, the Board decided to finalise the derecognition disclosures and related objectives, proposed in the exposure draft. Accordingly, in October 2010 the Board issued *Disclosures—Transfers of Financial Assets* (Amendments to IFRS 7), requiring disclosures to help users of financial statements:
- to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and
 - to evaluate the nature of and risks associated with the entity's continuing involvement in derecognised financial assets.

Transferred financial assets that are not derecognised in their entirety

- BC65E When financial assets are transferred but not derecognised, there has been an exchange transaction that is not reflected as such in the financial statements as a result of the accounting requirements. The Board concluded that in those situations, users of financial statements need to understand the relationship between those transferred financial assets and the associated liabilities that an entity recognises. Understanding that relationship helps users of financial statements in assessing an entity's cash flow needs and the cash flows available to the entity from its assets.
- BC65F The Board observed that IFRS 7 required disclosures about transferred financial assets that are not derecognised in their entirety. The Board decided to continue requiring those disclosures because they provide information that is useful in understanding the relationship between transferred financial assets that are not derecognised and associated liabilities.
- BC65G However, the Board also decided that the following additional disclosures were necessary:
- a qualitative description of the nature of the relationship between transferred assets and associated liabilities, including restrictions arising from the transfer on the reporting entity's use of the transferred assets; and
 - a schedule that sets out the fair value of the transferred financial assets, the associated liabilities and the net position when the counterparty to the associated liabilities has recourse only to the transferred assets.
- BC65H The Board concluded that these disclosures would provide information that is useful in assessing the extent to which the economic benefits generated by assets of an entity cannot be used in an unrestricted manner, as is implied when assets are recognised in an entity's statement of financial position. In addition, the disclosures would provide information about liabilities that will be settled entirely from the proceeds

received from the transferred assets, and thus identify liabilities for which the counterparties do not have claims on the assets of the entity in general. For those assets for which the underlying cash flows are committed to be used to satisfy related liabilities, the Board noted that a schedule that sets out the fair value of the transferred financial assets, the associated liabilities and the net position (in addition to showing the cash flow relationship between those assets and liabilities) also provides a means of understanding the net exposure of an entity following a transfer transaction that fails derecognition.

Transferred financial assets that are derecognised

- BC65I The Board was asked by users of financial statements, regulators and others to review the disclosure requirements for what are often described as ‘off balance sheet’ activities. Transfers of financial assets, particularly securitisation of financial assets, were identified as forming part of such activities.
- BC65J The Board was asked by users of financial statements, regulators and others to review the disclosure requirements for what are often described as ‘off balance sheet’ activities. Transfers of financial assets, particularly securitisation of financial assets, were identified as forming part of such activities.
- BC65K The Board observed that IFRS 7 already requires certain disclosures by class of financial instrument or by type of risk. However, the IFRS requires the information at an aggregated level, so information specific to derecognition transactions is often not available. In response to requests from users and others the Board concluded that disclosures specific to derecognition transactions were necessary.
- BC65L The Board concluded that the disclosures should focus on the risk exposure of an entity, and should provide information about the timing of the return and the cash outflow that would or may be required to repurchase the derecognised financial assets in the future. The Board reasoned that a combination of disclosures about the strike price or repurchase price to repurchase assets, the fair value of its continuing involvement, the maximum exposure to loss and qualitative information about an entity’s obligations to provide financial support are relevant in understanding an entity’s exposure to risks.
- BC65M In addition, the Board concluded that information about an entity’s gain or loss on derecognition and the timing of recognition of that gain or loss provides information about the proportion of an entity’s profit or loss that arises from transferring financial assets in which the entity also retains continuing involvement. Such information is useful in assessing the extent to which an entity generates profits from transferring financial assets while retaining some form of continuing involvement and thus exposure to risk.
- BC65N The Board observed that the total amount of proceeds from transfer activity (that qualifies for derecognition) in a reporting period may not be evenly distributed throughout the reporting period (eg if a substantial proportion of the total amount of transfer activity takes place in the closing days of a reporting period). The Board decided that if transfer activity is concentrated around the end of reporting periods, disclosure of this fact provides an indication of whether transfer transactions are undertaken for the purpose of altering the appearance of the statement of financial position rather than for an ongoing commercial or financing purpose. In such cases, the amendments require disclosure of when the greatest transfer activity took place within that reporting period, the amount recognised from the transfer activity in that part of the reporting period, and the total amount of proceeds from transfer activity in that part of the reporting period.

