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# Financial Instruments Disclosures.

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2 December 2009

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# Agenda

- Introduction
- Amendments to IFRS 7 Financial Instruments: Disclosures
- IAS 39 the sequel. Amendments to IAS 39 Financial Instruments: Recognition and Measurement
- IFRS 9

# Introduction

- Replacement of IAS 39 by the IASB
- Phase 1 - Classification & measurement proposals
- Phase 2 - Impairment & Provisioning
- Phase 3 - Hedge Accounting
- De-recognition project
- New standard

# IFRS 7 Financial Instruments: Disclosure

- On 5 March 2009 IASB issued amendment to IFRS 7
- Why?
- Enhanced fair value disclosures
- Enhanced liquidity risk disclosures
- Effective date & practical implications

# Fair value disclosures (1)

- Classification of fair value measurements by class of financial instrument using **fair value hierarchy** based on the **significance of inputs** used in making the measurements
- Three level **fair value hierarchy** for financial instruments:
  - **Level 1**: quoted prices (unadjusted) in active markets for identical instruments
  - **Level 2**: observable inputs (other than quoted prices included within Level 1), either directly (i.e. as prices) or indirectly (i.e. derived from prices)
  - **Level 3**: inputs that are not based on observable market data (unobservable inputs)
- Same as is required in US GAAP (FAS 157)

## Fair value hierarchy disclosure – example

Fair value measurement at end of  
the reporting period using:

Description	31 Dec 20X2	Level 1	Level 2	Level 3
		CU	CU	CU
		million	million	million
Financial assets at fair value through profit or loss				
Trading debt securities	100	40	55	5
Trading derivatives	39	17	20	2
Available-for-sale assets equity investments	75	30	40	5
<b>Total</b>	<b>214</b>	<b>87</b>	<b>115</b>	<b>12</b>

(NOTE: for liabilities a similar table might be presented)

## Fair value disclosures (2)

- **Reconciliation** from beginning to ending balances for financial instruments categorised under **Level 3** including specified reconciling items:
  - gains and losses in P/L
  - gains and losses in OCI
  - purchases, sales, issues and settlements (each separate)
  - transfers in/out of level 3
- Disclosure to be made in **tabular format** unless another format is appropriate
- If there has been a **change in valuation technique** change and the **reasons for change**
- Significant **transfers** between level 1 and level 2 and reason

# Assets at fair value based on Level 3 – example

	<b>Trading Securities CU million</b>	<b>Trading Derivatives CU million</b>	<b>Equity Investments CU million</b>	<b>CU million</b>
<b>Opening balance</b>	6	5	4	15
Total gains or losses in profit or loss	(2)	(2)	-	(4)
in OCI	-	-	(1)	(1)
Purchases	1	2	2	5
Issues	-	-	-	-
Settlements	-	(1)	-	(1)
Transfer out of Level 3	-	(2)	-	(2)
<b>Closing balance</b>	<b>7</b>	<b>7</b>	<b>6</b>	<b>20</b>
Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period	-1	-1	-	-2

Gains or losses included in profit or loss for the period (above) are presented in trading income and in other income as follows:

	<b>Trading Income</b>
Total gains or losses included in profit or loss for the period	-4
Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period	-2

(Note: For liabilities, a similar table might be presented.)

