www.pwc.ie

In depth

IFRS 7 and IFRS 13 disclosures

A In depth to the disclosure requirements of IFRS 7 and IFRS 13 for investment funds, private equity funds, real estate funds and investment managers investing into financial instruments

February 2014

pwc

Contents

Introduction

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

IFRS 7 is divided in two distinct sections. The first section covers quantitative disclosures about the numbers in the balance sheet and the income statement. The second section deals with risk disclosures which reflect the way management perceives measures and manages the fund's risks. IFRS 7 has been amended several times over the years with the clear intention to improve the disclosure requirements about financial instruments. The latest two amendments relate to transfers of financial assets (applicable for financial years beginning on or after 1 July 2011) and offsetting financial assets and financial liabilities (applicable for financial years beginning on or after 1 January 2013).

Furthermore, some disclosure requirements previously included in IFRS 7 have been transferred to IFRS 13. However, there are some new requirements as well as clarifications on previously existing requirements, included in IFRS 13.

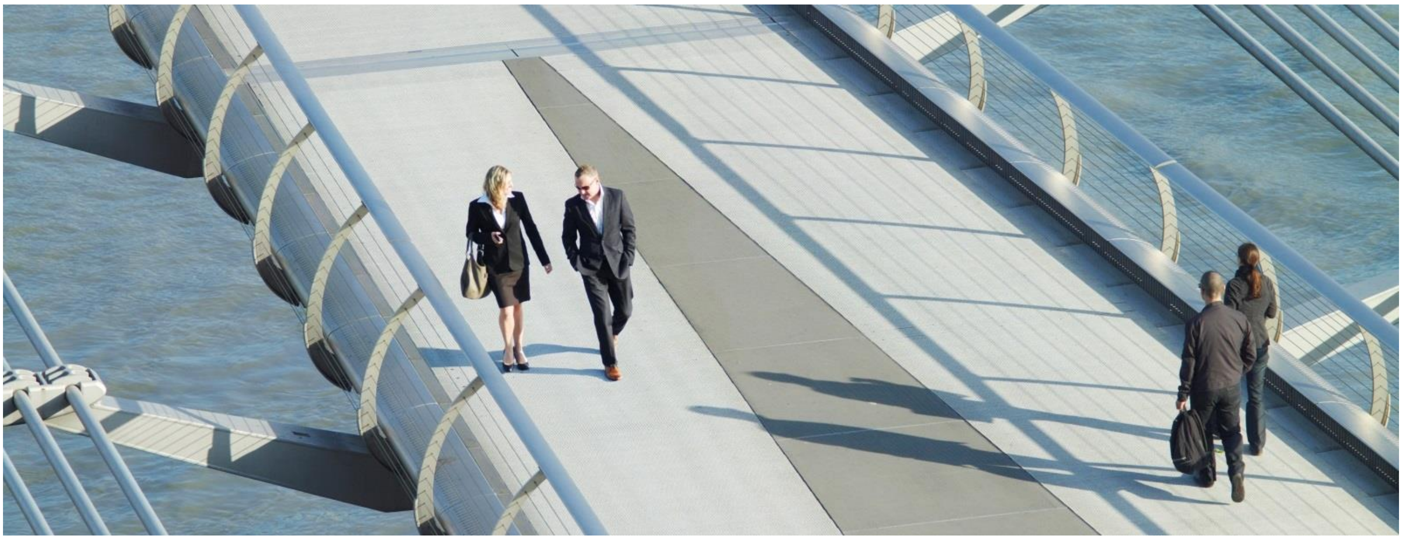
IFRS 13 defines fair value, sets out a single framework for measuring fair value and requires disclosures about fair value measurements. The scope of IFRS 13 is wider than that of IFRS 7 as it includes non-financial assets and liabilities measured at fair value. This publication only covers the disclosure requirements relating to financial assets and liabilities. IFRS 13 is applicable from 1 January 2013 with early adoption permitted.

The overall disclosure objective of IFRS 13 is for an entity to disclose information that helps users of financial statements assess:

- the valuation techniques and inputs used to measurement assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the statement of financial position after initial recognition; and
- the effect on profit or loss or other comprehensive income of significant unobservable inputs, used in the measurement of recurring Level 3 fair value measurements.

This publication contains a number of questions and answers on the application of the disclosure requirements of IFRS 7 and IFRS 13 with respect to financial instruments for investment funds, private equity funds, real estate funds and investment managers.
The document is not meant to be prescriptive, but is aimed at providing guidance on how the requirements of these standards could be applied under different scenarios.

This publication, which is based on the disclosure requirements of IFRS 7 and IFRS 13 applicable to financial periods beginning on or after 1 January 2013, and is not a substitute for reading the standards and interpretations themselves or for professional judgment as to fairness of presentation. They do not cover all possible disclosures that IFRS 7 and IFRS 13 require, nor do they take account of any specific legal framework. Further specific information may be required in order to ensure fair presentation under IFRS. We recommend that readers refer to our publication "IFRS Disclosure Checklist 2013". Additional accounting disclosures may be required in order to comply with local laws, stock exchange or other regulations.



1. Scope

The objective of IFRS 7 is to provide disclosures in their financial statements that enables users to evaluate the significance of financial instruments for the entity's financial position and performance as well as the nature and extent of risks arising from financial instruments to which the entity is exposed during the period, and how the entity manages the risks [IFRS 7 paragraph 1]. IFRS 7 applies to all entities and to all types of financial instruments - recognised and unrecognised [IFRS 7 paragraph 4], except to those mentioned in IFRS 7 paragraph 3.

The objective of IFRS 13 is to set out a single definition of fair value and to require entities to provide disclosures regarding fair value in their financial statements for all assets and liabilities (financial and non-financial) measured at fair value [IFRS 13 paragraph 1]. The scope of IFRS 13 is wider than that of IFRS 7 as it includes non-financial assets and liabilities measured at fair value. Transactions listed in IFRS 13 paragraphs 6 and 7 are exempt from applying IFRS 13. These include items such as share based payments, leases and items where the valuation is similar to fair value, but which are not measured at fair value e.g. inventory held at net realisable value in accordance with IAS 2 and assets at value in use in accordance with IAS 36. IFRS 13 applies when another IFRS requires or permits fair value measurement or disclosure [IFRS 13 paragraph 5].

1.1 Investment Manager who manages several investment funds for third party investors, is exposed to significant operational risk in relation to that. Are disclosures about operational risk required by IFRS 7?

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

1.2 A real estate fund is exposed significant market risk of the property held. Are disclosures on the market risk of real estate required by IFRS 7?

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

In addition to that, IFRS 13 may require additional disclosures for real estate property that is measured at fair value.

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

It depends. Accruals that represent a right to receive cash or an obligation to deliver cash are included in the scope of IFRS 7. Accordingly, when the performance period is completed and the right to receive cash by the investment manager is established, the performance fee payable is a financial liability in the scope of IAS 39 and shall be included in the IFRS 7 disclosures.

However, at interim periods - when the performance period is not completed - the investment fund has a policy choice to account for the performance fee either in accordance with IAS 39 or IAS 37. The performance fee accrual shall be included in the IFRS 7 disclosures, if the investment fund chooses to account for the performance fee payable in accordance with IAS 39, but would be excluded from the IFRS 7 disclosures, if the performance fee payable is accounted for as provision in accordance with IAS 37 [IAS 37 paragraph 2 and IFRS 7 paragraphs 3 to 4 and IAS 39 paragraph 2(j)].

1.4 An investment fund issues one class of redeemable participating shares which are classified as equity instruments in the fund's standalone financial statements in accordance with IAS 32 paragraph 16A and 16B. Are such redeemable participating shares in the scope of IFRS 7 (issuer's perspective)?

No. Instruments that are required to be classified as equity instruments in the issuer's financial statements are excluded from the scope of IFRS 7 [IFRS 7 paragraph 3(f), IAS 32 paragraph 96C]. This scope exception includes equity instruments that are required to be classified as equity in accordance with the Amendment to IAS 32 (issued February 2008).

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

1.5 An investment fund issues one class of redeemable participating shares which are classified as equity instruments in the fund's standalone financial statements in accordance with IAS 32 paragraphs 16A and 16B and for which IFRS 7 disclosures are not required from the fund's perspective [IFRS 7 paragraph 3(f), IAS 32 paragraph 96C].

Does IFRS 7 apply to the non-controlling interest classified as financial liability in accordance with IAS 32 paragraph AG29A in the investment manager's consolidated financial statements (investor's perspective)?

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

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

Yes. IFRS 7 applies to both recognised financial instruments and unrecognised financial instruments [IFRS 7 paragraph 4]. Uncalled capital commitments are accounted for similar to loan commitments and as loan commitments are specifically referred to as an example of unrecognised financial instruments for which certain disclosures are required by IFRS 7 the same principles apply to capital commitments in private equity funds.

However, the capital commitments are not to be included in every quantitative disclosure IFRS 7 requires. In example, uncalled capital commitments that are irrevocable are included in credit risk disclosures whereas all capital commitments are included in the liquidity risk disclosures [IFRS 7 paragraphs 36(a) and B10(d); IFRS 7 paragraphs 39(b) and B11B(b)].

1.7 A real estate investment fund enters into a forward purchase contract, which requires the fund to purchase a property in three months' time. The forward purchase contract provides for an option to either transfer the rights and obligations of the property in three months' time or to settle the contract net in cash?

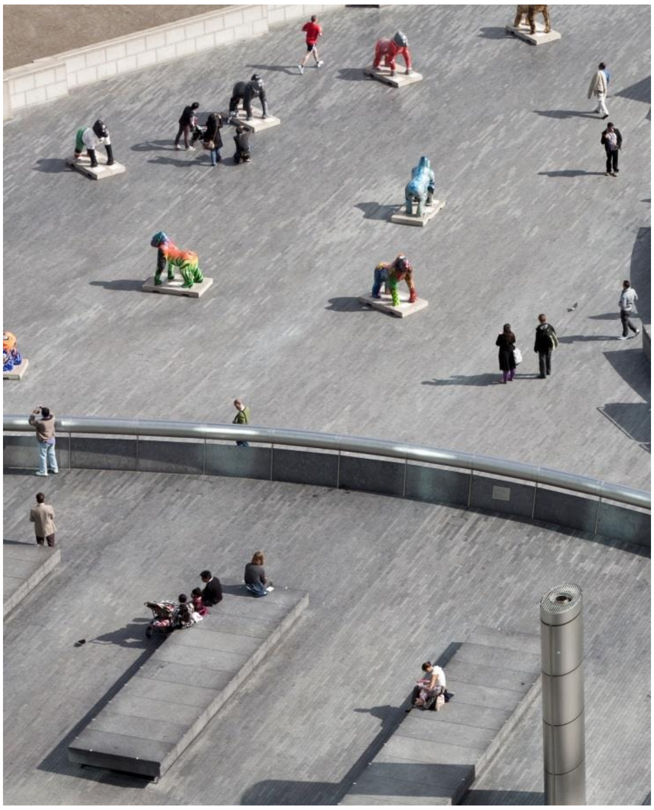
Yes. IFRS 7 applies also to contracts to buy or sell a non-financial instrument if this contract is in the scope of IAS 39 [IFRS 7 paragraph 5 and IAS 39 paragraphs 5 to 7]. However, if the forward purchase contract is excluded from the scope of IAS 39 because it is a contract which is held to receipt or delivery of a property without any option to settle the contract net in cash (own use exemption), no IFRS 7 disclosures are is required.

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

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

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

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



2. Classes of financial instruments

IFRS 7 requires certain disclosures by class of financial instrument - for example the reconciliation of an allowance account [IFRS 7 paragraph 16], the fair value of financial assets and financial liabilities [IFRS 7 paragraph 25] and the level of the fair value hierarchy within which the fair value measurements are categorised [IFRS 13 paragraph 93].

Neither IFRS 7 nor IFRS 13 provide a prescriptive list of classes of financial instruments. However, IFRS 7 states that a class contains financial instruments of the same nature and characteristics and that the classes are reconciled to the line items presented in the balance sheet [IFRS 7 paragraph 6].

IFRS 13 paragraph 94 states that an entity determines appropriate classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability; and the level of the fair value hierarchy within which the fair value measurement is categorised.

2.1 Are the classes identified applied consistently across all class-specific financial statement disclosures required by IFRS 7 and IFRS 13 or can management use different classes for each disclosure?

There is no requirement in either IFRS 7 or in IFRS 13 to use the same classes consistently across all class-specific disclosures.

IFRS 7 paragraph 6 states 'an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments'. For example, some disclosures of class-specific information for an investment fund investing in debt instruments may be more appropriately disclosed by type of debt instrument or, in other instances, by credit rating of the issuer.

IFRS 13 paragraph 94 has a similar requirement but also requires that the level of the fair value hierarchy within which the fair value measurement is categorised is considered in determining appropriate classes. Accordingly, the number of classes may need to be greater for fair value measurements categorised within Level 3 of the fair value hierarchy because those measurements have a greater degree of uncertainty and subjectivity.