Application of the disclosure requirements to a servicing contract

- BC65O Paragraphs 42A–42H of IFRS 7 require an entity to provide disclosures for all transferred financial assets that are not derecognised in their entirety and for any continuing involvement in a transferred asset that is derecognised in its entirety, existing at the reporting date, irrespective of when the related transfer transaction occurred.
- BC65P The Board received a request to clarify whether servicing contracts constitute continuing involvement for the purposes of applying the disclosure requirements in paragraphs 42E–42H of IFRS 7. The question raised was whether paragraph 42C(c) of IFRS 7 excludes servicing contracts from the scope of those disclosure requirements.
- BC65Q The Board observed that paragraph 42C(c) of IFRS 7 discusses arrangements whereby an entity retains the contractual rights to receive the cash flows of a financial asset but assumes a contractual obligation to pay the cash flows to one or more entities and the conditions in paragraph 3.2.5(a)–(c) of IFRS 9 are met; ie it is a ‘pass-through arrangement’.¹⁵ Paragraph 42C(c) of IFRS 7 confirms that the cash flows collected to be passed through are not themselves continuing involvement for the purposes of the transfer disclosure requirements. Consequently, the Board observed that the servicer’s obligation to pass through to one or

¹⁵ If IFRS 9 has not been applied early, the equivalent reference is paragraph 19(a)–(c) of IAS 39.

more entities the cash flows that it collects from a transferred financial asset is not in itself continuing involvement for the purposes of the disclosure requirements, because the activity of passing through cash flows does not in itself constitute an interest in the future performance of the transferred financial asset. The Board observed, however, that a servicing contract is generally continuing involvement for the purposes of the transfer disclosure requirements because, in most cases, the servicer has an interest in the future performance of the transferred financial assets as a result of that contract. That would be the case if the amount and/or timing of the servicing fee depended on the amount and/or timing of the cash flows collected from the transferred financial asset. This would be true irrespective of how the servicer receives its servicing fee; ie whether the servicer retains a portion of the cash flows collected from the transferred financial asset as its fee or it passes through all of the cash flows collected and receives its fee separately from the transferee or another entity.

- BC65R On the basis of these observations, the Board noted that paragraphs 42C and B30 of IFRS 7 are considered to determine whether a servicing contract gives rise to continuing involvement for the purposes of the transfer disclosure requirements. The Board decided to add guidance to the Application Guidance of IFRS 7 to clarify how the guidance in paragraph 42C of IFRS 7 is applied to servicing contracts.
- BC65S During its discussions on this issue, the Board noted that for the purpose of applying the disclosure requirements in paragraphs 42E–42H of IFRS 7, continuing involvement as described in paragraph 42C of IFRS 7 has a different meaning from that used in paragraphs 3.2.6(c)(ii) and 3.2.16 of IFRS 9.16 The Board considered, but decided against, making a clarification in respect of this point because it thought that this difference was already clear from the description of continuing involvement in the two IFRSs.

Effective date and transition (paragraphs 43–44A)

- BC66 The Board is committed to maintaining a ‘stable platform’ of substantially unchanged Standards for annual periods beginning on or before 1 January 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. Therefore, the Board decided that the effective date of IFRS 7 should be annual periods beginning on or after 1 January 2007, with earlier application encouraged.
- BC67 The Board noted that entities that apply IFRS 7 only when it becomes mandatory will have sufficient time to prepare comparative information. This conclusion does not apply to entities that apply IFRS 7 early. In particular, the time would be extremely short for those entities that would like to apply IFRS 7 when they first adopt IFRSs in 2005, to avoid changing from local GAAP to IAS 32 and IAS 30 when they adopt IFRSs and then changing again to IFRS 7 only one or two years later. Therefore, the Board gave an exemption from providing comparative disclosure in the first year of application of IFRS 7 to any entity that both (a) is a first-time adopter of IFRSs and (b) applies IFRS 7 before 1 January 2006. The Board noted that such an exemption for first-time adopters exists in IAS 32 and IFRS 4 and that the reasons for providing the exemption apply equally to IFRS 7.
- BC68 The Board also considered whether it should provide an exemption from presenting all or some of the comparative information to encourage early adoption of IFRS 7 by entities that already apply IFRSs.
- BC69 The Board noted that IFRS 7 contains two types of disclosures: accounting disclosures (in paragraphs 7–30) that are based on requirements previously in IAS 32 and new risk disclosures (in paragraphs 31–42). The Board concluded that existing users of IFRSs already will have complied with the requirements of IAS 32 and will not encounter difficulty in providing comparative information for the accounting disclosures.
- BC70 The Board noted that most of the risk disclosures, in particular those about market risk, are based on information collected at the end of the reporting period. The Board concluded that although IFRS 7 was published in August 2005, it will still be possible for entities to collect the information that they require to comply with IFRS 7 for accounting periods beginning in 2005. However, it would not always be possible to collect the information needed to provide comparative information about accounting periods that began in 2004. As a result, the Board decided that entities that apply IFRS 7 for accounting periods beginning in 2005 (ie before 1 January 2006) need not present comparative information about the risk disclosures.
- BC71 The Board also noted that comparative disclosures about risk are less relevant because these disclosures are intended to have predictive value. As a result information about risk loses relevance more quickly than other types of disclosure, and any disclosures required by previous GAAP are unlikely to be comparable with those required by IFRS 7. Accordingly, the Board decided that an entity that is not a first-time adopter and applies IFRS 7 for annual periods beginning before 1 January 2006 need not present comparative disclosures about the nature and extent of risks arising from financial instruments. In reaching this conclusion, the Board noted that

¹⁶ If IFRS 9 has not been applied early, the equivalent references are paragraphs 20(c)(ii) and 30 of IAS 39.

the advantages of encouraging more entities to apply IFRS 7 early outweighed the disadvantage of the reduced information provided.