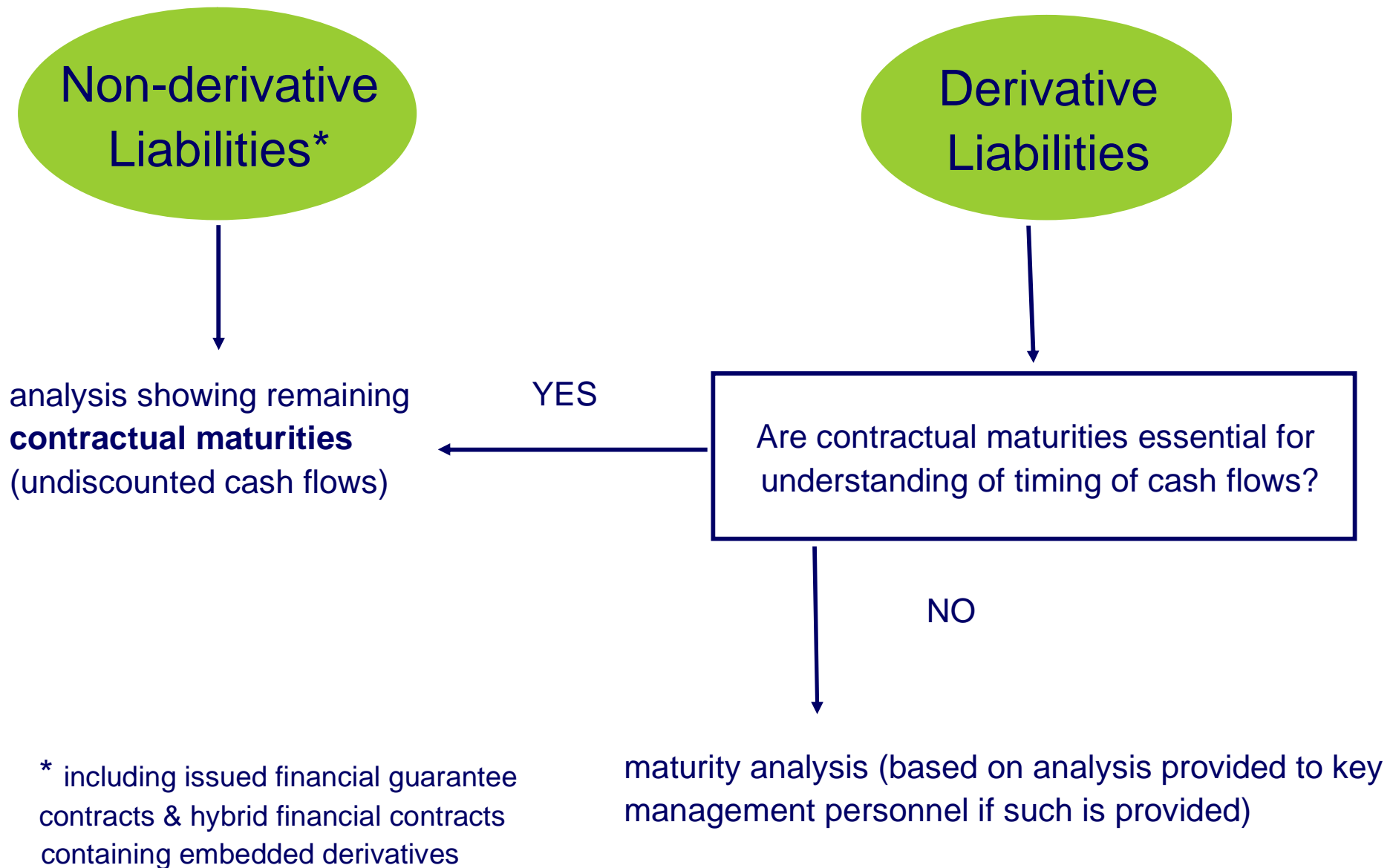
# Fair value disclosures: which level?

- Which level would be appropriate for the following instruments:
- An investment in corporate bond which is itself not quoted, however there have been recent market transactions for which prices are available
  - **Level 2**
- An investment in corporate bond which is itself not quoted, and there have been no recent transactions, however market prices are available for a similar bond of an issuer with same credit rating
  - **Level 2**
- An 5-year interest rate swap (fixed vs LIBOR) used in cash flow hedge
  - **Level 2?**
- A contract to buy a commodity that is within scope of IFRS 7 which matures in 5 years and forward prices for the underlying commodity are available for 4 years
  - **Level 3**

# IFRS 7 amendment (effective 1 Jan 09):

- “IFRS 7.39 An entity shall disclose:
  - (a) a maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.
  - (b) a maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows (see paragraph B11B).
  - (c) a description of how it manages the liquidity risk inherent in (a) and (b).”

# Liquidity risk disclosures



# Liquidity risk – which liabilities are in scope?

- Which of the items below are within scope of maturity analysis or liquidity risk in IFRS 7?
  - a) Financial liabilities, including those settled by delivering own equity instruments where amounts are fixed, but excluding those settled by delivery of a non-financial asset
  - b) Only those financial liabilities which are settled by delivering cash or another financial asset
  - c) All financial liabilities and all obligations which are settled by delivery of a non-financial asset

# Liquidity risk – when are contractual maturities essential?

- Which of following financial liabilities should be disclosed in liquidity analysis required by IFRS 7 based on contractual maturity?
  - a) derivative liabilities used in cash flow hedges
  - b) non-derivative liabilities used in net investment hedges
  - c) issued financial guarantee contracts
  - d) loan commitments
  - e) all of the above

# Effective Date & practicalities

- Annual periods beginning **on or after 1 January 2009**
- Comparatives **not** required in the first year
- Earlier application permitted (needs to be disclosed)

## Practicalities - need to:

- **collect relevant data for disclosures (especially on FV) from beginning of period beginning on or after 1 January 2009**
- **consider judgements on classification within FV hierarchy**

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# IAS 39 - the sequel.