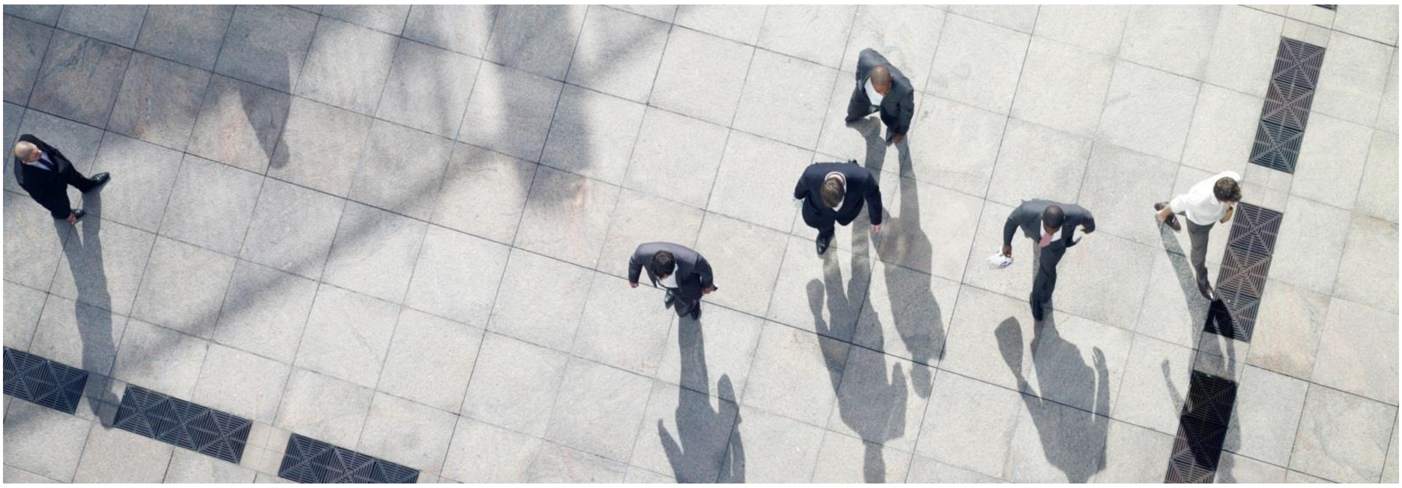
However, in all instances sufficient information should be provided to permit reconciliation to line items presented in the balance sheet.

2.2 When IFRS 7 and IFRS 13 refer to 'class' does this require disclosure by categories defined in IAS 39?

No. A 'class' of financial instruments is not the same as a 'category' of financial instruments. Categories are defined in IAS 39 as financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables, available-for-sale financial assets, financial liabilities at fair value through profit or loss and financial liabilities measured at amortised cost. Classes are determined at a lower level than the measurement categories in IAS 39 and reconciled back to the statement of financial position, as required by IFRS 7 paragraph 6 and IFRS 13 paragraph 94.

2.3 Can an investment fund disclose 'investments in debt instruments' as a single class or should it be split further into separate classes?

In the case of an investment fund, the category 'investments in debt instruments' will generally comprise more than one class of financial instrument unless the debt instruments have similar characteristics (e.g. corporate bonds with similar credit ratings). In that case, 'investments in debt instruments' can be one class.



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

As stated in 2.3 above, the portfolio of an investment fund will generally comprise more than one class of debt instrument. However, the level of detail for a class is determined on an entity-specific basis. This requires management to take into account the characteristics of the financial instruments as well as whether the classes are appropriate to disclose useful information [IFRS 7 paragraphs 6 and 7]. This judgment should be based on the way in which the investments are reported to and evaluated by the fund's key management personnel.

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

- Type of debt instruments (e.g. government bonds, corporate bonds, asset backed securities);
- Type of investment (e.g. automotive, technology, health care);
- Credit rating of issuers (e.g. AAA, AA, A, BBB,);
- Payment of interest (e.g. fixed rate debt, floating rate debt).

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

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

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

2.6 Where IFRS 7 requires disclosures by class of financial instrument (e.g. IFRS 7 paragraphs 25, 36 and 37; IFRS 13 paragraph 94) the question arises whether different classes of redeemable participating units issued by an investment fund can be grouped together even though they are legally different.

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

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

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

3. Fair value measurement disclosures

a) Disclosure of fair value by class of financial instrument

IFRS 7 paragraph 25 requires the disclosure of the fair value of financial assets and financial liabilities by class in a way that permits it to be compared with its carrying amount for each class of financial asset and financial liability. However, disclosure of fair value is not required when the carrying amount is a reasonable approximation of fair value, and for a contract containing a discretionary participation feature in accordance with IFRS 4 for which the fair value of that feature cannot be measured reliably [IFRS 7 paragraph 29].

IFRS 13 paragraph 93(a) requires that for recurring and non-recurring fair value measurements, the fair value measurement at the end of the reporting period, and for non-recurring fair value measurements, the reasons for the measurements.

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

Yes. IFRS 7 paragraph 25 requires the disclosure of the fair value for all financial instruments irrespective of the fact that a financial instrument is measured at amortised cost in the statement of financial position. The disclosure is presented in a way that allows a comparison of the amounts disclosed and the carrying amounts. However, disclosure of fair value is not required; if the amounts disclosed in the statement of financial position for financial instruments measured at amortised cost are a reasonable approximation of fair value. [IFRS 7 paragraph 29]

The following examples illustrate when the amount disclosed in the statement of financial position is a reasonable approximation of fair values to be disclosed under IFRS 7 paragraph 25:

- A money market fund holding commercial paper measures its investments at amortised cost as a reasonable approximation of fair value.
- The fair value of the variable interest bank borrowings is estimated to be the discounted contractual future cash flows and there was no significant change in the entity's own credit risk during the period.

IFRS 13 applies where another standard requires or permits fair value measurement or disclosure [IFRS 13 paragraph 5]. Therefore, irrespective of the fact that a financial instrument is measured at amortised cost in the statement of financial position, IFRS 13 applies if fair value information is disclosed.

However, the disclosure requirements of IFRS 13 are limited to

- The level of fair value hierarchy in which the fair value measurements are categorised in their entirety [IFRS 13 paragraph 93(b)];
- A description of the valuation technique(s) and the inputs used in the fair value measurement for all Level 2 and Level 3 measurements, incl. a description of the change in the valuation technique if applicable, with the exception that quantitative disclosures about significant unobservable inputs are not required [IFRS 13 paragraph 97]

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

The investors of a private equity fund committed themselves to invest EUR 150 million into the fund over the next 10 years. The fund already called EUR 50 million over the past 2 years. The remaining uncalled capital commitments amount to EUR 100 million at the balance sheet date.

Is a private equity fund required to disclose the total amount of outstanding uncalled capital commitments (EUR 100 million) under that requirement?

No. IFRS 7 applies to both recognised and unrecognised capital commitments. However, the disclosure requirements in IFRS 7 paragraph 25 may only be relevant in rare circumstances as usually, the fair value of such capital commitments in private equity funds will be nil as the new fund units are issued at fair value.

b) Applying the fair value hierarchy

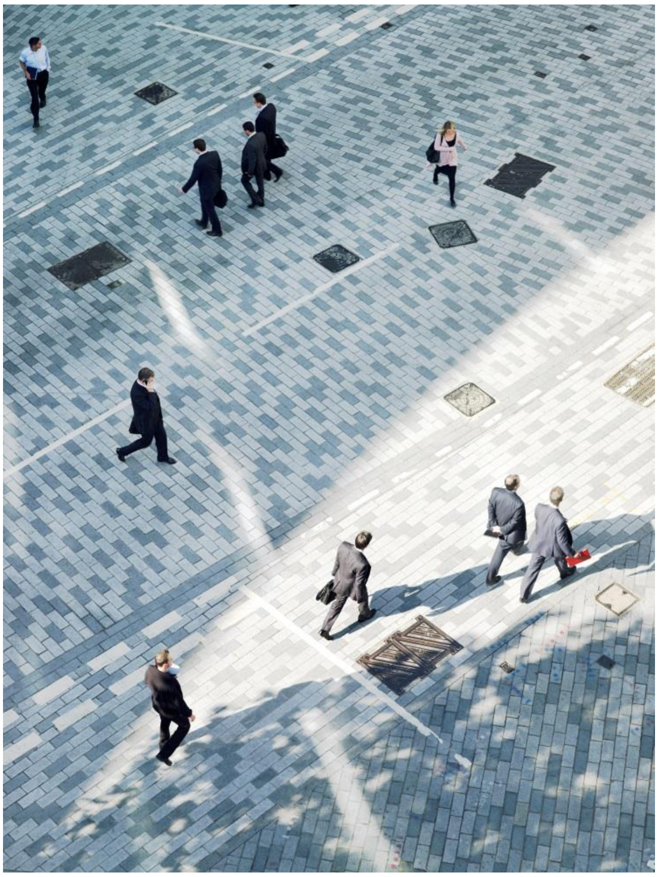
As part of the disclosure requirements for fair value measurements, an entity shall classify fair value measurements using a "fair value hierarchy" that categorises the inputs to valuation techniques used to measure fair value. The fair value hierarchy has three different levels and gives the highest priority to quoted (unadjusted) prices in active markets and the lowest priority to unobservable inputs [IFRS 13 paragraph 72].

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets and liabilities the entity can access at the measurement date (refer to IFRS 13 paragraphs 76 to 80 for further details).

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset and liability, either directly or indirectly (refer to IFRS 13 paragraphs 81 to 85 for further details).

Level 3 inputs are unobservable inputs for the asset or liability (refer to IFRS 13 paragraphs 86 to 90).

The categorisation of the fair value measurement into one of the three different levels shall be determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, taking into account factors specific to the asset or liability [IFRS 13 paragraph 73].



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

The use of a valuation model (rather than simply taking a price from the market) precludes the use of Level 1. However, the fair value hierarchy prioritises the inputs to valuation techniques, not the valuation techniques that the respective models used to measure fair value [IFRS 13 paragraph 74].

The level within the hierarchy is determined based on the valuation inputs, not on the methodology or complexity of the model. The use of a model does not automatically result in a Level 3 fair value measurement. For example, a standard valuation model used to compute a value by using all observable inputs is likely to result in a measurement that is classified as Level 2.

However, to the extent that adjustments or interpolations are made to Level 2 inputs in an otherwise standard model, the measurement may fall into Level 3, depending on whether the adjusted inputs are significant to the measurement. Furthermore, if a reporting entity uses a valuation model that is proprietary and relies on unobservable inputs, the resulting fair value measurement will be categorised as Level 3.

3.4 Does the valuation technique (i.e. multiples, discounted cash flows) selected by an private equity fund impact the classification of the fair value measurement within the fair value hierarchy?

No. The IFRS 13 fair value hierarchy prioritises the inputs to the valuation techniques, not the valuation techniques themselves [IFRS 13. paragraph 74]. Selecting the appropriate valuation technique for which sufficient data is available in accordance with IFRS 13 paragraph 61 should be based on an assessment of the facts and circumstances specific to the asset or liability being measured and should be independent of the classification of inputs used within the fair value hierarchy.

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

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

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

Many reporting entities obtain information from pricing services that accumulate and disseminate market pricing information to their subscribers, from broker pricing information, and from similar sources, for use as inputs in their fair value measurements. The information provided by these sources could be any level in the fair value hierarchy, depending on the source of the information for a particular security.

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

Level 1 inputs
Level 1 inputs are unadjusted quoted prices, in active markets for identical assets or liabilities that the entity can access at the measurement date. For a price to qualify as Level 1, reporting entities should be able to obtain the price from multiple sources as a single market maker would almost by definition suggest an inactive market. Level 1 inputs related to items traded on an exchange or an active index/market location.
Level 2 inputs
Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly e.g.: • Quoted prices for similar assets or liabilities in active markets • Quoted prices for identical or similar assets or liabilities in markets that are not active e.g. dealer markets where the dealer is standing ready and able to transact at that price such as an OTC market. • Broker quotes corroborated with observable market information • Inputs other than quoted prices are observable for the asset or liability, for example: - Interest rates and yield curves observable at commonly quoted intervals, - Implied volatilities - Credit spreads
Level 3 inputs
Examples of Level 3 values include: • Inputs obtained from broker quotes or a pricing service that are indicative (that is, not being transacted upon) and not corroborated with observable market data. • Models that incorporate management assumptions that cannot be corroborated with observable market data.

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

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

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

This is even more important in the context of determining the level in the fair value hierarchy the investment should be classified in. It is important to note that third party prices might only be indicative prices and not firm quotations upon which the third party would actually trade. Accordingly, understanding the:

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

will be required to provide the management with considerable insight necessary to determine which level a measure should be classified into in accordance with IFRS 13 paragraph 93(b).

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

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

There are no bright lines for determining significance of an input to the fair value measurement in its entirety. Accordingly, two different investment funds may determine that the same facts lead to different conclusions.