BC72 The Board considered and rejected arguments that it should extend the exemption:

- (a) from providing comparative information to first-time adopters that applied IFRS 7 before 1 January 2007 (rather than only those that applied IFRS 7 before 1 January 2006). The Board concluded that an entity that intends to adopt IFRSs for the first time on or after 1 January 2006 will have sufficient time to collect information for its accounting period beginning on or after 1 January 2005 and, thus, should not have difficulty in providing the comparative disclosures for accounting periods beginning on or after 1 January 2006.
- (b) from providing comparative disclosures about the significance of financial instruments to all entities adopting the IFRS for annual periods beginning before 1 January 2006 (rather than only to first-time adopters). The Board concluded that only first-time adopters warranted special relief so that they would be able to adopt IFRS 7 early without first having to adopt IAS 32 and IAS 30 for only one period. Entities that are not first-time adopters already apply IAS 32 and IAS 30 and have no particular need to adopt IFRS 7 before 1 January 2007.
- (c) from providing comparative disclosures about risk to periods beginning before 1 January 2007 (rather than 2006). The Board noted that entities adopting IFRS 7 after 1 January 2006 would have a full calendar year to prepare after the publication of the IFRS.

BC72A *Annual Improvements to IFRSs 2012–2014 Cycle*, issued in September 2014, amended paragraph B30 and added paragraph B30A of IFRS 7. The Board considered whether the amendment should apply to any period presented that begins before the annual period for which the entity first applies the amendment. The Board noted that paragraph 42E(b) of IFRS 7 requires disclosure of the fair value of the assets and liabilities that represent the entity's continuing involvement in the derecognised financial assets. Application of the amendment to such a period might therefore require an entity to determine the fair value as at the end of the period for a servicing asset or servicing liability, which the entity might not have previously determined. It might be impracticable for an entity to determine the fair value of such a servicing asset or servicing liability without using hindsight. The Board also noted that paragraph 44M of IFRS 7 provides transition relief by which the entity need not apply the transfer disclosure requirements to comparative periods. Consequently, to avoid the risk of hindsight being applied, the Board decided to require the application of the amendment only to annual periods beginning on or after the beginning of the annual period for which the amendment is applied for the first time. Furthermore, for the same reason, the Board observed that those transition provisions should be available to first-time adopters. The Board has characterised the transition provisions in paragraph 44AA of IFRS 7 as retrospective despite this relief, because entities are required to look back to past derecognition events to determine whether a servicing asset or servicing liability needs to be disclosed.

Applicability of the offsetting amendments to IFRS 7 to condensed interim financial statements (paragraph 44R)

BC72B The Board was asked to clarify the applicability of the amendments to IFRS 7 *Disclosure–Offsetting Financial Assets and Financial Liabilities* (the 'amendments to IFRS 7 concerning offsetting'), issued in December 2011, to condensed interim financial statements. It was asked to clarify the meaning of the reference to 'interim periods within those annual periods', used in paragraph 44R of IFRS 7. There was uncertainty about whether the disclosures required by paragraphs 13A–13F and B40–B53 of IFRS 7 were required to be included in condensed interim financial statements prepared in accordance with IFRS and, if so, whether those disclosures should be presented in every set of condensed interim financial statements, or only in those interim financial statements presented in the first year in which the disclosure requirements are effective or for which disclosure would be required under the principles in IAS 34 *Interim Financial Reporting*.

BC72C The Board noted that IAS 34 was not consequentially amended upon issue of the amendments to IFRS 7 concerning offsetting and that when the Board intends to require an entity to provide a disclosure in condensed interim financial statements in all circumstances it amends IAS 34. Consequently, the Board decided to amend paragraph 44R of IFRS 7 within the *Annual Improvements to IFRSs 2012–2014 Cycle* in order to clarify that the additional disclosure required by the amendments to IFRS 7 concerning offsetting is not specifically required for all interim periods. However, when considering this amendment, the Board noted that the additional disclosure is required to be given in condensed interim financial statements prepared in accordance with IAS 34 when its inclusion would be required in accordance with the general requirements of that IFRS. IAS 34 requires the disclosure of information in condensed interim financial statements when its omission would make the condensed interim financial statements misleading. The Board noted that in accordance with paragraph 15 of IAS 34 "an entity shall include in its interim financial report

an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period". The Board further noted that in accordance with paragraph 25 of IAS 34: "The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an entity's financial position and performance during the interim period".

Summary of main changes from the Exposure Draft

BC73 The main changes to the proposals in ED 7 are:

- (a) ED 7 proposed disclosure of the amount of change in the fair value of a financial liability designated as at fair value through profit or loss that is not attributable to changes in a benchmark interest rate as a proxy for the amount of change in fair value attributable to changes in the instrument's credit risk. The IFRS permits entities to determine the amount of change in fair value attributable to changes in the instrument's credit risk using an alternative method if the entity believes that its alternative method gives more faithful representation. The proxy disclosure has been amended to be the amount of change in fair value that is not attributable to changes in market conditions that give rise to market risk. As a result, entities may exclude factors other than a change in a benchmark interest rate when calculating the proxy.
- (b) a requirement has been added for disclosures about the difference between the transaction price at initial recognition (used as fair value in accordance with paragraph AG76 of IAS 39) and the results of a valuation technique that will be used for subsequent measurement.
- (c) no disclosure is required of the fair value of collateral pledged as security and other credit enhancements as was proposed in ED 7.
- (d) the sensitivity analysis requirements have been clarified.
- (e) the exemption from presenting comparatives has been widened.
- (f) the capital disclosures are a stand-alone amendment to IAS 1, rather than part of the IFRS. No disclosure is required of whether the entity has complied with capital targets set by management and of the consequences of any non-compliance with those targets.
- (g) the amendments to IFRS 4 related to IFRS 7 have been modified to reduce systems changes for insurers.