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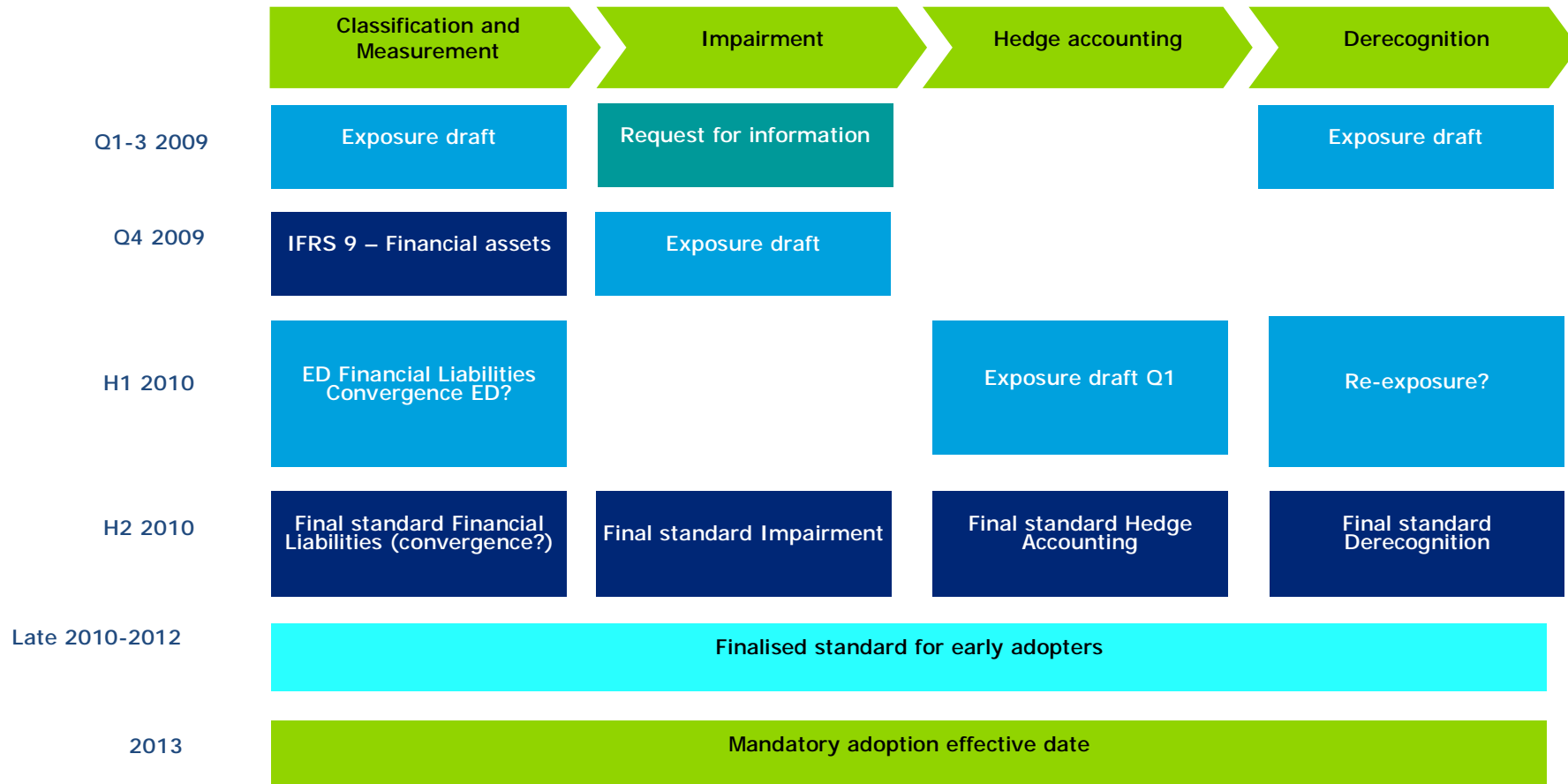
# Agenda