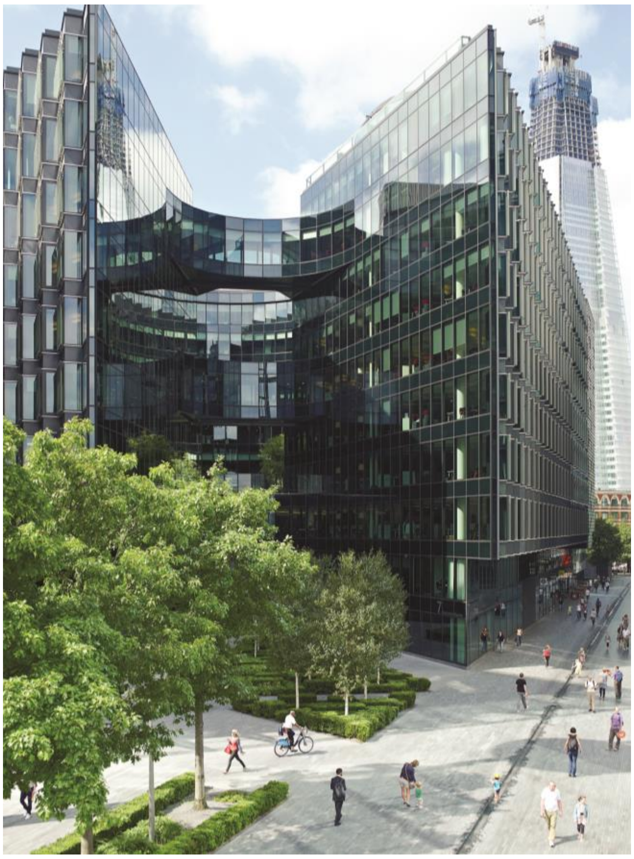
In assessing the significance of unobservable inputs to an asset or liability's fair value, management

(a) Considers the sensitivity of the asset or liability's overall value to changes in the data, and

(b) Reassesses the likelihood of variability in the data over the life of the asset or liability.

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

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



3.9 An investment fund invests solely in financial instruments that are listed on a stock exchange but which are thinly traded or where there has been a significant decrease in the volume or level of activity. Can the fund still classify all financial instruments held in Level 1?

It depends. IFRS 13 paragraph 76 states that Level 1 financial instruments have quoted prices (unadjusted) in active markets that the entity can access at the measurement date. An active market is one in which transactions for the asset and liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis [IFRS 13 App. A]. If transactions are occurring frequently enough to obtain reliable pricing information on an ongoing basis, the market is considered active.

However, the price quote may be a Level 2 or Level 3 input or may not represent fair value. In making this determination, the entity should consider factors such as the following:

- There are few recent transactions for the instrument,
- Price quotations that are not developed using current information,
- Price quotations that vary substantially either over time or among market makers (for example, some brokered markets),
- Indices that were previously highly correlated with the fair value of the asset or liability are demonstrably uncorrelated with recent indications of fair value
- There is significant increases in implied liquidity premiums, yields or performance indicators for observed transactions or quoted prices when compared with the entity's estimate of expected future cash flows, taking into account all available market data about credit and other non-performance risk for the asset or liability
- There is a wide bid-ask spread or a significant increase in the bid-ask spread
- There is a significant decline in the activity of, or there is an absence of a market for new issues for the asset or liability or similar assets or liabilities.
- There is little information publicly available.

3.10 An investment fund invests solely in financial instruments that are listed on a stock exchange. The investments are geographical dispersed and include holdings listed in Asia as well as in Canada. The fund values its investments at closing of the New York Stock Exchange.

However, due to the early closing of the Asian market the fund does not value the Asian holdings with the last transaction price provided by the Hong Kong stock exchange but adjusts the prices by an expected market shift (sometimes referred to as indexation). The expected market shift is calculated on an instrument by instrument basis and takes into account the development of the later closing stock exchanges.

Based on past experience there is a strong correlation between the development of the New York Stock Exchange and the Asian financial instruments.

Can the investment fund disclose all its investments as Level 1?

No. IFRS 13 paragraph 76 provides that Level 1 fair values shall be quoted prices (unadjusted) in an active market for identical assets that the entity can access at the measurement date. As the fund adjusts certain quoted prices to reflect expected market fluctuations after closing of the stock exchange, the quoted prices are no longer unadjusted and therefore do not qualify for Level 1.

In the above scenario the fair value measurement of such investments is most likely considered Level 2 as it represents an adjustment for new information to quoted prices in active markets for identical assets or liabilities. The adjustment renders the fair value measurement at a lower level measurement.

Due to the relatively mechanical nature of the calculation and correlation factors which are based on market observable inputs, it would likely not be considered a Level 3 valuation as long as the calculation and the correlation factors are relevant and are observable.

3.11 Is it required to look through to the investments of a fund when determining the level in the fair value hierarchy in which the fair value measure should be categorised by the investor?

No. The investor in shares of a fund must consider the nature of the fund shares itself and not look through to the underlying investments held by the fund in determining the valuation level. This is because the unit of account is the investment in the fund and not the investment in the underlying assets of the investment fund. Accordingly, if transactions are observable for the fund such transactions should be taken into account when determining the level of the fair value hierarchy.

However, if no observable market input for the shares themselves is available, valuation techniques should be applied. This might include using observable prices in the underlying investments as inputs into the fair value of the investment in the fund.

The level of inputs used to determine the fair value will determine the level of fair value hierarchy.

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

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

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

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

It depends. IFRS 13 paragraph 76 states that Level 1 financial instruments have quoted prices (unadjusted) in active markets that the entity can access at the measurement date. An active market is one in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an on-going basis. If transactions are occurring frequently enough to obtain reliable pricing information on an on-going basis, then the market would be considered active.

Where there are few transactions for the instrument, the price is not current, or price quotations vary substantially either over time or among market makers (for example, some brokered markets), or which little information is released publicly, the price quote may be a Level 2 or Level 3 input.

Level 1
Investments in exchange traded investment funds (ETF) are classified as Level 1, if transactions occur with sufficient frequency and volume to provide pricing information on an ongoing basis. ***Example:*** *retail mutual funds with (subscriptions and) redemptions on a daily basis at a daily reported redemption price.*
Level 2
Investments in ETFs are classified as Level 2 if transactions occur less frequently and with a low trading volume.
Level 3
Investments in ETFs are classified as Level 3 if the ETF cannot be traded at the stock exchange (listing for marketing purpose only) and price quotations received from brokers and market makers are indicative prices and not firm quotations upon which the broker respective market maker would actually trade.

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

It depends. Level 1 inputs are unadjusted quoted prices in active market for identical assets and liabilities that the entity can access at the measurement date. Accordingly, if subscriptions and/or redemptions at the fund's net asset value (NAV) take place with sufficient frequency and volume to provide observable pricing information on an on-going basis, the redeemable participating shares of the fund valued at the NAV should be classified in Level 1.

However, with less frequent subscriptions and/or redemptions the NAV may be considered as Level 2 input. Since, the unit of account are the redeemable participating shares and not the underlying assets of the investment fund, mutual fund shares for which the underlying investments are all valued using Level 2 or Level 3 inputs might nonetheless be considered a Level 1 valuation for the Fund of Fund's interest in such funds (and vice versa).

In determining whether an active market exists the following questions are helpful considerations:

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

Level 1
Open-ended funds that are redeemable at any time, that report a daily net asset value (NAV) and for which sufficient subscriptions and redemptions occur at NAV that support the assessment that an active market exists. ***Example:*** *retail mutual funds with (subscriptions and) redemptions on a daily basis with sufficient volume at a daily reported redemption price.*
Level 2
Open-ended funds that are redeemable at the reportable NAV at the measurement date, for which however, none or no significant subscriptions and redemptions occur, if a transaction at NAV could have taken place at the balance sheet date. ***Example:*** *Open-ended funds held by a single investor (dedicated funds, special funds) for which NAV is calculated on a quarterly basis and on each date a subscription or redemption takes place.*
Level 3
Open-ended funds that might be redeemable at a future date, if the length of the time until the investment will become redeemable is considered significant a thus an adjustment would be made to NAV for credit and liquidity risk. ***Example:*** *Mutual funds for which temporary the redemption has been suspended.* Open-ended funds for which significant unobservable adjustments to NAV are made when valuing the fund units ***Example:*** *Mutual fund for which an adjustment has been made to NAV to reflect the developments at a stock market that occurred after the NAV has been calculated*

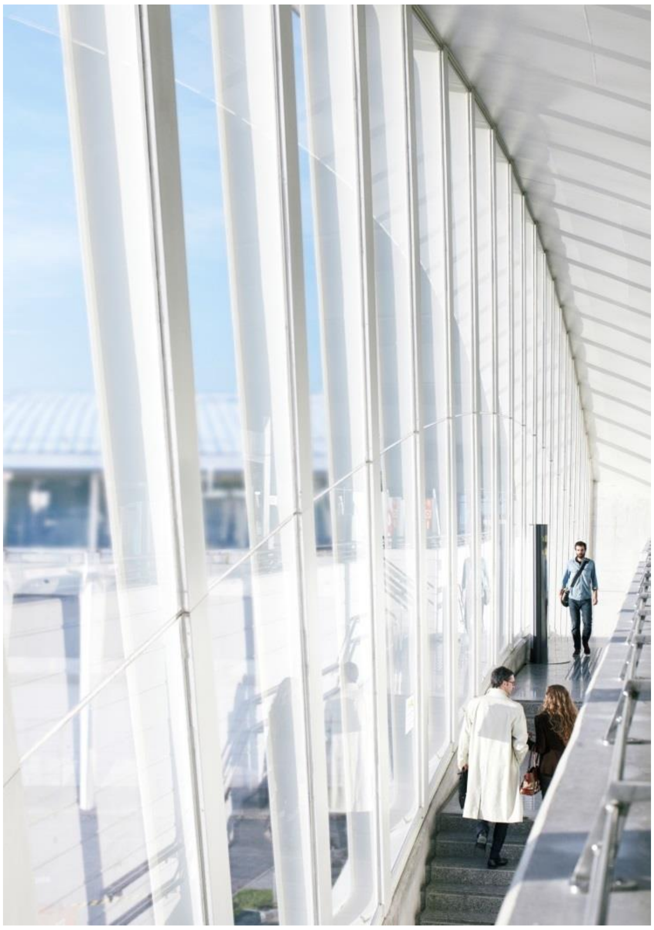
3.15 Investment fund X is an open-ended investment fund that is redeemable at any time and for which a daily net asset value (NAV) is reported. As the fund has significant investments in illiquid investments (i.e. investment properties) redemptions may be suspended or postponed at the discretion of its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

It depends. The observability (e.g. evidence obtained from transactions in secondary markets), and the significance of the adjustment to the NAV will need to be considered in determining whether the investment is classified as Level 2 or Level 3.

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

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

Level 1
Closed-ended funds with a secondary market for which the trading volume supports the assessment that an active market exists and the investor can access that market at the measurement date (this is expected to be a very rare scenario).
Level 2
Closed-ended funds with recent transactions in a secondary market, if the observable price represents fair value or is used as an input to value the fund units.
Level 3
Closed-ended funds that cannot be redeemed by the reporting entity at all until maturity. ***Example:*** *Fixed-life private equity fund with no secondary market.* Closed-ended funds that are valued using a valuation technique (significant unobservable inputs) and/or for which no current net asset value (NAV) is reported. ***Examples:*** *Private equity fund with only quarterly reporting.* Funds for which significant unobservable inputs are used which may include the published NAV or the investors adjustments to that NAV hen valuing the fund units. ***Examples:*** *Hedge funds for which significant adjustments are made, for example credit and liquidity risk premiums.*



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

It depends. Level 2 classification requires that when a valuation technique is used to value the investment in a fund that inputs are used, that are based on observable market data. The calculation of the net asset value (NAV) based on the quoted prices in an active market could be interpreted as valuation technique that is solely based on observable market data.

However, in the above scenario the investor needs to carefully assess whether the NAV is a reasonable and appropriate estimate of the fair value of the investment. Due to the illiquidity of the closed ended fund it is expected that the illiquidity of the investment is taken into account when valuing the fund units. Such an input to the valuation could be significant and therefore the fund would be classified Level 3.

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

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

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

Level 2 inputs are therefore data that is readily available for market participants and that impose no assumption made to determine the data. Accordingly, the use of earnings multiples is most likely to be a Level 3 input as:

- the multiples are derived from observable market data by applying assumptions on the comparability of the businesses, considering operational, market, financial and non-financial factors; and
- the earnings, revenues or cash flows of the entity to which the multiples are applied, are typically unobservable to the market.

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

3.19 Hedge funds may allocate a percentage of capital to side-pocket investments (also referred to as side pocket shares). These investments may not be redeemable until the investment has been realised or written off. How should an investor in a hedge fund categorise the side-pocket shares when applying the IFRS 13 fair value hierarchy?