Appendix

Amendments to Basis for Conclusions on other IFRSs

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with IFRS 7. In the amended paragraphs, new text is underlined and deleted text is struck through.

The amendments contained in this appendix when IFRS 7 was issued in 2005 have been incorporated into the text of the Basis of Conclusions on IFRS 4 and on IASs 32, 39 and 41 as issued at 18 August 2005.

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Guidance on implementing IFRS 7 *Financial Instruments: Disclosures*

This guidance accompanies, but is not part of, IFRS 7.

Introduction

- IG1 This guidance suggests possible ways to apply some of the disclosure requirements in IFRS 7. The guidance does not create additional requirements.
- IG2 For convenience, each disclosure requirement in the IFRS is discussed separately. In practice, disclosures would normally be presented as an integrated package and individual disclosures might satisfy more than one requirement. For example, information about concentrations of risk might also convey information about exposure to credit or other risk.
- IG3–IG4 [Deleted]

Classes of financial instruments and level of disclosure (paragraphs 6 and B1–B3)

- IG5 Paragraph B3 states that ‘an entity decides in the light of its circumstances how much detail it provides to satisfy the requirements of this 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 this guidance.
- IG6 Paragraph 17(c) of IAS 1 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.’

Significance of financial instruments for financial position and performance (paragraphs 7–30, B4 and B5)

Financial liabilities at fair value through profit or loss (paragraphs 10(a)(i) and B4)

- IG7 The following example illustrates the calculation that an entity might perform in accordance with paragraph B4 of Appendix B of the IFRS.
- IG8 On 1 January 20X1, an entity issues a 10-year bond with a par value of CU150,000 and an annual fixed coupon rate of 8 per cent, which is consistent with market rates for bonds with similar characteristics.
- IG9 The entity uses LIBOR as its observable (benchmark) interest rate. At the date of inception of the bond, LIBOR is 5 per cent. At the end of the first year:
- (a) LIBOR has decreased to 4.75 per cent.
 - (b) the fair value for the bond is CU153,811, consistent with an interest rate of 7.6 per cent.¹⁷
- IG10 The entity assumes a flat yield curve, all changes in interest rates result from a parallel shift in the yield curve, and the changes in LIBOR are the only relevant changes in market conditions.

¹⁷ This reflects a shift in LIBOR from 5 per cent to 4.75 per cent and a movement of 0.15 per cent which, in the absence of other relevant changes in market conditions, is assumed to reflect changes in credit risk of the instrument.

IG11 The entity estimates the amount of change in the fair value of the bond that is not attributable to changes in market conditions that give rise to market risk as follows:

<p>[paragraph B4(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 observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.</p>	<p>At the start of the period of a 10-year bond with a coupon of 8 per cent, the bond's internal rate of return is 8 per cent. Because the observed (benchmark) interest rate (LIBOR) is 5 per cent, the instrument-specific component of the internal rate of return is 3 per cent.</p>
<p>[paragraph B4(b)] Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in accordance with paragraph B4(a).</p>	<p>The contractual cash flows of the instrument at the end of the period are:</p> <ul style="list-style-type: none"> • interest: CU12,000^a per year for each of years 2–10. • principal: CU150,000 in year 10. <p>The discount rate to be used to calculate the present value of the bond is thus 7.75 per cent, which is 4.75 per cent end of period LIBOR rate, plus the 3 per cent instrument-specific component. This gives a present value of CU152,367.^b</p>
<p>[paragraph B4(c)] The difference between the observed market price of the liability at the end of the period and the amount determined in accordance with paragraph B4(b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed.</p>	<p>The market price of the liability at the end of the period is CU153,811.^c Thus, the entity discloses CU1,444, which is CU153,811–CU152,367, as the increase in fair value of the bond that is not attributable to changes in market conditions that give rise to market risk.</p>

(a) $CU150,000 \times 8\% = CU12,000$

(b) $PV = [CU12,000 \times (1 - (1 + 0.0775)^{-9}) / 0.0775] + CU150,000 \times (1 + 0.0775)^{-9}$

(c) $market\ price = [CU12,000 \times (1 - (1 + 0.076)^{-9}) / 0.076] + CU150,000 \times (1 + 0.076)^{-9}$

Defaults and breaches (paragraphs 18 and 19)

IG12 Paragraphs 18 and 19 require disclosures when there are any defaults or breaches of loans payable. Any defaults or breaches may affect the classification of the liability as current or non-current in accordance with IAS 1.

Total interest expense (paragraph 20(b))¹⁸

IG13 Total interest expense disclosed in accordance with paragraph 20(b) is a component of the finance costs, which paragraph 82(b) of IAS 1 requires to be presented separately in the statement of comprehensive income. The line item for finance costs may also include amounts associated with non-financial liabilities.

