

Chapter 9

HKFRS 7 “Financial Instruments: Disclosures”

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¶19-100 Introduction

In recent years, the techniques used by entities for measuring and managing exposure to risks arising from financial instruments have evolved and new risk management concepts and approaches have gained acceptance. It is generally believed that users of financial statements need information about an entity’s exposure to risks and how those risks are managed.

The objective of HKFRS 7 “Financial Instruments: Disclosures” is to require entities to provide disclosures in their financial statements that enable users to evaluate (para 1):

- (a) the significance of financial instruments for the entity’s financial position and performance; and
- (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

HKFRS 7 shall be applied by all entities to all types of financial instruments, except for (para 3):

- (a) those interests in subsidiaries, associates, or joint ventures that are accounted for under HKFRS 10 “Consolidated Financial Statements”, HKAS 27 “Separate Financial Statements”, or HKAS 28 “Investments in Associates and Joint Ventures”. However, in some cases, HKFRS 10, HKAS 27 or HKAS 28 require or permit an entity to account for an interest in a subsidiary, associate or joint venture using HKFRS 9; in those cases, entities shall apply the requirements of HKFRS 7 and, for those measured at fair value, the requirements of HKFRS 13 “Fair Value Measurement”. HKFRS 7 also applies to

all derivatives linked to interests in subsidiaries, associates or joint ventures unless the derivative meets the definition of an equity instrument in HKAS 32 “Financial Instruments: Presentation”;

- (b) employers’ rights and obligations under employee benefit plans, to which HKAS 19 “Employee Benefits” applies;
- (c) [deleted]
- (d) insurance contracts as defined in HKFRS 17 “Insurance Contracts” or investment contracts with discretionary participation features within the scope of HKFRS 17. However, HKFRS 7 applies to:
 - (i) derivatives that are embedded in contracts within the scope of HKFRS 17, if HKFRS 9 requires the entity to account for them separately.
 - (ii) investment components that are separated from contracts within the scope of HKFRS 17, if HKFRS 17 requires such separation, unless the separated investment component is an investment contract with discretionary participation features.
 - (iii) an issuer’s rights and obligations arising under insurance contracts that meet the definition of financial guarantee contracts, if the issuer applies HKFRS 9 in recognising and measuring the contracts. However, the issuer shall apply HKFRS 17 if the issuer elects, in accordance with para 7(e) of HKFRS 17, to apply HKFRS 17 in recognising and measuring the contracts.
 - (iv) an entity’s rights and obligations that are financial instruments arising under credit card contracts, or similar contracts that provide credit or payment arrangements, that an entity issues that meet the definition of an insurance contract if the entity applies HKFRS 9 to those rights and obligations in accordance with para 7(h) of HKFRS 17 and para 2.1(e)(iv) of HKFRS 9.
 - (v) an entity’s rights and obligations that are financial instruments arising under insurance contracts that an entity issues that limit the compensation for insured events to the amount otherwise required to settle the policyholder’s obligation created by the contract, if the entity elects, in accordance with para 8A of HKFRS 17, to apply HKFRS 9 instead of HKFRS 17 to such contracts.
- (e) financial instruments, contracts and obligations under share-based payment transactions covered under HKFRS 2 “Share-based Payment”, except that HKFRS 7 applies to contracts within the scope of HKFRS 9; and
- (f) instruments that are required to be classified as equity instruments in accordance with paras 16A and 16B or paras 16C and 16D of HKAS 32 “Financial Instruments: Presentation”.

HKFRS 7 shall also be applied to those contracts to buy or sell a non-financial item that are within the scope of HKFRS 9 (para 5).

The credit risk disclosure requirements in paras 35A–35N apply to those rights that HKFRS 15 “Revenue from Contracts with Customers” are accounted for in accordance with HKFRS 9 for the purposes of recognising impairment gains or loss. Any reference to financial assets or financial instruments in these paragraphs shall include those rights unless otherwise specified (para 5A).

The disclosures required by HKFRS 7 may be categorised into:

- (a) accounting disclosures (see 9-300); and
- (b) risk disclosures (see 9-340).