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

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

3.20 IAS 39 paragraph 46(c) allows for investments in equity instruments that do not have a quoted price in an active market and whose fair value cannot be reliably measured to be measured at cost. Investor A invests into a Private Equity fund for which there is no reliable fair value available and therefore accounts for its investment at cost, however, when the investment is considered to be impaired the investment is written down to the present value of the future cash flows discounted at the current market rate for a similar investment [IAS 39 paragraph 66]. Are such investments subject to IFRS 13 fair value disclosures and if so, in what level of the hierarchy should the investments be classified in?

Investments recorded at cost in accordance with IAS 39 paragraph 46(c) are not subject to fair value measurement and therefore are not subject to the disclosure requirements of IFRS 7 paragraph 25 [IFRS 7 paragraph 29(b)].

However, in the event of an impairment and a write down of the investment to its present value of the future cash flows as required in IAS 39 paragraph 66 the investor shall disclose the method used and the assumptions applied in determining the present value as best estimate of fair value in accordance with IFRS 13 paragraph 91. The disclosures required in IFRS 13 paragraphs 93 and 97 will also be required. Such valuations should be classified as Level 3.

Note: When IFRS 9 is applied, financial institutions and investment funds will be prohibited from using cost as an approximation of fair value [IFRS9.BC5.18].

c) Level 3 disclosure requirements

The objective of the disclosures in IFRS 13 is to provide users of financial statements with information about the valuation techniques and inputs used to develop fair value measurements and how fair value measurements using significant unobservable inputs affect profit or loss or other comprehensive income for the period. The IASB received requests from users of financial statements for more information about fair value measurements categorised within Level 3 of the fair value hierarchy. As a result, the disclosure requirements with respect to assets and liabilities categorised within Level 3 of the fair value hierarchy have been expanded.

For fair value measurements in Level 3 of the fair value hierarchy the following additional disclosures are required:

- For recurring and non-recurring fair value measurements, a description of the valuation technique(s) and inputs used in the fair value measurement, if there has been a change in valuation technique, the nature and reasons for the change and quantitative information about significant unobservable inputs used in the fair value measurement [IFRS 13 paragraph 93(d)]
- For recurring fair value measurements, reconciliation from the beginning balance to the ending balance should be disclosed [IFRS 13 paragraph 93(e))].
- For recurring fair value measurements, the amount of total gains or losses for the period as set out in the reconciliation noted above that is included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period and the line items in which those unrealised gains or losses are recognised [IFRS 13 paragraph 93(f)
- For recurring and non-recurring fair value measurements, a description of the valuation processes used by the entity [FRS 13 paragraph 93(g)

For recurring fair value measurements, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs of a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are inter-relationships between those inputs and other unobservable inputs used in the fair value measurement, an entity shall provide a description of those interrelationships and how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

If changing one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly, the entity shall state that fact and disclose Recurring fair value measurements of assets or liabilities are those that other IFRSs require or permit in the statement of financial position at the end of each reporting period. Non-recurring fair value measurements of assets or liabilities are those that other IFRSs require or permit in the statement of financial position in particular circumstances.

Furthermore, the entity discloses how the effect of a change to a reasonably possible alternative assumption has been calculated. [IFRS 13 paragraph 93(h)

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

Yes. For recurring fair value measurements in Level 3 of the fair value hierarchy, a reconciliation from the beginning balances to the ending balances should be presented ([IFRS 13.93(e))] disclosing separately changes during the period attributable to:

- Purchases, sales, issues and settlements (each type of movement disclosed separately),
- Total gains or losses for the period recognised in profit or loss, and the line items in profit or loss in which those gains and losses are recognised
- Total gains or losses for the period recognised in other comprehensive income, and the line items in other comprehensive income in which those gains and losses are recognised
- Transfers into and out of Level 3 (including the reason for such transfers and the entity's policy for determining when those transfers between levels are deemed to have occurred.

IFRS 13 IE 61 gives an illustrative example on how the above reconciliation should be presented.

3.22 IFRS 13 paragraph 93(h)(ii) requires that for fair value measurements in Level 3, if changing one or more of the unobservable inputs to reasonably possible alternative assumptions would change fair value significantly, the entity should state that fact and disclose the effect of those changes. Based on this requirement is there likely to be a sensitivity analysis for all Level 3 measurements where fair value measurement is sensitive to underlying assumptions?

Not necessarily. In determining whether to classify an instrument as Level 3, the entity considers whether an unobservable input is significant to the fair value of that individual instrument in its entirety. However, IFRS 13 paragraph 93(h)(ii) is explicit that for the purpose of disclosure of sensitivity analysis for each class of financial instrument with Level 3 measurements, significance should be judged with respect to the reporting entity's profit or loss, total assets or total liabilities, or when changes in fair value are recognized in other comprehensive income, total equity.

3.23 Investment Company X is a fund of fund structure and invests in other private equity funds (the underlying funds). The underlying funds, which are managed by a third party manager not related to X, are invested directly in private equity investments (the underlying investments). X receives periodically information on the Net Asset Values (NAV) of the underlying funds. However, there are insufficient transactions in shares of the underlying funds at the NAV date to constitute a quoted price in an active market. Company X therefore needs to apply valuation technique to determine the fair value of the fund investments.

Accordingly, X doesn't just rely on the NAV received but performs a high level check on the valuation of the underlying investments. It normally uses multiples on earnings to assess the reliability of the fair value of the investments made by the underlying fund.

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

No. In the above scenario, the company uses the multiples only for internal control purposes to back test whether NAV is a reliable measure for fair value. Therefore the disclosure of the multiples applied to back test the value is not required, but X shall provide information on how the NAV has been determined which might require the disclosure of parameters used by the underlying funds to value their assets.

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

3.24 A private equity fund acquires unlisted securities. The transaction price is different from fair value at initial recognition determined by using a valuation technique. Does IFRS 7 or IFRS 13 require entities to disclose that difference?

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

When determining whether the fair value at initial recognition equals the transaction price an entity shall take into accounts factors specific to the transactions and to the asset or liability. Examples of situations in which the transaction price might not represent the fair value of an asset or liability at inception might include situations where the transaction is between related parties, or when the transaction takes place where the seller is experiencing financial difficulty, or when the market in which the transaction takes place is not the principal (or most advantageous) market.

It should be noted that an unrecognised 'day 1' gain or loss is not separately identified in the balance sheet. IFRS 7 paragraph 28 requires disclosure of the unrecognised amount, together with the change in the amount previously deferred, and the entity's accounting policy for determining when amounts deferred are recognised in profit or loss. Further, IFRS 7 paragraph 28 requires entities disclose why the entity concluded that the transaction price was not the best evidence of fair value.

3.25 What comparative information is required in the first year of application of the IFRS 13 on fair values by an entity who was previously complying with the disclosure requirements of IFRS 7?

IFRS 13 paragraph C2 states IFRS 13 shall be applied prospectively as of the beginning of the annual period in which it is initially applied. While IFRS 13 Appendix C requires its application to be applied prospectively, the requirement to disclose by class is not new. IFRS 13 has simply provided further guidance on this matter, including an illustrative table [IFRS 13 paragraph IE60]. So whilst comparative information is not required, it would seem odd not to provide the disclosures provided in IFRS 7 from the previous year.

d) New disclosure requirements of IFRS 13

3.26 What are the new fair value disclosure requirements of IFRS 13 when compared with those that were previously included in IFRS 7, and how might entities satisfy these requirements?

The new disclosure requirements are largely qualitative in nature and are set out below:

a) IFRS 13 applies when another IFRS requires or permits fair value measurements or **disclosures** about fair value measurements.

Therefore the new disclosure requirements set out below apply also to situations where an asset or liability is measured in the statement of financial position at cost/amortised cost, but there is a requirement to disclose fair value information.

b) For fair value measurements categorised within Level 3 of the fair value hierarchy, an entity is required to disclose a description of the valuation processes used by the entity (including, for example, how an entity decides its valuation policies and procedures and analyses changes in fair value measurements from period to period) [IFRS13 paragraph 93(g)].

To satisfy this new requirement, an entity might disclose information, such as the group within the entity that decides the entity's valuation policies and procedures, to whom that group reports, the frequency and methods for calibration, back testing and other testing procedures of pricing models, etc. [IFRS13 paragraph IE65].

c) For fair value measurements categorised within Level 3 of the fair value hierarchy, quantitative information about the significant unobservable inputs used in the fair value measurement.

An entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the entity when measuring fair value (for example, when an entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure, an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity [IFRS13 paragraph 93(d)].

IFRS13 paragraph BC191 considers this to be a clarification to the pre-existing requirements.

While IFRS 7 required a quantitative sensitivity analysis, there was previously no specific language that stated that quantitative data on unobservable inputs was needed [IFRS7 paragraph 27B9e)].

d) IFRS 13 paragraph 93(h)(i) requires a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement.

e) IFRS 13 paragraph 93(h)(i) also requires that if there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

f) A requirement to disclose transfers between levels existed in IFRS 7; however, IFRS 13 includes the following additional requirements: an entity should disclose the amounts of any transfers between levels of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred. Transfers into each level should be disclosed and discussed separately from transfers out of each level [IFRS13 paragraphs 93(c), (e), (iv), p95].

The requirement for the disclosure of transfers between levels in IFRS 7 was applied only to 'significant' transfers. IFRS 13 removes the 'significant' threshold and adds a new requirement to disclose the entities policy for determining when transfers between levels are deemed to have occurred.

The policy with regard to the timing of the recognition of transfers should be the same for transfers into the levels as for transfers out of the levels. Examples of policies for determining the timing of transfers include the following [IFRS13 paragraph 95]:

- The date of the event or change in circumstances that caused the transfer.
- The beginning of the reporting period.
- The end of the reporting period.

g) For recurring level 3 fair values, the amount of total gains or losses for the period included in profit or loss that is attributable to the unrealised gains/losses relating to those assets and liabilities held at the end of the reporting period and the line items in which those unrealised gains/losses are recognised [IFRS 13 paragraph 93(f)]

3.27 ABC Fund is an open ended investment fund that has a number of financial assets and liabilities that are categorised as Level 2 and Level 3 in the fair value hierarchy. Some 'significant' transfers between Levels 1 and 2 and Levels 2 and 3 have been made during the year.

(1) How might ABC Fund meet the disclosure requirements set out in IFRS 13?

(2) Is ABC Fund required to provide comparative information?

(1) Suggested disclosures for ABC Fund are set out in the tables below.

(2) IFRS 13 has an effective date of 1 January 2013 and is applied prospectively Early application is permitted but should be disclosed. IFRS 13 disclosures for comparative information relating to periods before initial application are not required.

(a) Assets and liabilities not carried at fair value but for which fair value is disclosed

The following table analyses within the fair value hierarchy the Fund's assets and liabilities (by class) not measured at fair value at 31 December 2012 but for which fair value is disclosed.

	Level 1	Level 2	Level 3	Total balance
Assets				
Due from brokers	-	2,356	-	2,356
Other receivables	-	497	-	497
Margin accounts	1,026	-	-	1,026
Cash and cash equivalents	1,620	-	-	1,620
Total	**2,626**	**2,853**	**-**	**5,499**
Liabilities				
Due to brokers	-	893	-	893
Accruals		257		257
Net assets attributable to holders of redeemable shares	-	114,414	-	114,414
Total	**-**	**115,564**	**-**	**115,564**

The assets and liabilities included in the above table are carried at amortised cost; their carrying values are a reasonable approximation of fair value.

Margin accounts, cash and cash equivalents include cash in hand, deposits held with banks and other short-term investments in an active market.

Amounts due from brokers and other receivables include the contractual amounts for settlement of trades and other obligations due to the Fund. Amounts due to brokers and accruals represent the contractual amounts and obligations due by the Fund for settlement of trades and expenses.

The puttable value of redeemable shares is calculated based on the net difference between total assets and all other liabilities of the Fund in accordance with the Fund's offering memorandum. These shares are not traded on an active market. A demand feature is attached to these shares, as they are redeemable at the holders' option and can be put back to the Fund at any dealing date for cash equal to a proportionate share of the Fund's net asset value attributable to the share class (Note 2.8). The fair value is based on the amount payable on demand, discounted from the first date that the amount could be required to be paid. The impact of discounting in this instance is not material. As such, Level 2 is deemed to be the most appropriate categorisation for net assets attributable to holders of redeemable shares.

3. Fair value measurement disclosures

The following table analyses within the fair value hierarchy the Fund's assets and liabilities (by class) measured at fair value at 31 December 2012.

All fair value measurements disclosed are recurring fair value measurements.