- Why?
  - Existing long-term project
  - G20 countries (plus other pressure)
- When?
  - 14 July 2009 (ED on classification)
  - 12 November 2009 (IASB issued IFRS 9 replacing existing IAS 39 Classification and Measurement requirements)
  - ED on impairment and hedge accounting (Expected Q4/09)

# Next Steps..

- The IASB expects to replace the remaining components of IAS 39 in the second half of 2010. Thus, it plans to incorporate requirements in IFRS 9 addressing the following topics:
- Classification and measurement of financial liabilities — As issued, IFRS 9 only addresses the classification and measurement of financial assets.
- Impairment — On 5 November 2009, the IASB issued an ED proposing an expected loss model for recognising and measuring impairment of financial assets measured at amortised cost.
- Hedge accounting — The IASB plans to issue an ED on hedge accounting in the first half of 2010.
- Derecognition — The IASB issued an ED on derecognition of financial assets and financial liabilities in March 2009 with a comment period that closed in July 2009.

# When? IAS 39 replacement project: Timeline



# IFRS 9 'Financial Instruments'

- The standard replaces the existing classification and measurement requirement of IAS 39 for financial assets
- It covers the classification and measurement of financial assets - debt and equity securities, loan assets, trade receivables and derivative financial assets – assets measured at either amortised cost or fair value depending on the entity's business model and contractual cash flow characteristics of the asset.
- Effective from annual periods commencing on or after 1 January 2013.
- Not yet endorsed by the European Union

# What has changed?

## IFRS 9

- Only two measurement categories: fair value & amortised cost
- Impairment only for amortised cost assets
- New fair value through other comprehensive income classification (FVTOCI)
- No AFS or HTM
- No embedded derivatives in financial assets
- No cost exemption for unquoted equities
- Limited reclassifications
- Limited fair value option

# IFRS 9 'Financial Instruments'

- Classification Criteria:

## *The Business Model Test*

If the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows (rather than to sell the instrument before its contractual maturity to realise its fair value changes)?

## *The Cash flow Characteristics Test*

Do the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payment of principal and interest on the outstanding principal?

- Must meet both of this criteria to be measured at amortised cost
- Examples: Loan assets, trade receivables and investments in debt securities

# IFRS 9 'Financial Instruments'

- 'Fair Value Option' (i.e. irrevocably elect on initial recognition to designate as FVLPL)
- Financial assets that don't meet the classification criteria are measured at Fair Value

## Equity Investments

- Equity Investments are required to be measured at fair value – this means that unquoted equity investments for which FV measurement is not sufficiently reliable can no longer be measured at cost less impairment.
- Equity investments can be designated as FVTOCI – all gains and losses except dividend income, which is recognised in profit and loss, are recognised directly in equity without any reclassifications to profit or loss even if the investment is subsequently sold