“Supplier Finance Arrangements (Amendments to HKAS 7 Statement of Cash Flows and HKFRS 7 Financial Instruments: Disclosures)” introduce new disclosure requirements to enhance the transparency of supplier finance arrangements and their effects on an entity’s liabilities, cash flows and exposure to liquidity risk in response to investors’ concerns that some entities’ supplier finance arrangements are not sufficiently visible, hindering investors’ analysis. Para B11 of Application Guidance is amended (see ¶9-420). The amendments are effective for annual reporting period beginning on or after 1 January 2024, with early application permitted.

Note:

“Amendments to the Classification and Measurements of Financial Instruments (Amendments to HKFRS 9 and HKFRS 7)” addresses issues identified during the post-implementation review of the classification and measurement requirements of HKFRS 9. The amendments are effective for annual periods beginning on or after 1 January 2026, Details for the amendments will be included in the next update.

¶9-200 Classes of financial instruments and level of disclosure

When HKFRS 7 requires disclosures by class of financial instrument, an entity is required to 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. Sufficient information should be provided to permit reconciliation to the line items presented in the statement of financial position (para 6).

The classes determined by the entity are, thus, distinct from the categories of financial instruments specified in HKFRS 9 (which determine how financial instruments are measured and where changes in fair value are recognised (para B1 of Application Guidance). At a minimum, an entity shall (para B2 of Application Guidance):

- (a) distinguish between those financial instruments that are measured at amortised cost and those that are measured at fair value.
- (b) treat as a separate class or classes those financial instruments that are outside the scope of HKFRS 7 (if the entity provides disclosures regarding such financial instruments in addition to the requirements of HKFRS 7).

It is management's judgement to decide how much detail of information to provide. An entity, however, must strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation (para B3 of Application Guidance).

¶9-300 Accounting disclosures

HKFRS 7 requires an entity to disclose such accounting information so as to enable users of its financial statements to evaluate the significance of financial instruments for its financial position and performance (para 7).

Such accounting information shall be disclosed either in the statement of financial position, statement of profit or loss and other comprehensive income or the notes.

¶9-310 Statement of financial position disclosures

HKFRS 7 requires the following information in relation to statement of financial position items to be disclosed.

Categories of financial assets and financial liabilities

The carrying amounts of each of the following categories, as specified in HKFRS 9, shall be disclosed either in the statement of financial position or in the notes (para 8):

- (a) financial assets measured at fair value through profit or loss, showing separately:
 - (i) those designated as such upon initial recognition or where a credit exposure is subsequently measured at fair value through profit or loss in accordance with para 6.7.1 of HKFRS 9;
 - (ii) those measured as such in accordance with the election in accordance with para 3.3.5 of HKFRS 9;
 - (iii) those measured as such in accordance with the election in accordance with para 33A of HKAS 32; and
 - (iv) those mandatorily measured at fair value through profit or loss in accordance with HKFRS 9 (e.g. financial assets that meet the definition of held for trading in HKFRS 9).

- (b)-(d) [deleted]
- (e) financial liabilities at fair value through profit or loss, showing separately:
 - (i) those designated as such upon initial recognition or where a credit exposure is subsequently measured at fair value through profit or loss in accordance with para 6.7.1 of HKFRS 9; and
 - (ii) those that meet the definition of held for trading in HKFRS 9.
- (f) financial assets measured at amortised cost.
- (g) financial liabilities measured at amortised cost.
- (h) financial assets measured at fair value through other comprehensive income, showing separately:
 - (i) financial assets that are measured at fair value through other comprehensive income in accordance with para 4.1.2A of HKFRS 9 (e.g. debt instruments that are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets — see the Chapter for HKFRS 9); and
 - (ii) investments in equity instruments designated as such upon initial recognition in accordance with para 5.7.5 of HKFRS 9.

These disclosures would assist users in understanding the extent to which accounting policies affect the amounts at which financial assets and financial liabilities are recognised (para BC14 of Basis for Conclusions).