Fair value (paragraph 28)

IG13A–IG13B [Deleted]

IG14 The fair value at initial recognition of financial instruments that are not traded in active markets is measured in accordance with IFRS 13 *Fair Value Measurement* and paragraph AG76 of IAS 39. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the

¹⁸ In *Improvements to IFRSs* issued in May 2008, the Board amended paragraph IG13 and removed 'total interest income' as a component of finance costs. This amendment removed an inconsistency with paragraph 32 of IAS 1 *Presentation of Financial Statements*, which precludes the offsetting of income and expenses (except when required or permitted by an IFRS).

amount determined at initial recognition using that valuation technique. In these circumstances, the difference will be recognised in profit or loss in subsequent periods in accordance with IAS 39 and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would take into account when pricing the asset or liability (see paragraph AG76(b) of IAS 39). Paragraph 28 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 28:

Background		
On 1 January 20X1 an entity purchases for CU15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets.		
The transaction price of CU15 million is the fair value at initial recognition.		
After initial recognition, the entity will apply a valuation technique to measure the financial assets' fair value. This valuation technique uses inputs other than data from observable markets.		
At initial recognition, the same valuation technique would have resulted in an amount of CU14 million, which differs from fair value by CU1 million.		
The entity has existing differences of CU5 million at 1 January 20X1.		
Application of requirements		
The entity's 20X2 disclosure would include the following:		
<i>Accounting policies</i>		
The entity uses the following valuation technique to measure the fair value of financial instruments that are not traded in an active market: [description of technique, not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with IFRS 13 and IAS 39, is normally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].		
<i>In the notes to the financial statements</i>		
As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with IFRS 13 and IAS 39, the fair value of an instrument at inception is normally the transaction price. If the transaction price differs from the amount determined at reception using the valuation technique, that difference is [description of the entity's accounting policy]. The differences yet to be recognised in profit or loss are as follows:		
	31 Dec X2	31 Dec X1
	CU million	CU million
Balance at beginning of year	5.3	5.0
New transactions	–	1.0
Amounts recognised in profit or loss during the year	(0.7)	(0.8)
Other increases	–	0.2
Other decreases	(0.1)	(0.1)
Balance at end of year	<u>4.5</u>	<u>5.3</u>

Nature and extent of risks arising from financial instruments (paragraphs 31–42 and B6–B28)

Qualitative disclosures (paragraph 33)

IG15 The type of qualitative information an entity might disclose to meet the requirements in paragraph 33 includes, but is not limited to, a narrative description of:

- (a) the entity's exposures to risk and how they arose. Information about risk exposures might describe exposures both gross and net of risk transfer and other risk-mitigating transactions.

- (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, including its policies and procedures for taking collateral; 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.
- IG16 Information about the nature and extent of risks arising from financial instruments is more useful if it highlights any relationship between financial instruments that can affect the amount, timing or uncertainty of an entity's future cash flows. The extent to which a risk exposure is altered by such relationships might be apparent to users from the disclosures required by this Standard, but in some cases further disclosures might be useful.
- IG17 In accordance with paragraph 33(c), entities disclose 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 34–42 and B7–B28)

- IG18 Paragraph 34 requires disclosure of quantitative data about concentrations of risk. For example, concentrations of credit risk may arise from:
- (a) industry sectors. 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. Thus, if an entity's counterparties are concentrated in one or more geographical markets (such as Asia or Europe), it would disclose separately exposure to risks arising from each concentration of counterparties.
 - (d) a limited number of individual counterparties or groups of closely related counterparties.
- Similar principles apply to identifying concentrations of other risks, including liquidity risk and market risk. For example, concentrations of liquidity risk 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. Concentrations of foreign exchange risk may arise if an entity has a significant net open position in a single foreign currency, or aggregate net open positions in several currencies that tend to move together.
- IG19 In accordance with paragraph B8, disclosure of concentrations of risk includes a description of the shared characteristic that identifies each concentration. For example, the shared characteristic may refer to geographical distribution of counterparties by groups of countries, individual countries or regions within countries.
- IG20 When quantitative information at the end of the reporting period is unrepresentative of the entity's exposure to risk during the period, paragraph 35 requires further disclosure. 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, or disclose the highest, lowest and average exposures.

Credit risk (paragraphs 36–38, B9 and B10)

- IG21 Paragraph 36 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.

Collateral and other credit enhancements pledged (paragraph 36(b))

- IG22 Paragraph 36(b) requires an entity to describe collateral available as security for assets it holds and other credit enhancements obtained. 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.

Credit quality (paragraph 36(c))

- IG23 Paragraph 36(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;
 - (c) historical information about counterparty default rates; and
 - (d) any other information used to assess credit quality.
- IG24 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.
- IG25 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 either past due or impaired (paragraph 37)

- IG26 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 month. On the first day of the next month, 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.
- IG27 When the terms and conditions of financial assets that have been classified as past due are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether the financial asset remains past due.
- IG28 Paragraph 37(a) requires an analysis by class of the age of financial assets that are past due but not impaired. 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.