	Level 1	Level 2	Level 3	Total balance
Assets				
Financial assets held for trading:				
Equity securities				
Eurozone				
Industrial	11,774	-	-	11,774
United States				
Information technology	13,469	-	-	13,469
Financials	13,540	2,694	-	16,234
Health care	11,417	-	-	11,417
Derivatives				
Listed options	845	-	-	845
Listed futures	755	-	-	755
Debt securities				
US Treasury bills	2,000	-	-	2,000
Eurozone sovereign	8,000	4,501	-	12,501
Sub total	**61,800**	**7,195**	**-**	**68,995**
Financial assets designated at fair value through profit or loss at inception:				
Equity securities				
United States				
Consumer staples	8,741	3,250	7,298	19,289
Energy	8,500	4,077	-	12,577
Consumer discretionary	4,650	4,181	-	8,831
Other sectors	4,800	1,355		6,155
Debt securities				
Eurozone sovereign	3,499	-	-	3,499
Eurozone corporate	-	1,600	-	1,600
United States corporate	-	182	600	782
Sub total	**30,190**	**14,645**	**7,898**	**52,733**
Total assets at fair value through profit or loss	**91,990**	**21,840**	**7,898**	**121,728**
Liabilities				
Financial liabilities held for trading:				
Equity securities sold short				
United States				
Consumer staples	6,198	4,350	-	10,548
Derivatives				
Listed options	410	-	-	410
Listed futures	705	-	-	705
Total liabilities at fair value through profit or loss	**7,313**	**4,350**	**-**	**11,663**

3. Fair value measurement disclosures

The following table analyses within the fair value hierarchy the Fund's assets and liabilities measured at fair value at 31 December 2011.*

	Level 1	Level 2	Level 3	Total balance
Assets				
Financial assets held for trading:				
Equity securities				
Eurozone				
Industrial	6,523	-	-	6,523
Other	491	-	-	491
United States				
Information technology	10,685	-	-	10,685
Financials	11,244	-	-	11,244
Health care	6,572	-	-	6,572
Derivatives				
Listed options	700	-	-	700
Listed futures	600	-	-	600
Debt securities				
US Treasury bills	1,000	-	-	1,000
Eurozone sovereign	1,401	4,000	-	5,401
Sub total	**39,216**	**4,000**	**-**	**43,216**
Financial assets designated at fair value through profit or loss at inception:				
Equity securities				
United States				
Consumer staples	12,438	3,600	306	16,344
Energy	3,745	5,077	-	8,822
Consumer discretionary	6,337	-	-	6,337
Other sectors	8,112	-	-	8,112
Debt securities				
Eurozone Sovereign	8,299	-	-	8,299
United States corporate	-	501	85	586
Sub total	**38,931**	**9,178**	**391**	**48,500**
Total assets	**78,147**	**13,178**	**391**	**91,716**
Liabilities				
Financial liabilities held for trading:				
Equity securities sold short				
United States				
Consumer staples	4,850	4,350	-	9,200
Derivatives				
Listed options	318	-	-	318
Listed futures	220	-	-	220
Total liabilities	**5,388**	**4,350**	**-**	**9,738**

3. Fair value measurement disclosures

Investments whose values are based on quoted market prices in active markets, and are therefore classified within Level 1, include active listed equities, exchange traded derivatives, US government treasury bills and certain non-US sovereign obligations. The Fund does not adjust the quoted price for these instruments.

Financial instruments that trade in markets that are not considered to be active but are valued based on quoted market prices, dealer quotations or alternative pricing sources supported by observable inputs are classified within Level 2. These include investment-grade corporate bonds and certain non-US sovereign obligations, listed equities and over-the-counter derivatives. As Level 2 investments include positions that are not traded in active markets and/or are subject to transfer restrictions, valuations may be adjusted to reflect illiquidity and/or non-transferability, which are generally based on available market information.

Investments classified within Level 3 have significant unobservable inputs, as they trade infrequently. Level 3 instruments include private equity and corporate debt securities. As observable prices are not available for these securities, the Fund has used valuation techniques to derive the fair value.

(b) Level 3 valuations are reviewed on a weekly basis by the Fund’s valuation committee who report to the Board of Directors on a monthly basis. The committee considers the appropriateness of the valuation model inputs, as well as the valuation result using various valuation methods and techniques generally recognised as standard within the industry. In selecting the most appropriate valuation model the committee performs back testing and considers which model’s results have historically aligned most closely to actual market transactions.

(c) The Level 3 equity that amounts to €7,298 consists of private equity positions. The Fund utilises comparable trading multiples in arriving at the valuation for these positions. Management determines comparable public companies (peers) based on industry, size, developmental stage and strategy. Management then calculates a trading multiple for each comparable company identified. The multiple is calculated by dividing the enterprise value of the comparable company by its earnings before interest, taxes, depreciation and amortisation (EBITDA). The trading multiple is then discounted for considerations such as illiquidity and differences between the comparable companies based on company-specific facts and circumstances.

(d) & (e) The Level 3 debt that amounts to €600 consists of US corporate debt positions. The Fund values these instruments using the net present value of estimated future cash flows. The Fund also considers other liquidity, credit and market risk factors, and adjusts the valuation model as deemed necessary.

Description	Fair value at 31 Dec 2012	Valuation Technique	Unobservable Inputs	Weighted average input *	Reasonable possible shift +/- (absolute value)	Change in Valuation +/-
US equity securities: − Consume staples	7,298	Comparable trading multiples	EBITDA multiple	9.5	1	605/(605)
			Discount for lack of marketability	10%	5%	(405)/405
			Control premium	12%	6%	487/(487)
Debt securities: − US corporate	600	Discounted cash flows	Cost of capi al	10%	2%	(24)/24
			Probability of default	15%	10%	(75)/75

The change in valuation disclosed in the above table shows the direction an increase or decrease in the respective input variables would have on the valuation result. For equity securities, increases in the EBITDA multiple and control premium inputs would each lead to an increase in estimated value. However, an increase in the discount for lack of marketability would lead to a decrease in value. For debt securities, increases in cost of capital and probability of default would both lead to a decrease in estimated value**.

No interrelationships between unobservable inputs used in the Fund’s valuation of its Level 3 equity investments have been identified. However, for Level 3 debt securities, a change in the assumption used for the probability of default is expected to be accompanied by a directionally similar change in the cost of capital***.

A sensitivity analysis for Level 3 positions was not presented in the prior year, as it was deemed that the impact of reasonable changes in inputs would not be significant.

3. Fair value measurement disclosures

(f) The following table presents the transfers between levels for the year ended 31 December 2012.

	Level 1	Level 2	Level 3
Transfers between Levels 1 and 2:			
US equities securities			
Financial sector	(2,200)	2,200	-
Consumer discretionary	(3,520)	3,520	-
Transfers between Levels 2 and 3:			
United States corporate	-	(450)	450

The equity securities transferred out of Level 1 relate to positions whose trading was inactive as at 31 December 2012 but was actively traded on 31 December 2011. The debt transferred from Level 2 to Level 3 relates to a single corporate debt security whose issuer experienced financial difficulty during the year. This ultimately resulted in a halt in trading activity on all of its issued debt instruments. The valuation inputs for this security were not therefore based on market observable inputs and resulted in the reclassification to Level 3.

The following table presents the transfers between levels for the year ended 31 December 2011.

	Level 1	Level 2	Level 3
Transfers between Levels 1 and 2:			
US equities securities			
Consumer staples	(525)	525	-
Consumer discretionary	1,012	(1,012)	-
Transfers between Levels 2 and 3:			
United States corporate	-	(600)	600

The equity securities transferred out of level 1 relate to positions whose trading was inactive as at 31 December 2011 but was actively traded on 31 December 2009. The equity securities transferred into Level 1 relate to positions for which significant trading activity existed on 31 December 2011 but which were only thinly traded on and around 31 December 2009. The transfer from Level 2 to Level 3 relates to corporate debt securities whose issuers experienced significant reductions in trading activity during the year as well as significant credit rating downgrades. The valuation inputs for these securities were not therefore based on market observable inputs and resulted in the reclassification to Level 3.

Transfers between levels of the fair value hierarchy, for the purpose of preparing the above table, are deemed to have occurred at the beginning of the reporting period.

(g) The following table presents the movement in level 3 instruments for the year ended 31 December 2012 by class of financial instrument.

	US equity securities – consumer staples	US corporate debt	Total
Opening balance	**306**	**85**	**391**
Purchases	6,500	-	6,500
Sales	(850)	(20)	(870)
Transfers into Level 3	-	450	450
Net gains/(losses) recognised in other net changes in fair value on financial assets and financial liabilities at fair value through profit or loss	1,342	85	1,427
Closing balance	**7,298**	**600**	**7,898**
Change in unrealised gains or losses for Level 3 assets held at year end and included in other net changes in fair value on financial assets and financial liabilities at fair value through profit or loss	1,292	80	1,372

The following table presents the movement in Level 3 instruments for the year ended 31 December 2011 by class of financial instrument.

	US equity securities – consumer staples	US corporate debt	Total
Opening balance	**-**	**-**	**-**
Purchases	450	-	450
Sales	(150)	(400)	(550)
Transfers into Level 3	-	600	600
Net gains/(losses) recognised in other net changes in fair value on financial assets and financial liabilities at fair value through profit or loss	6	(115)	(109)
Closing balance	**306**	**85**	**391**
Change in unrealised gains or losses for Level 3 assets held at year end and included in other net changes in fair value on financial assets and financial liabilities at fair value through profit or loss *	4	(25)	(109)

3.28 What types of assets and liabilities would be recognised at fair value on a non-recurring basis?

Assets classified as held for sale in accordance with IFRS 5 will be measured at fair value less costs to sell. This would be categorised as a non-recurring fair value measurement. It is likely that most funds will only have recurring fair value measurements.

4. Risk disclosures

a) General requirements

An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period [IFRS 7 paragraph 31]. The disclosures required focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, liquidity risk and market risk [IFRS 7 paragraph 32]. Providing qualitative disclosures in the context of quantitative disclosures enables users to link related disclosures and hence form an overall picture of the nature and extent of risks arising from financial instruments [IFRS 7 paragraph 32A].

Qualitative and quantitative disclosures are required. Accordingly, for each type of risk arising from financial instruments, an entity shall disclose:

- the exposures to risk and how they arise and its objectives, policies and processes for managing the risk and the methods used to measure the risk (qualitative disclosure) [IFRS 7 paragraph33];
- summary quantitative data about its exposure to that risk at the end of the reporting period (quantitative disclosures) [IFRS 7 paragraph 34 (a)].

The quantitative disclosure shall be based on the information provided internally to key management personnel of the entity [IFRS 7 paragraph 34(a)]. When an entity uses several methods to manage a risk exposure, the entity shall disclose information using the method or methods that provide the most relevant and reliable information [IFRS 7 App B7].

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

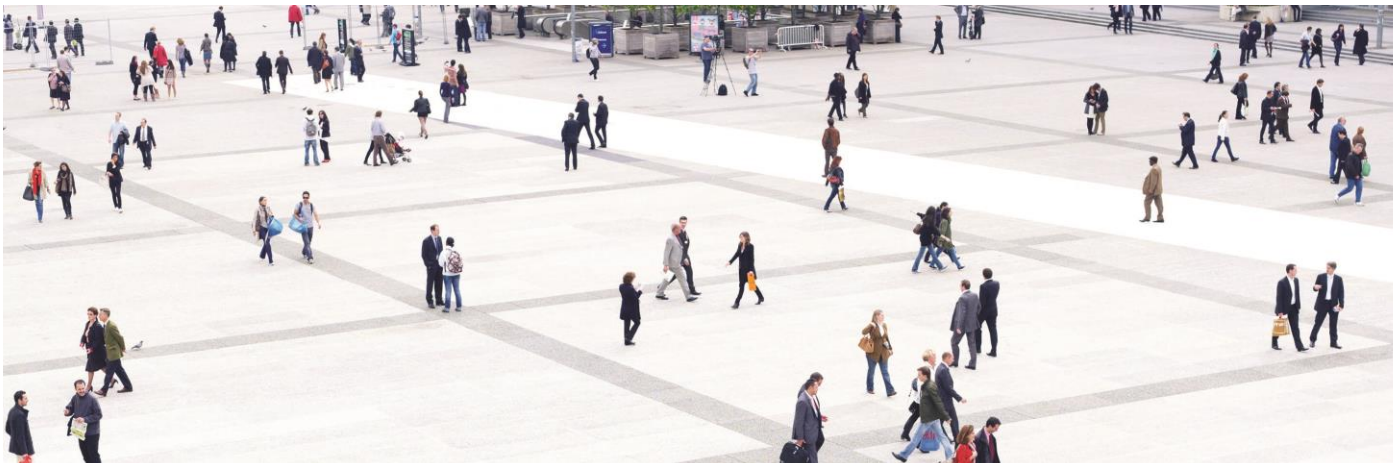
4.1 How should a fund with two distinct investment portfolios (for example, a bond portfolio and an equity portfolio) present its risk disclosures required by IFRS 7 paragraph 34(a) if management monitors each portfolio separately?

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

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

A fund with two distinct investment portfolios could provide the minimum disclosures on a consolidated (combined) basis for the bond portfolio and the equity portfolio. All disclosures should normally be provided on a consolidated basis in accordance with IFRS 10 paragraph 21 and IFRS 10 App B86(c), unless there is a specific exception (such as for those disclosures that are based on management's reporting).

