10 November 2008

To: Members of the Hong Kong Institute of CPAs
   All other interested parties

INVITATION TO COMMENT ON IASB EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO IFRS 7 – IMPROVING DISCLOSURES ABOUT FINANCIAL INSTRUMENTS

Comments to be received by 28 November 2008

The Hong Kong Institute of Certified Public Accountants’ (Institute) Financial Reporting Standards Committee (FRSC) is seeking comments on the IASB Exposure Draft which has been posted on the Institute’s website at: www.hkicpa.org.hk/professionaltechnical/accounting/exposedraft/content.php.

The Exposure Draft forms part of the IASB’s response to the credit crisis and follow recommendations of the Financial Stability Forum. The Exposure Draft also reflects discussions by the IASB’s Expert Advisory Panel on measuring and disclosing fair values of financial instruments when markets are no longer active.

The Exposure Draft proposes:

- to enhance disclosures about fair value measures, particularly for those that use the most subjective inputs; and
- to improve disclosures about liquidity risk to address current diversity in practice in interpretation of these disclosure requirements, including proposing quantitative disclosures for derivative liabilities based on how liquidity risk is actually managed.

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A summary of the main proposals in the Exposure Draft is set out in the Appendix.

In accordance with the Institute’s Convergence Due Process, comments are invited from any interested party. The FRSC would like to hear from both those who do agree and those who do not agree with the proposals contained in the IASB Exposure Draft.

Comments should be supported by specific reasoning and should be submitted in written form.

To allow your comments on the IASB Exposure Draft to be considered, they are requested to be received by the Institute on or before 28 November 2008.

Comments may be sent by mail, fax or e-mail to:

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Comments will be acknowledged and may be made available for public review unless otherwise requested by the contributor.
Summary of the main proposals in the Exposure Draft

(1) Fair Value Measurement Disclosures

(a) Introduction of a Fair Value Hierarchy

The Exposure Draft proposes disclosure requirements for fair value measurements using a three-level fair value hierarchy that reflects the significance of the inputs used in measuring fair values. The proposed fair value hierarchy is made up of the following levels:

(i) quoted prices in active markets for the same instrument (that is, without modification or repackaging) (Level 1);

(ii) quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data (Level 2); and

(iii) valuation techniques for which any significant input is not based on observable market data (Level 3).

For the purposes of the fair value hierarchy, a significant input is an input that is significant to the fair value measurement in its entirety. Assessing the significance of a particular input requires judgement.

(b) Fair Value Measurement Disclosures about Financial Instruments

The Exposure Draft proposes that for fair value measurements recognised in the statement of financial position, an entity disclose, for each class of financial instruments, the level in the fair value hierarchy into which the fair value measurements are categorised in their entirety. In addition, the Exposure Draft proposes disclosure of movements between levels in the fair value hierarchy from period to period and the reasons for such movements.

An entity shall provide the information required in tabular format unless another format is more appropriate. In addition, an entity shall disclose any other information that is necessary for users to evaluate the quantitative information disclosed.

An entity shall also disclose the fair value, by level of the fair value hierarchy into which the financial instruments are categorised in their entirety, of the financial instruments or the classes of financial instruments that are not measured at fair value in the statement of financial position.

(c) Specific Level 3 Fair Value Measurement Disclosures

The Exposure Draft proposes specific disclosure requirements when fair value measurements are categorised as Level 3 in the fair value hierarchy. A reconciliation shall be disclosed for each class of financial instruments from the beginning balances to the ending balances, disclosing separately changes during the period attributable to the following:

(i) total gains or losses for the period (realised and unrealised) recognised in profit or loss, and a description of where they are presented in the statement of comprehensive income;

(ii) total gains or losses recognised in other comprehensive income;
(iii) purchases, sales, issues and settlements (net); and

(iv) transfers into and/or out of Level 3 category (for example, transfers attributable to changes in the observability of market data).

The Exposure Draft also proposes, for each class of financial instruments in the Level 3 category, disclosure of the total amount of unrealised gains or losses for the period included in profit or loss relating to assets and liabilities held at the end of the reporting period and where they have been presented in the statement of comprehensive income.

In addition, the Exposure Draft proposes enhancing existing requirements in IFRS 7 by requiring disclosure, for each class of financial instruments, of the effect, if significant, on the fair value measurement of one or more of the inputs used in the fair value measurement is changed to a reasonably possible alternative assumption. For this purpose, significance shall be judged with respect to profit or loss, and total assets or total liabilities, or, when changes in fair value are recognised in other comprehensive income and total equity.

(2) Liquidity Risk Disclosures

The Exposure Draft amends the definition of liquidity risk and thus requires liquidity risk disclosures only for financial liabilities that are settled by delivering cash or another financial asset.

The Exposure Draft proposes that for derivative financial liabilities an entity shall disclose a maturity analysis based on how the entity manages the liquidity risk associated with such liabilities.

For non-derivative financial liabilities, the Exposure Draft proposes that for those entities that manage liquidity risk for those financial liabilities based on expected maturities, they shall disclose the remaining expected maturities in addition to the contractual maturities disclosure.

The Exposure Draft also proposes to include additional disclosure over how the estimates in the maturity analysis for both derivative and non-derivative financial liabilities are determined. If the estimated cash flows included in the maturity analysis could either occur significantly earlier than indicated in the maturity analysis, or at significantly different amounts, the entity shall disclose this fact and provides further quantitative information to enable users to evaluate the extent of this risk.

In respect of disclosure requirements of how an entity manages the liquidity risk inherent in financial liabilities, the entity shall disclose a maturity analysis of financial assets it holds for managing liquidity risk.