- IG29 Paragraph 37(b) requires an analysis of impaired financial assets by class. This analysis might include:
- the carrying amount, before deducting any impairment loss;
 - the amount of any related impairment loss; and
 - the nature and fair value of collateral available and other credit enhancements obtained.

IG30–IG31 [Deleted]

Market risk (paragraphs 40–42 and B17–B28)

- IG32 Paragraph 40(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. There are three types of market risk: interest rate risk, currency risk and other price risk. Other price risk may include risks such as equity price risk, commodity price risk, prepayment risk (ie the risk that one party to a financial asset will incur a financial loss because the other party repays earlier or later than expected), and residual value risk (eg a lessor of motor cars that writes residual value guarantees is exposed to residual value risk). Risk variables that are relevant to disclosing market risk include, but are not limited to:
- the yield curve of market interest rates. It may be necessary to consider both parallel and non-parallel shifts in the yield curve.
 - foreign exchange rates.
 - prices of equity instruments.
 - market prices of commodities.
- IG33 Paragraph 40(a) requires the sensitivity analysis to show the effect on profit or loss and equity of reasonably possible changes in the relevant risk variable. For example, relevant risk variables might include:
- prevailing market interest rates, for interest-sensitive financial instruments such as a variable-rate loan; or
 - currency rates and interest rates, for foreign currency financial instruments such as foreign currency bonds.
- IG34 For interest rate risk, the sensitivity analysis might show separately the effect of a change in market interest rates on:
- interest income and expense;
 - other line items of profit or loss (such as trading gains and losses); and
 - when applicable, equity.
- An entity might disclose a sensitivity analysis for interest rate risk for each currency in which the entity has material exposures to interest rate risk.
- IG35 Because the factors affecting market risk vary depending on the specific circumstances of each entity, the appropriate range to be considered in providing a sensitivity analysis of market risk varies for each entity and for each type of market risk.
- IG36 The following example illustrates the application of the disclosure requirement in paragraph 40(a):

Interest rate risk

At 31 December 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, post-tax profit for the year would have been CU1.7 million (20X1—CU2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings, and other comprehensive income would have been CU2.8 million (20X1—CU3.2 million) higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as available for sale. If interest rates had been 10 basis points higher, with all other variables held constant, post-tax profit would have been CU1.5 million (20X1—CU2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings, and other comprehensive income would have been CU3.0 million (20X1—CU3.4 million) lower, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as available for sale. Profit is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X).^a

continued...

^a Paragraph 39(a) requires disclosure of a maturity analysis of liabilities.

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Foreign currency exchange rate risk

At 31 December 20X2, if the CU had weakened 10 per cent against the US dollar with all other variables held constant, post-tax profit for the year would have been CU2.8 million (20X1—CU6.4 million) lower, and other comprehensive income would have been CU1.2 million (20X1—CU1.1 million) higher. Conversely, if the CU had strengthened 10 per cent against the US dollar with all other variables held constant, post-tax profit would have been CU2.8 million (20X1—CU6.4 million) higher, and other comprehensive income would have been CU1.2 million (20X1—CU1.1 million) lower. The lower foreign currency exchange rate sensitivity in profit in 20X2 compared with 20X1 is attributable to a reduction in foreign currency denominated debt. Equity is more sensitive in 20X2 than in 20X1 because of the increased use of hedges of foreign currency purchases, offset by the reduction in foreign currency debt.

Other market risk disclosures (paragraph 42)

IG37 Paragraph 42 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 when there is a low volume of transactions in similar assets and an entity finds 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 or premium to the quoted market price for a smaller holding.

IG38 In the situation in paragraph IG37(a), additional disclosure might include:

- (a) the terms and conditions of the financial instrument (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) a description of how 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 might trigger payments under the written option that, because of the leverage, might 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.

IG39 In the situation described in paragraph IG37(b), additional disclosure might include the reasons for the lack of liquidity and how the entity hedges the risk.

IG40 In the situation described in paragraph IG37(c), additional disclosure might include:

- (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 profit or loss; and
- (d) how the entity hedges the risk.

Derecognition (paragraphs 42D and 42E)

IG40A The following examples illustrate some possible ways to meet the quantitative disclosure requirements in paragraphs 42D and 42E.

IG40B The following examples illustrate how an entity that has adopted IFRS 9 *Financial Instruments* might meet the quantitative disclosure requirements in paragraphs 42D and 42E.

Transferred financial assets that are not derecognised in their entirety

Illustrating the application of paragraph 42D(d) and (e)

	Financial assets at fair value through profit or loss		Financial assets at amortised cost		Financial assets at fair value through other comprehensive income
	CU million		CU million		CU million
	Trading assets	Derivatives	Mortgages	Consumer loans	Equity investments
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to the transferred assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred financial assets that are derecognised in their entirety

Illustrating the application of paragraph 42E(a)–(d)

Type of continuing involvement	Cash outflows to repurchase transferred (derecognised) assets	Carrying amount of continuing involvement in statement of financial position			Fair value of continuing involvement		Maximum exposure to loss
	CU million	CU million			CU million		CU million
		Financial assets at fair value through profit or loss	Financial assets at fair value through other comprehensive income	Financial liabilities at fair value through profit or loss	Assets	Liabilities	
Written put options	(X)			(X)		(X)	X
Purchased call options	(X)	X			X		X
Securities lending	(X)			(X)	X	(X)	X
Total		X		(X)	X	(X)	X

Illustrating the application of paragraph 42E(e)

Undiscounted cash flows to repurchase transferred assets								
	Maturity of continuing involvement CU million							
Type of continuing involvement	Total	less than 1 month	1–3 months	3–6 months	6 months –1 year	1–3 years	3–5 years	more than 5 years
Written put options	X		X	X	X	X		
Purchased call options	X			X	X	X		X
Securities lending	X	X	X					

IG40C The following examples illustrate how an entity that has not adopted IFRS 9 might meet the quantitative disclosure requirements in paragraphs 42D and 42E.