# IFRS 9 'Financial Instruments'

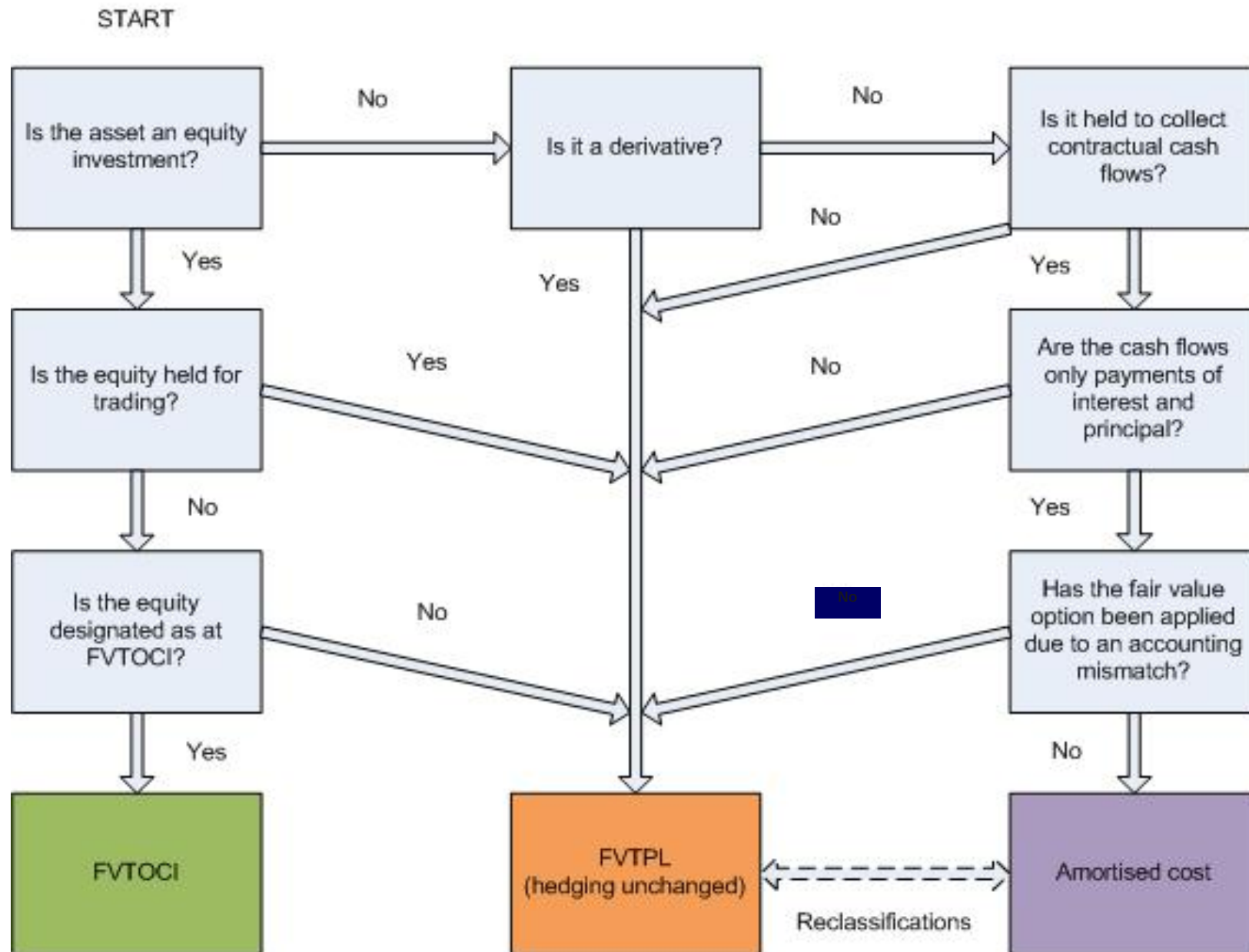
## Equity Investments

- The FVTOCI classification for Equity investment removes the current requirement in IAS 39 for an entity to perform an assessment of impairment and to reclassify the cumulative fair value gain or loss on disposal, because all fair value changes other than dividend income remain permanently in equity.
- IFRS 9 also amends IFRS 7 to require extensive disclosures of investments in equity instruments designated as FVTOCI, including why an entity has chosen to designate the equity instruments as FVTOCI.

## Embedded Derivatives

- Embedded derivatives (hybrid contracts) accounted for separately at FV under IAS 39 as they were not closely related to the financial host asset, will no longer be separated under IFRS 9. The contractual cash flows of the hybrid financial asset are analysed in their entirety and the whole asset is required to be classified as FVTPL if any of its cash flows do not represent payments of principal and interest.

# IFRS 9: Classification and Measurement Model



# Major changes IFRS 9 compared to ED

Issue	ED	Final draft
Can acquired distressed debt ever be amortised cost?	No	Yes, if to hold contractual cash flows
Is an investment in an subordinated tranche issued by an SPE (e.g. asset-backed security) ever amortised cost?	No	Yes, potentially, though assets in SPE must be 'basic' or derivatives that don't create leverage (e.g. cannot write credit default swaps) <i>and</i> credit risk of tranches is less than the average <i>and</i> holder intends to collect contractual cash flows
Can financial assets be reclassified?	No	Yes, but only for non-derivative loans/debt instruments if business model changes (i.e. from or to 'hold contractual cash flows')
If designated at FVTOCI are <u>all</u> gains/losses recognised in OCI?	Yes	Yes, <u>except</u> dividends received
Mandatory effective date	2012	2013
Restate comparatives in all periods	Yes	No, if early adopt before 2012 then no need to restate comparatives

# Communications

- Things you need to think about:
  - potential early adoption
  - timing of elections/choices
  - plan for transitioning to new standard (particularly how to retrospectively apply)
- Newsletter: '*Heads Up*' (vol 16, issue 42)
- *Dbriefs* for Financial Executives –webcasts at [www.deloitte.com/us/dbriefs](http://www.deloitte.com/us/dbriefs)