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

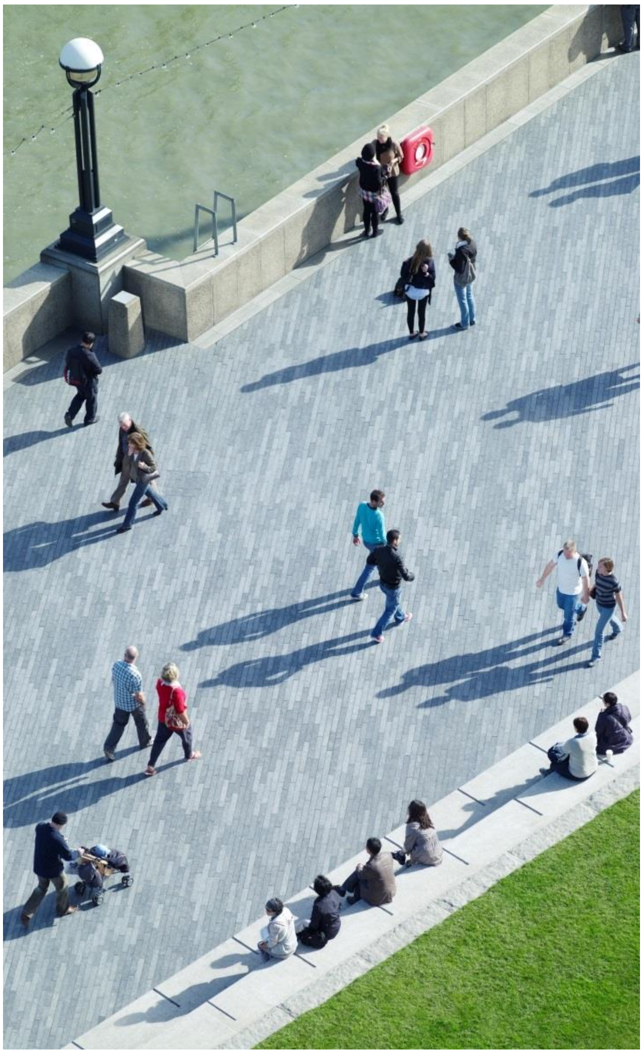


4.3 Fund A and Fund B have similar portfolio compositions investing solely in stocks included in the S&P 500 stock index. Fund A's management follows a 'top-down' approach when selecting investments, deciding first how much of the fund's portfolio to allocate to different industry sectors, then deciding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

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

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

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



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

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

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

4.6 Should an entity, in the following situations, disclose additional information that is representative of an entity's exposure to risk during the period in addition to disclosure of period-end positions (IFRS 7 paragraph 35)?

(a) Investment entity A held a significant amount of US sub-prime debt for an insignificant portion of the year, which resulted in large losses. For the remainder of the year and at year end, investment entity A held virtually no sub-prime debt.

(b) Investment entity B held a significant amount of US sub-prime debt for a significant portion of the year; however, by year end it held virtually no sub-prime debt.

(c) Investment entity C has liquidated its equity investments during the period in anticipation of redeeming all shareholders as part of an orderly wind up. As at the reporting date, investment entity C has investments in cash only.

(d) Investment entity D operated as a feeder fund into a master fund for a significant portion of the year. Investment entity D then reorganised itself into a fund of fund investing directly into a portfolio of other investment entities that it was previously exposed to indirectly via its investment in the master fund.

(e) Investment entity E traded some equity index derivatives during the period; however, it held no such derivatives at year end. The net profit and loss from such trading during the period was insignificant; however, for a significant amount of the period the overall exposure from such derivatives was significant to the entity.

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

(a) Investment entity A presents additional disclosure of risk during the period given the significance of the exposure and resultant large losses.

(b) Investment entity B presents additional disclosure of risk (relating to US sub-prime debt) during the period because the positions at year end are not representative of the risks to which the entity was exposed during the period.

(c) Investment entity C presents additional disclosure of risks during the period because during the year the entity was exposed to the risk inherent in the equity investments.

(d) Investment entity D presents additional disclosure of risk during the period although such additional disclosure could simply explain qualitatively the structure prior to the reorganisation if the ultimate exposures are similar if not the same.

(e) Investment entity E presents additional disclosure of risk (relating to the risk associated with equity index derivatives) during the period. This is because it is the actual risk exposures that are relevant when considering compliance with IFRS 7 paragraph 35 rather than how much profit and loss was made from the activity that resulted in the risk exposures.

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

(a) The issuers of debt in which the entity invests are concentrated in the manufacturing and retail sectors.

(b) The debt instruments in which the entity invests are concentrated in the sub-prime market.

(c) The entity invests in the debt of European corporate issuers. At year end, the entity's investments are concentrated in the issuers of an individual country.

(d) The entity invests a significant portion of its funds in the debt of a group of closely related companies.

Yes. Separate disclosure of the concentration of credit risk is required, if the concentration of credit risk is not apparent from other disclosures, such concentrations may arise from:

(a) A concentration of issuers in individual sectors,

(b) Investment in debt of similar credit quality,

(c) Investment in issuers in individual countries or

(d) Investing in a limited number of issuers or groups of closely related issuers.

Disclosure of the concentrations of risk include: a description of how management determines the concentrations, a description of the shared characteristics that identifies each concentration (for example, counterparty, geographical area, currency, market or industry), and the amount of the risk exposure associated with all financial instruments sharing that characteristic [IFRS 7 App B8].

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

4.14 Investment Fund A issues together with its primary financial statements a management report that provides detailed information about how the fund manages risk. In order to avoid double information in the annual report management wishes to incorporate the risk disclosure required by IFRS 7 to be included in the management report rather than to give additional disclosures in the Notes to the financial statements. Is such an approach acceptable?

Yes. IFRS 7 App B6 allows for certain disclosures required by IFRS 7 to be given either in the Notes to the financial statements or in another statement, such as the management commentary or risk report. In order to comply with the IFRS 7 requirements the Notes to the financial statements need to cross-reference to that other statement which needs to be available to users of the financial statements on the same terms as the financial statements and at the same time.

An entity that wishes to apply such a disclosure shall apply this approach for all disclosures required in IFRS 7 paragraph 31 to 42. The exemption is not to be applied to any other disclosure requirement in IFRS 7.

b) Credit risk – credit quality

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

Activities that give rise to credit risk include but are not limited to:

- granting loans to borrowers, entering into transactions that give rise to receivables, and placing deposits with other entities;
- entering into derivative contracts, e.g. foreign exchange contracts, interest rate swaps and credit derivatives;
- granting financial guarantees;
- making a loan commitment that is irrevocable over the life of the facility or is revocable only in response to a material adverse change [IFRS 7 App B10].

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

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

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

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

(a) Only the amount past due (i.e. the instalment not paid when contractually due);

(b) The whole balance which relates to the amount past due; or

(c) The whole balance which relates to the amount past due, including any other balances with the same debtor?

The investment entity shall disclose the whole balance which relates to the amount past due.

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

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

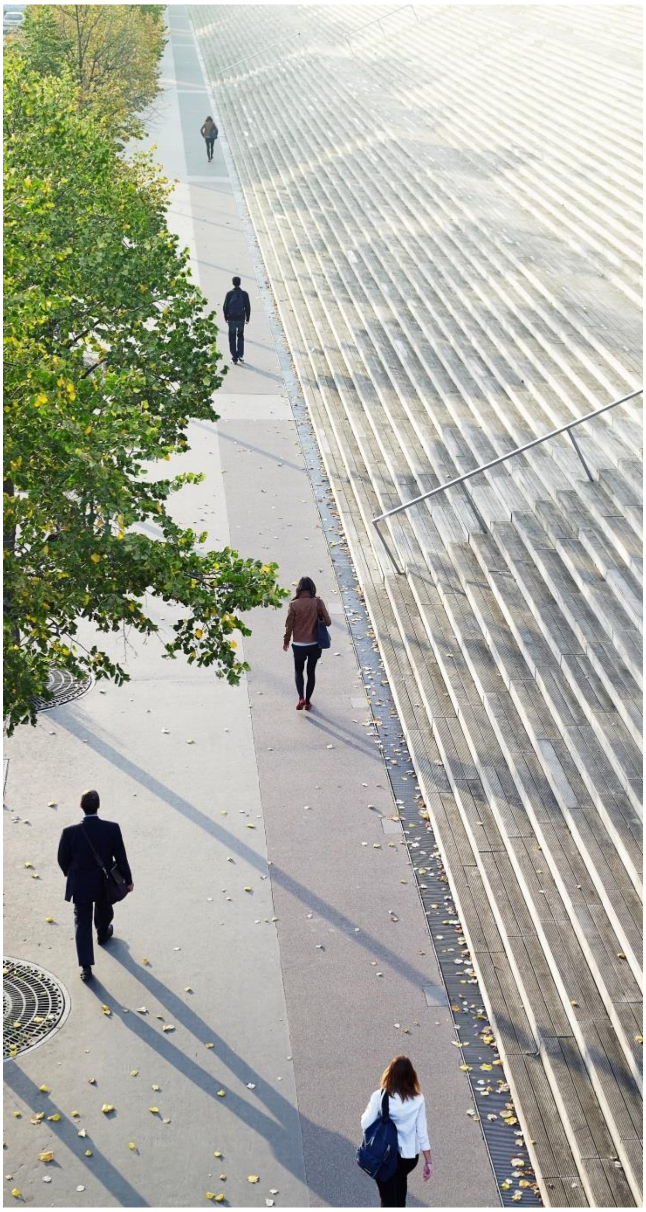
4.17 A private equity fund holds equity investments in other entities. Its management asserts that the IFRS 7 credit risk disclosures [IFRS 7 paragraphs 36 to 38] are not relevant. Do the credit risk disclosures required by IFRS 7 paragraph 36 to 38 apply to an entity's holdings of equity investments?

No, except for the disclosures required by IFRS 7 paragraph 37(b). The definition of equity in IAS 32 requires that the issuer has no obligation to pay cash or transfer other assets. It follows that such equity investments are subject to price risk, not credit risk. Hence, most of the IFRS 7 credit risk disclosures are not relevant to investments in equity instruments.

However, IFRS 7 paragraph 37(b) requires entities to disclose an analysis of financial assets that are impaired. This disclosure is relevant and should be given for impaired equity investments classified as available for sale. (see question (4.18).

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

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



4.19 IFRS 7 paragraph 37(b) states that disclosure includes an analysis of financial assets that are individually determined to be impaired as at the reporting date, including the factors the entity considered in determining that they are impaired.

Consider a situation where a real estate investment fund has EUR 3 million of receivables (i.e. outstanding lease payments) where this amount is categorized into:

(1) EUR 1 million of the receivables have been assessed individually for impairment and based on the conditions stated in IAS 39 paragraphs 58-61, are concluded to be impaired;

(2) EUR 1 million of a collection of insignificant receivables that are individually concluded to be impaired on the basis of the IAS 39 but the impairment calculation is carried out on the EUR m amount for efficiency purposes; and

(3) EUR 1 million of a portfolio of assets for which there is observable data indicating that there is a measurable decrease in the estimated future cash flows from that group of financial assets, although the decrease cannot be identified with individual financial assets [IAS 39 paragraph 59(f)].

Of these three categories, which require disclosure under IFRS 7 paragraph 37(b)?

Both categories (1) and (2) would require disclosure under IFRS 7 paragraph 37(b) as in these categories the receivables are individually assessed for impairment.

The disclosure would not be required for category (3) as in this category the receivable are assessed on a portfolio basis rather than an individual basis. However, actual impairment loss on the portfolio of assets will also have to be disclosed for income statement purposes under IFRS 7 paragraph 20(e).

c) Liquidity risk – maturity analysis

An entity shall disclose a maturity analysis for all non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities (IFRS 7 paragraph 39(a)). The maturity analysis required for derivative financial liabilities 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 (IFRS 7 paragraph 39(b), IFRS 7 App B11B).

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

(a) A derivative for which contractual maturities are essential to an understanding of the timing of the cash flows and which has multiple cash flows?

(b) A ten year loan which has annual contractual interest payments?

(c) A five year loan which has annual contractual interest and principal repayments?

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

4.21 Is a maturity analysis for financial assets required?

IFRS 7 App B11E requires an entity to disclose a maturity analysis of financial assets it holds for managing liquidity risk (for example, financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities), if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk.

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

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

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

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

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

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

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

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

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

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

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

4.26 An investment fund, which is to a significant extent invested in illiquid investments, has issued participating shares redeemable at the discretion of the holders, and classified them as liabilities. Due to significant redemption request received, the management of the fund decided to close the fund for redemptions for the next 6 months and announced that to the investors. In which time band in the maturity analysis should the shares be included if there are restrictions on the redemptions?

The investment contract provides the investment manager with the option to temporary dispense the redemption of the fund units. Therefore, the contractual maturity of the units has changed as a result of the fund's closure. The investment fund discloses the amounts attributable to unit holders in the due after 6 months' time band [IFRS 7 App B11C].