Transferred financial assets that are not derecognised in their entirety**Illustrating the application of paragraph 42D(d) and (e)**

	Financial assets at fair value through profit or loss		Loans and receivables		Available-for-sale financial assets
	CU million		CU million		CU million
	Trading securities	Derivatives	Mortgages	Consumer loans	Equity investments
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to the transferred assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred financial assets that are derecognised in their entirety

Illustrating the application of paragraph 42E(a)–(d)

Type of continuing involvement	Cash outflows to repurchase transferred (derecognised) assets	Carrying amount of continuing involvement in statement of financial position			Fair value of continuing involvement		Maximum exposure to loss
	CU million	CU million			CU million		CU million
		Held for trading	Available-for-sale financial assets	Financial liabilities at fair value through profit or loss	Assets	Liabilities	
Written put options	(X)			(X)		(X)	X
Purchased call options	(X)	X			X		X
Securities lending	(X)		X	(X)	X	(X)	X
Total		X	X	(X)	X	(X)	X

Illustrating the application of paragraph 42E(e)

Undiscounted cash flows to repurchase transferred assets								
Type of continuing involvement	Total	Maturity of continuing involvement CU million						
		less than 1 month	1–3 months	3–6 months	6 months – 1 year	1–3 years	3–5 years	more than 5 years
Written put options	X		X	X	X	X		
Purchased call options	X			X	X	X		X
Securities lending	X	X	X					

Disclosures (paragraphs 13A–13F and B40–B53)

IG40D The following examples illustrate ways in which an entity might provide the quantitative disclosures required by paragraph 13C. However, these illustrations do not address all possible ways of applying the disclosure requirements as set out in paragraphs 13B–13E.

Background

An entity has entered into transactions subject to an enforceable master netting arrangement or similar agreement with the following counterparties. The entity has the following recognised financial assets and financial liabilities resulting from those transactions that meet the scope of the disclosure requirements in paragraph 13A.

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Counterparty A:

The entity has a derivative asset (fair value of CU100 million) and a derivative liability (fair value of CU80 million) with Counterparty A that meet the offsetting criteria in paragraph 42 of IAS 32. Consequently, the gross derivative liability is set off against the gross derivative asset, resulting in the presentation of a net derivative asset of CU20 million in the entity's statement of financial position. Cash collateral has also been received from Counterparty A for a portion of the net derivative asset (CU10 million). The cash collateral of CU10 million does not meet the offsetting criteria in paragraph 42 of IAS 32, but it can be set off against the net amount of the derivative asset and derivative liability in the case of default and insolvency or bankruptcy, in accordance with an associated collateral arrangement.

Counterparty B:

The entity has a derivative asset (fair value of CU100 million) and a derivative liability (fair value of CU80 million) with Counterparty B that do not meet the offsetting criteria in paragraph 42 of IAS 32, but which the entity has the right to set off in the case of default and insolvency or bankruptcy. Consequently, the gross amount of the derivative asset (CU100 million) and the gross amount of the derivative liability (CU80 million) are presented separately in the entity's statement of financial position. Cash collateral has also been received from Counterparty B for the net amount of the derivative asset and derivative liability (CU20 million). The cash collateral of CU20 million does not meet the offsetting criteria in paragraph 42 of IAS 32, but it can be set off against the net amount of the derivative asset and derivative liability in the case of default and insolvency or bankruptcy, in accordance with an associated collateral arrangement.

Counterparty C:

The entity has entered into a sale and repurchase agreement with Counterparty C that is accounted for as a collateralised borrowing. The carrying amount of the financial assets (bonds) used as collateral and posted by the entity for the transaction is CU79 million and their fair value is CU85 million. The carrying amount of the collateralised borrowing (repo payable) is CU80 million.

The entity has also entered into a reverse sale and repurchase agreement with Counterparty C that is accounted for as a collateralised lending. The fair value of the financial assets (bonds) received as collateral (and not recognised in the entity's statement of financial position) is CU105 million. The carrying amount of the collateralised lending (reverse repo receivable) is CU90 million.

The transactions are subject to a global master repurchase agreement with a right of set-off only in default and insolvency or bankruptcy and therefore do not meet the offsetting criteria in paragraph 42 of IAS 32. Consequently, the related repo payable and repo receivable are presented separately in the entity's statement of financial position.