4.27 Investment Manager A's own holding in Mutual Fund B, which he controls, is 45%. The remaining 55% are held by retail clients. Fund B issues only puttable shares which can be put back at any time without any notice period. Based on historic data the average investment period of a retail client is 4 years.

In Investment Manager A's consolidated financial statements Fund B is included as subsidiary according to IAS 27 (or IFRS 10 once effective]. The minority interest of the retail clients is classified as a financial liability.

Can Investment Manager A present the third party interest in consolidated funds which is classified as financial liability in the liquidity analysis using the expected maturity date i.e. the historic average maturity of 4 years?

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

In addition to the disclosure requirements in IFRS 7 paragraph 39(a), the 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 in IFRS 7 paragraph 34(a) and App B10A.

4.28 Private equity fund ABC LP has a contractual maturity of 12 years. The fund presents the paid in capital as a financial liability. The partnership agreement requires ABC LP to make liquidity distributions within 90 days after a private equity investment has been sold. The liquidity distributions include the redemption of a proportionate share of the invested capital.

How should ABC LP present the maturity analysis?

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

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

The investor should include the un-drawn amount of the capital commitment in the earliest period in which the private equity fund may be able to draw it (IFRS 7 App B11C(b)). IFRS 7 App B11D is not relevant as the amount the investor is required to pay in cash is fixed.

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

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

	Gross settled derivatives	Net settled derivatives
*Contractual maturity is **essential** to understanding*	• Disclose pay leg based on contractual maturity • Disclosure of receive leg	• Disclose net cash flows based on contractual maturity
*Contractual maturity is **not essential** to understanding*	• Disclose pay leg either based on contractual maturity or how the risk is managed, e.g. expected maturity • Disclosure of receive leg optional	• Disclose net cash flows either based on contractual maturity or how the risk is managed, e.g. fair value

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

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

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

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

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

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

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

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

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

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

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

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

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

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

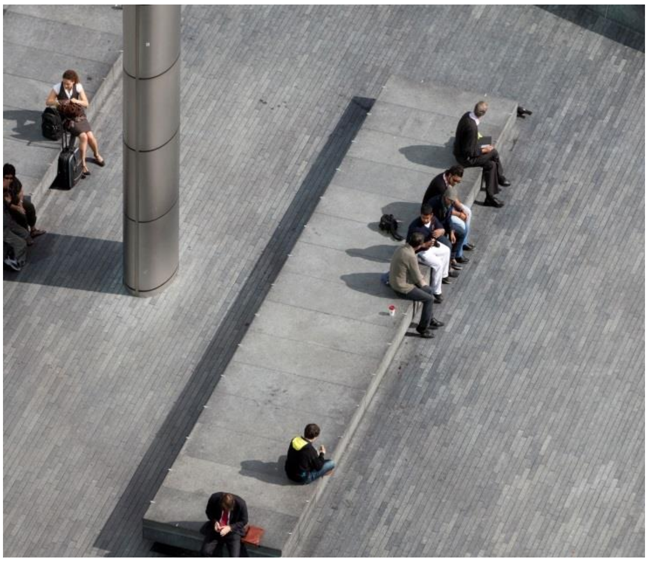
4.36 A private equity fund invests in unlisted securities. These securities are highly illiquid and the private equity fund finds it difficult to find a buyer. Is the fund required to provide additional disclosures because of the lack of liquidity of the investment?

In addition to the disclosure requirements in IFRS 7 paragraph 25 and 26 and IFRS 13 paragraph 93, the 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 in IFRS 7 paragraph 34(a).

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

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

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



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

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

4.38 Should exposure to collateral calls be disclosed?

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

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

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

d) Market risk – sensitivity analysis

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

4.40 Is management required to provide sensitivity analysis on a 'worst case scenario' basis?

No. IFRS 7 paragraph 40(a) requires a sensitivity analysis to show the effect on profit or loss and equity of reasonably possible changes in the relevant risk variable. A reasonably possible change is judged relative to the economic environments in which the entity operates; it does not include remote or 'worst case' scenarios or 'stress test'. Furthermore, entities are not required to disclose the effect for each change within a range of reasonably possible changes of the relevant risk variable. Disclosure of the effects of the changes at the limits of the reasonably possible range would be sufficient [IFRS 7 App B18-19].

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

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

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

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

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

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

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

4. Risk disclosures

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The investment fund uses a value-at-risk (VaR) methodology which reflects interdependencies between risk types for its equity portfolio but manages its bond portfolio using a methodology that reflects each type of market risk.

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

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

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

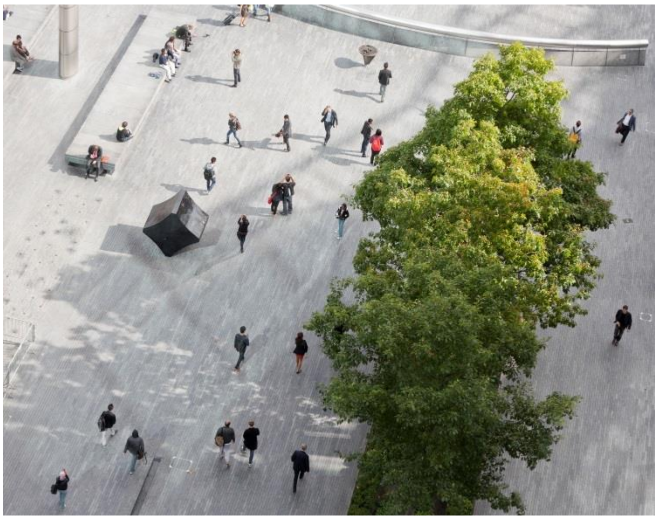
No. In order to use to VAR, or any sensitivity analysis that reflects interdependencies between risk variables, IFRS 7 paragraph 41 specifically states that the entity should use such analysis to 'manage financial risks'. If the entity does not use VAR to manage its financial risks, it cannot use VAR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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

IFRS 7 requires an entity to present a sensitivity analysis for all financial instruments. Fund investments do qualify as financial instruments and therefore a sensitivity analysis needs to be disclosed. The sensitivity can directly be derived from the balance sheet value. If the fair value of the investments would increase by 10% /decrease by 10% then the profit would increase by EUR 1 million / decrease by EUR 1 million.

4.57 A private equity fund (ABC, LP) invests in a number of other funds (referred to as a "Fund of Funds"). The underlying funds invest in a variety of quoted and unquoted portfolio companies spanning multiple industry sectors and geographies. Management manages the portfolio by allocating and reallocating money to specific investment strategies and specific manages within those strategies after performing comprehensive due diligence. As at year end ABC LP invested in 25 funds which could be categorised into 4 major strategies. ABC's investment in the Funds is evidenced by way of limited partnership interests. Management of ABC consider and view ABC's exposure to risk to be to the managers of the underlying funds they invest and to the respective strategies. In assessing that risk, management obtain quarterly overall investment updates and performance figures from the respective underlying managers.

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

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

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

As Management consider and view ABC's exposure to risk to be to the managers of the underlying Funds they invest and to the respective strategies, the sensitivity of the portfolio could be disclosed by Fund strategy. If the relevant risk variable is determined to be Fund strategy, Management should look to provide meaningful disclosure of the sensitivity of ABC LP to movements in the respective strategies. We would also expect Management to disclose qualitative information on the types of risk the Funds, within each strategy, are directly exposed i.e. the inherent risks of each of the Funds within a strategy.

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

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

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

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

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

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

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

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

For example:

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

Buyouts: On the basis that earnings multiples are the key market risk variable impacting the fair value, EF should divide its portfolio into the three industries, determine what a reasonable possible shift of PE multiples would be, by sector, and work out the impact for each investment of applying this variation.

Infrastructure: On the basis that interest rates are the key market risk variable impacting the fair value, EF should consider past variability in the appropriate interest rate and determine a reasonable change, and apply to its DCF calculations.

Industry	Market risk variable	Number of investee companies	Reason-able possible change (%)	Impact on post-tax profit ("000)
Consumer goods	PE multiple	10	2	500
Transportation	PE multiple	4	1,5	350
Technology	PE Multiple	8	4	600
Infrastructure	Interest rates	2	1	200
Total		**24**		**1650**

Note that this question focuses only on the market risk disclosures required by paragraph 40. However, additional disclosures may be required with respect to DCF calculations. IFRS 7 paragraph 27 requires that when a valuation technique is used, disclosure must be made of the assumptions used. If there has been a change in valuation technique, the entity shall disclose that change and the reasons for making it. For fair value measurement in Level 3 of the fair value hierarchy, the entity shall disclose if a change of one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly. Furthermore the disclosure of the effect of those changes is required [IFRS 7 paragraph 27B(e)].

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

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

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

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

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

Additionally, the private equity fund also considers disclosure of risk concentration and/or liquidity risks. IFRS 7 paragraph 34 requires disclosure of quantitative data about concentrations of risk [IFRS 7 IG 18] and IFRS 7 paragraph 39(c) requires the entity to describe how it manages the liquidity risk inherent in the maturity analysis of financial liabilities. The following additional disclosures might be considered:

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

5. Reclassification of financial assets

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

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

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

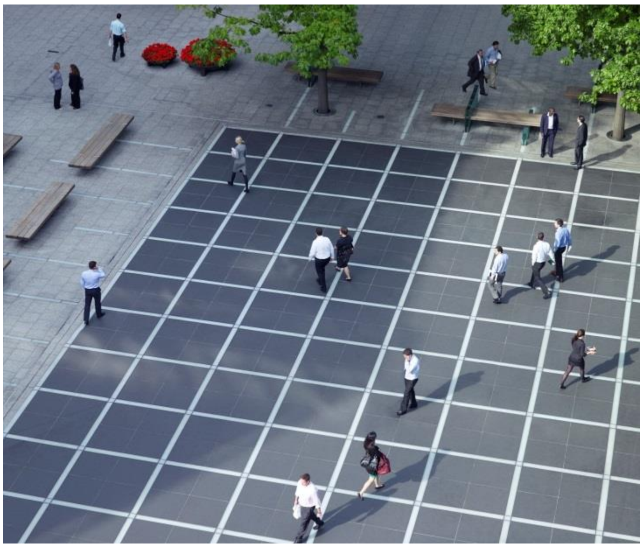
No. Only non-derivative financial assets classified as held for trading can be considered for reclassification out of the fair value through profit or loss category.

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

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

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

No. Loan commitments in the scope of IAS 39 meet the definition of a derivative and are therefore prohibited from being reclassified under this amendment as per IAS 39.50(a).



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

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

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

5.5 IAS 1.122 requires disclosure of critical accounting judgments. Should an entity treat a decision to reclassify financial assets under the IAS 39 reclassifications amendment as a critical accounting judgment and provide the disclosure required by IAS 1.122?

It depends. Where significant judgment was involved and the impact on financial statements is significant the disclosure required by IAS 1.122 should be made. In this case, the significant judgment note should include a cross reference to relevant information presented elsewhere in the financial statements (for example, as part of IFRS 7 reclassification disclosure). If the effect on the financial statements is not significant, the IAS 1.122 disclosure may not be required; however, the reclassification disclosures required by IFRS 7 paragraphs 12A (a)-(f) should still be given.

6. Other disclosure requirements

a) Collateral

An entity shall disclose the carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with paragraph 37(a) of IAS 39 (respective paragraph 3.2.23(a) of IFRS 9) and the terms and conditions relating to its pledge [IFRS 7 paragraph 14].

When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose [IFRS 7 paragraph15]:

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

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

The extent of the disclosures required depends on the terms and conditions relating to the pledge. For all assets pledged the fund is required to disclose the carrying amount and the terms and conditions relating to the pledge [IFRS 7 paragraph 14]. However, if the transferee has the right to sell or repledge the collateral received, the fund is required to disclose the financial assets pledged separate in its statement of financial position [IAS 39 paragraph 37(a); IFRS 9 paragraph 3.2.23(a)].

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

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

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

It depends. If the collateral held is permitted to be sold or repledged in the absence of default by the owner of the collateral, the fair value of the collateral is disclosed [IFRS 7 paragraphs 15(a) and (b)], in addition to qualitative disclosure [IFRS 7 paragraph 15(c)]. If the collateral is not permitted to be sold or repledged, qualitative disclosure and a description of their financial effect (e.g. a quantification of the extent to which collateral and other credit enhancements mitigate credit risk) in respect of the amount that best represents the maximum exposure to credit risk [IFRS 7 paragraph 36(b)].

b) Offsetting financial assets and financial liabilities

An entity shall 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. This includes the effect or potential effect of rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities for all recognised financial instruments that are subject set off in accordance with paragraph 42 of IAS 32 and those recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement irrespective of whether they are set off in accordance with paragraph 42 of IAS 32. (IFRS 7 paragraph 13A). The detailed disclosure requirements are set out in IFRS 7, paragraphs 13B to 13E.