Illustrating the application of paragraph 13C(a)–(e) by type of financial instrument

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)	(d)	(e)=(c)-(d)	
	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position	Related amounts not set off in the statement of financial position		Net amount
Description				(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral received	
Derivatives	200	(80)	120	(80)	(30)	10
Reverse repurchase, securities borrowing and similar agreements	90	-	90	(90)	-	-
Other financial instruments	-	-	-	-	-	-
Total	290	(80)	210	(170)	(30)	10

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)	(d)	(e)=(c)-(d)	
	Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the statement of financial position	Net amounts of financial liabilities presented in the statement of financial position	Related amounts not set off in the statement of financial position		Net amount
Description				(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral pledged	
Derivatives	160	(80)	80	(80)	-	-
Repurchase, securities lending and similar agreements	80	-	80	(80)	-	-
Other financial instruments	-	-	-	-	-	-
Total	240	(80)	160	(160)	-	-

Illustrating the application of paragraph 13C(a)–(c) by type of financial instrument and paragraph 13C(c)–(e) by counterparty

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)
Description	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position
Derivatives	200	(80)	120
Reverse repurchase, securities borrowing and similar agreements	90	-	90
Other financial instruments	-	-	-
Total	290	(80)	210

Net financial assets subject to enforceable master netting arrangements and similar agreements, by counterparty

CU million

As at 31 December 20XX	(c)	(d)		(e)=(c)-(d)
Description	Net amounts of financial assets presented in the statement of financial position	Related amounts not set off in the statement of financial position		Net amount
		(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral received	
Counterparty A	20	-	(10)	10
Counterparty B	100	(80)	(20)	-
Counterparty C	90	(90)	-	-
Other	-	-	-	-
Total	210	(170)	(30)	10

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)
Description	Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the statement of financial position	Net amounts of financial liabilities presented in the statement of financial position
Derivatives	160	(80)	80
Repurchase, securities lending and similar agreements	80	-	80
Other financial instruments	-	-	-
Total	240	(80)	160

Net financial liabilities subject to enforceable master netting arrangements and similar agreements, by counterparty

CU million

As at 31 December 20XX	(c)	(d)		(e)=(c)-(d)
Description	Net amounts of financial liabilities presented in the statement of financial position	Related amounts not set off in the statement of financial position		Net amount
Other	(d)(i), (d)(ii)	(d)(i)	(d)(ii)	Net amount
Total	Financial instruments	Cash collateral pledged	Cash collateral pledged	Net amount
Counterparty A	-	-	-	-
Counterparty B	80	(80)	-	-
Counterparty C	80	(80)	-	-
Other	-	-	-	-
Total	160	(160)	-	-

Transition (paragraph 44)

IG41 The following table summarises the effect of the exemption from presenting comparative accounting and risk disclosures for accounting periods beginning before 1 January 2006, before 1 January 2007, and on or after 1 January 2007. In this table:

- (a) a **first-time adopter** is an entity preparing its first IFRS financial statements (see IFRS 1 *First-time Adoption of International Financial Reporting Standards*).
- (b) an **existing IFRS user** is an entity preparing its second or subsequent IFRS financial statements.

	Accounting disclosures (paragraphs 7–30)	Risk disclosures (paragraphs 31–42)
Accounting periods beginning before 1 January 2006		
First-time adopter not applying IFRS 7 early	Applies IAS 32 but exempt from providing IAS 32 comparative information	Applies IAS 32 but exempt from providing IAS 32 comparative information
First-time adopter applying IFRS 7 early	Exempt from presenting IFRS 7 comparative information	Exempt from presenting IFRS 7 comparative information
Existing IFRS user not applying IFRS 7 early	Applies IAS 32. Provides full IAS 32 comparative information	Applies IAS 32. Provides full IAS 32 comparative information
Existing IFRS user applying IFRS 7 early	Provides full IFRS 7 comparative information	Exempt from presenting IFRS 7 comparative information^a
Accounting periods beginning on or after 1 January 2006 and before 1 January 2007		
First-time adopter not applying IFRS 7 early	Applies IAS 32. Provides full IAS 32 comparative information	Applies IAS 32. Provides full IAS 32 comparative information
First-time adopter applying IFRS 7 early	Provides full IFRS 7 comparative information	Provides full IFRS 7 comparative information
Existing IFRS user not applying IFRS 7 early	Applies IAS 32. Provides full IAS 32 comparative information	Applies IAS 32. Provides full IAS 32 comparative information
Existing IFRS user applying IFRS 7 early	Provides full IFRS 7 comparative information	Provides full IFRS 7 comparative information
Accounting periods beginning on or after 1 January 2007 (mandatory application of IFRS 7)		
First-time adopter	Provides full IFRS 7 comparative information	Provides full IFRS 7 comparative information
Existing IFRS user	Provides full IFRS 7 comparative information	Provides full IFRS 7 comparative information

(a) See paragraph 44 of IFRS 7

Appendix

Amendments to guidance on other IFRSs

This appendix contains amendments to guidance on IFRSs other than IFRS 4 that are necessary in order to ensure consistency with IFRS 7. Amendments to the Guidance on Implementing IFRS 4 will be published at a later date. In the amended paragraphs, new text is underlined and deleted text is struck through.

The amendments contained in this appendix when IFRS 7 was issued in 2005 have been incorporated into the text of the Guidance on Implementing IAS 39 as issued at 18 August 2005. The revised Guidance on Implementing IFRS 4 was published in December 2005.