6.4 What types of financial instruments might be within the scope of these disclosures?

- Financial instruments that are offset in accordance with paragraph 42 of IAS 32
- Financial instruments that do not meet the criteria for offset in accordance with paragraph 42 of IAS 32 and that are subject to an enforceable master netting agreement
- Financial instruments that do not meet the criteria for offset in accordance with paragraph 42 of IAS 32 and are subject to 'similar agreements that cover similar financial instruments and transactions' – these might include:

Similar agreements	Similar financial instruments and transactions
• Derivatives clearing agreements, • Global master repurchase agreements, • Global master securities lending agreements; and • Any related rights to financial collateral	• Derivatives, • Sale and repurchase agreements, • Reverse sale and repurchase agreements; and • Securities borrowing and securities lending agreements.

6.5 ABC Fund has the following financial instruments

- **Counterparty A - derivative asset (fair value EUR100 million) and a derivative liability (fair value EUR80 million) that meet the offsetting criteria in paragraph 42 of IAS 32. Cash collateral has also been received from Counterparty A for apportion of the net derivative asset (EUR10 million). The cash collateral 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 - derivative asset (fair value EUR100 million) and a derivative liability (fair value EUR80 million) 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. Cash collateral has also been received from Counterparty A for the net amount of the derivative asset and derivative liability (EUR20 million). The cash collateral 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 fund entered into a sale and repurchase agreement with Counterparty C that is accounted for as collateralised borrowing. The carrying amount of the financial assets used as collateral and posted by the fund for the transaction is EUR79 million and their fair value is EUR 85 million. The carrying amount of the collateralised borrowing (repo payable) is EUR 80 million. The fund has also entered into a reverse sale and repurchase agreement with Counterparty C that is accounted for as collateralised lending. The fair value of the financial assets received as collateral (and not recognised in the fund statement of financial position) is EUR 105 million. The carrying amount of the collateralised lending (reverse repo receivable) is EUR 90 million. The transaction are subject to a global master repurchase agreement with a right of set off only in default or bankruptcy and therefore do not meet the offsetting criteria in paragraph 42 of IAS 32.**

- **How might the disclosures required by IFRS 7 paragraphs 13C(a)-(e) be presented in the financial statements of ABC Fund?**

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements. (disclosures required by IFRS 13C(a)-(e) by type of financial instrument)

EUR million – At 31 December 2013

(a)	(b)	(c)=(a)-(b)	(d)		(e)=(c)-(d)	
			Related amounts not set off in the statement of financial position			
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	(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral received	Net amount	
Derivatives	200	(80)	120	(80)	(30)	10
Reverse repurchase, securities borrowing and similar agreements	90	-	90	(90)	-	-
Total	**290**	**(80)**	**210**	**(170)**	**(30)**	**10**

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements.(disclosures required by IFRS 13C(a)-(e) by type of financial instrument)

EUR million – At 31 December 2013

	(a)	(b)	(c)=(a)-(b)	(d)		(e)=(c)-(d)
				Related amounts not set off in the statement of financial position		
	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	(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral pledged	Net amount
Derivatives	160	(80)	80	(80)	-	-
Reverse repurchase, securities borrowing and similar agreements	80	-	80	(80)	-	-
Total	**240**	**(80)**	**160**	**(160)**		

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements. (disclosures required by IFRS 13C(c)-(e) by counterparty)

EUR million – At 31 December 2013

	(c)=(a)-(b)	(d)		(e)=(c)-(d)
		Related amounts not set off in the statement of financial position		
	Net amounts of financial assets presented in the statement of financial position	(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral pledged	Net amount
Counterparty A	20	-	(10)	10
Counterparty B	100	(80)	(20)	-
Counterparty C	90	(90)		
Total	**210**	**(170)**	**(30)**	**10**

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements. (disclosures required by IFRS 13C(c)-(e) by counterparty)

EUR million – At 31 December 2013

	(c)=(a)-(b)	(d)		(e)=(c)-(d)
		Related amounts not set off in the statement of financial position		
	Net amounts of financial liabilities presented in the statement of financial position	(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral pledged	Net amount
Counterparty A	-	-	-	-
Counterparty B	80	(80)	-	-
Counterparty C	80	(80)		
Total	**160**	**(160)**		

6.6 If a reporting entity is party to a contract whereby the counterparty has the right of offset in the event of default of the reporting entity, but under which the reporting entity does not have the right of offset in any circumstance, would the contract be captured within the scope of the disclosure requirements?

No. The standard was written from the perspective of the reporting entity and requires disclosure that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities, on the entity's financial position [IFRS7pIN9]. Paragraph BC24V in the basis of conclusions further indicates that an objective of the standard was to allow preparers to present disclosures in the same way that they manage their credit exposure. In the above scenario the reporting entity will always be obligated to settle gross with the counterparty and the fact that the counterparty has the ability to choose net settlement in the event of the reporting entity's default does not affect the credit risk to which the reporting entity is exposed.

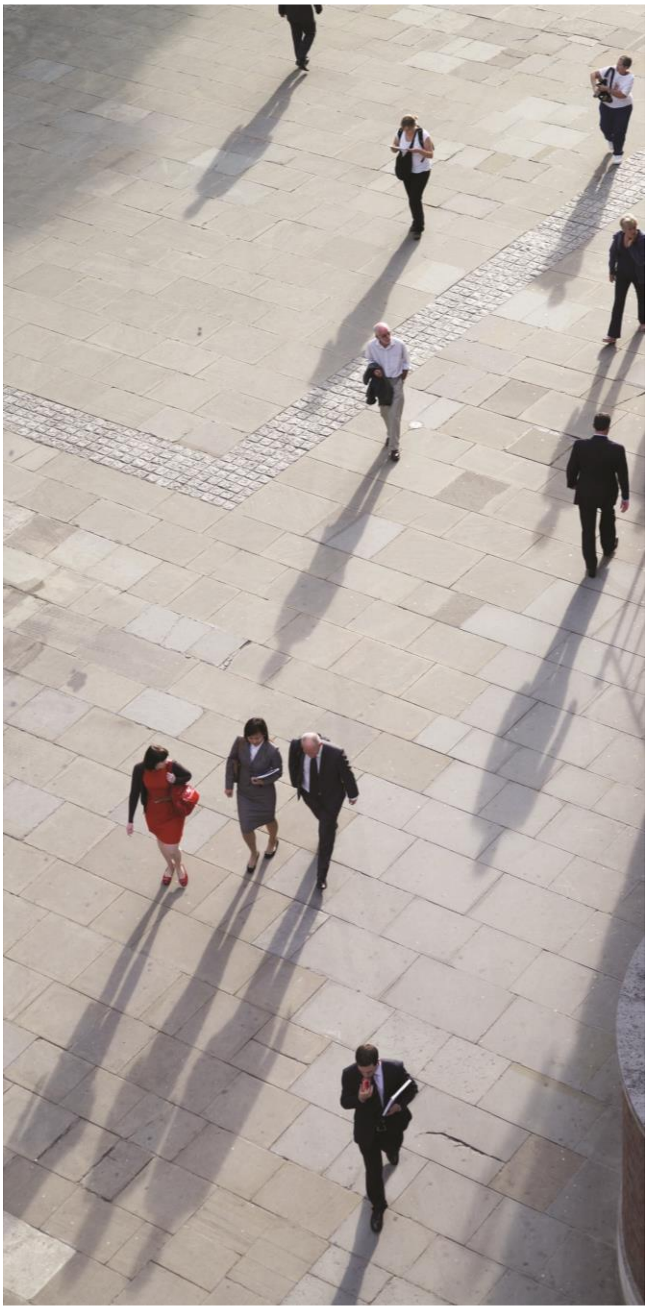
6.7 Fund A (the "Fund") has entered into an agreement with Broker X (the "Broker") whereby the Fund will trade securities through its brokerage account and will also maintain deposit and overdraft balances with Broker X. Unsettled trades will result in due to and due from balances recognised in the statement of financial position of the Fund. Per the terms of the agreement, the Broker will hold a general lien against all assets of the Fund held in the brokerage account. All receivable and payable balances are required to be settled on a gross basis and the ability to set-off for both parties only exists in the event of default. The Fund does not have any derivative clearing, repurchase or security lending/borrowing arrangements in place with Broker X that are governed by this agreement. Will this Broker Agreement be considered to be a master netting arrangement or similar agreement per IFRS7p13A and therefore be subject to the offsetting disclosures of the IFRS 7 amendment?

Yes. While US GAAP specifically issued a scope amendment to its equivalent standard clarifying the scope and excluding trade payables and receivables, the IASB has not. In the absence of such clarification, it is understood that the scope under IFRS therefore remains as defined in the Amendments to IFRS 7, issued in December 2011 and is therefore arguably broader scope than the US GAAP equivalent in that trade payables and receivables will likely be within scope providing the reporting entity has the right of set of.

c) Transfer of financial assets and financial liabilities

IFRS 7 paragraph 42B to 42H outlines the disclosures required for all transferred financial assets that are not derecognised and for any continuing involvement in a transferred asset existing at the reporting date. Such disclosure should be given irrespective of whether the transfer transaction occurred in previous years [IFRS 7 paragraph 42 A].

An entity shall disclose information that enables users of its financial statements to understand the relationship between the transferred financial assets that are not derecognised in their entirety and the associated liabilities and to evaluate the nature of the risks associated with the entity's continuing involvement in the derecognised financial assets [IFRS 7 paragraph 42B].



d) Other quantitative disclosures

An entity shall disclose the quantitative information on several items of income, expense, gains or losses either on the face of the financial statements or in the notes.

6.8 Shall interest income, interest expense and dividend income on financial instruments at fair value through profit or loss be reported as part of net gains or net losses on these financial instruments in accordance with IFRS 7 paragraph 20(a) or disclosed separately as part of interest income, interest expense or dividend income?

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

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

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

However, separate disclosure of interest income, interest expenses and dividends is required by other standards:

IAS 18 paragraph 35(b)(iii) requires entities to disclose the amount of interest, if significant. The same applies to dividend income [IAS 18 paragraph 35(b)(v)]. Thus, if dividend income is reported as part of net gains or net losses on financial instruments at fair value through profit or loss, the amount of dividend income on financial assets at fair value through profit or loss shall be disclosed in the notes as part of the disclosure of the dividend income recognised during the period.

Further disclosure is required by IFRS 7 paragraph 20(b) and (d).

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

- **net gains/losses per category of financial assets and liabilities;**
- **total interest income and total interest expense for financial assets not at fair value through profit or loss;**
- **fee income and expense arising from financial assets measured at amortised cost or financial liabilities that are not at fair value through profit or loss and from trust and other fiduciary activities;**
- **interest income on impaired assets;**
- **the amount of any impairment loss for each class of financial assets.**

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

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

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

6.10 Investment Manager X is acting as manager for funds as well as for individuals. Investment Manager X receives a management fee of EUR 10 million. The assets under management of X are EUR 1.5 billion.

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

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

Even though there is no requirement in IFRS 7 to disclose the assets under management, such a disclosure would be very helpful to readers of the accounts as it would give an indication of the extent of those fiduciary activities. However, the disclosure of the assets under management might be required by some jurisdictions.

In addition to that, IFRS 12 requires additional disclosures for interests in consolidated and unconsolidated structured entities. Where an investment fund meets the definition of a structured entity in IFRS 12 Appendix A, disclosure e.g. on the size and activities of the investment funds managed by the investment manager may be required [for example: IFRS 12 paragraph 26].

6.11 Investment Manager A is managing investment funds sold to retail and institutional investors. To sell the fund Investment Manager A employed an independent financial advisor and pays a trail commission of x% of the relevant net asset value.

Should Investment Manager A disclose the trail commission paid as fee expense from fiduciary capacity?

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

6.12 Investment Management Company A is managing investment funds sold to retail and institutional investors. For managing the funds A employs several fund managers. Each of the fund managers receives a fixed payment and in addition to that if the performance of the fund exceeds a defined benchmark a bonus of 10% of the performance fee the Investment Management Company receives.

Should Investment Management Company A disclose the remuneration of the fund managers as fee expenses from fiduciary capacity?

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

Contacts

This publication has been prepared by the Global IFRS Asset Management Industry Accounting Group:

Australia	*Luxembourg*
Craig Cummins +61 2 826 67937 craig.cummins@au.pwc.com	**Marc Minet** +352 494848 6113 marc.minet@lu.pwc.com

Canada	*Hong Kong*
Derek Hatoum +1 416 869 8755 derek.hatoum@ca.pwc.com	**Josephine Kwan** +852 2289 1203 josephine.wt.kwan@hk.pwc.com

Cayman Islands	*Ireland*
Paul Donovan +1 345 914 8676 paul.donovan@ky.pwc.com	**Jonathan O'Connell** +353 1 792 8737 jonathan.oconnell@ie.pwc.com

Channel Islands	*UK*
Roland Mills +44 1481 752 048 roland.c.mills@gg.pwc.com	**Richard McGuire** +44 207 212 5838 richard.mcguire@uk.pwc.com

Germany	*US*
Anita Dietrich +49 69 9585 2254 anita.dietrich@de.pwc.com	**Christopher R. May** +1 973 236 5729 christopher.r.may@us.pwc.com

www.pwc.ie