Financial assets at fair value through profit or loss

If the entity has designated a financial asset (or group of financial assets) as measured at fair value through profit or loss that would otherwise be measured at fair value through other comprehensive income or amortised cost, HKFRS 7 requires it to disclose (para 9):

- (a) the maximum exposure to *credit risk* of the financial asset (or group of financial assets) at the end of the reporting period;
- (b) the amount by which any related credited derivatives or similar instruments mitigate that maximum exposure to credit risk;
- (c) the amount of change, during the period and cumulatively, in the fair value of the financial asset (or group of financial assets) that is attributable to changes in the credit risk of the financial asset determined either:
 - (i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk;
 - or

- (ii) using an alternative method that the entity believes to more faithfully represent the amount of change in its fair value attributable to changes in the credit risk of the asset; and
- (d) the amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the financial asset was designated.

Additionally, HKFRS 7 requires the entity to disclose (para 11):

- (a) a detailed description of the methods used to comply with the requirements in para 9(c) above and para 5.7.7(a) of HKFRS 9, including an explanation of why the method is appropriate; and
- (b) if the entity believes that the disclosure it has given, either in the statement of financial position or in the notes, to comply with the requirements in para 9(c) or para 5.7.7(a) of HKFRS 9 does not faithfully represent the change in the fair value of the financial asset attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.

Financial liabilities at fair value through profit or loss

If the entity has designated a financial liability as at fair value through profit or loss in accordance with para 4.2.2 of HKFRS 9 and is required to present the effects of changes in that liability's credit risk in other comprehensive income (see para 5.7.7 of HKFRS 9), HKFRS 7 requires it to disclose (para 10):

- (a) the cumulative change in the fair value of the financial liability that is attributable to changes in credit risk of that liability.
- (b) the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.
- (c) any transfers of the cumulative gain or loss within equity during the period including the reason for such transfers.
- (d) if a liability is derecognised during the period, the amount (if any) presented in other comprehensive income that was realised at derecognition.

If the entity has designated a financial liability as at fair value through profit or loss in accordance with para 4.2.2 of HKFRS 9, and is required to present all changes in the fair value of that liability (including the effects of changes in the credit risk of the liability) in profit or loss (see paras 5.7.7 and 5.7.8 of HKFRS 9), HKFRS 7 requires it to disclose (para 10A):

- (a) the amount of the change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in credit risk of that liability; and

- (b) the difference between the financial liability’s carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

Additionally, HKFRS 7 requires the entity to disclose (para 11):

- (a) a detailed description of the methods used to comply with the requirements in para 10(a) and 10A(a) and para 5.7.7(a) of HKFRS 9, including an explanation of why the method is appropriate;
- (b) if the entity believes that the disclosure it has given, either in the statement of financial position or in the notes, to comply with the requirements in para 10(a) and 10A(a) and para 5.7.7(a) of HKFRS 9 does not faithfully represent the change in the fair value of the financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant; and
- (c) a detailed description of the methodology or methodologies used to determine whether presenting the effects of changes in a liability’s credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss (see paras 5.7.7 and 5.7.8 of HKFRS 9). If an entity is required to present the effects of changes in a liability’s credit risk in profit or loss (see paras 5.7.8 of HKFRS 9), the disclosure must include a detailed description of the economic relationship describe in para B5.7.6 of the Application Guidance of HKFRS 9.

Investments in equity instruments designated at fair value through other comprehensive income

If the entity has chosen to designate investments in equity instruments to be measured at fair value through other comprehensive income, as permitted by para 5.7.5 of HKFRS 9, HKFRS 7 requires it to disclose (para 11A):

- (a) which investments in equity instruments have been designated to be measured at fair value through other comprehensive income.
- (b) the reasons for using this presentation alternative.
- (c) the fair value of *each* such investment at the end of the reporting period.
- (d) dividends recognised during the period, showing separately those related to investments derecognised during the reporting period and those related to investments held at the end of the reporting period.
- (e) any transfers of the cumulative gain or loss within equity during the period including the reason for such transfers. For example, an entity may transfer the amounts accumulated in other comprehensive income to another component of equity upon derecognition of equity instruments.

Additionally, in the reporting period in which the investments in equity instruments are derecognised, HKFRS 7 requires the entity to disclose (para 11B):

- (a) the reasons for disposing of the investments.
- (b) the fair value of the investments at the date of derecognition.
- (c) the cumulative gain or loss on disposal.

Reclassification

When an entity has reclassified any financial assets in the current or previous reporting periods, the entity is required, for each such event, to disclose the following (para 12B):

- (a) the date of reclassification.
- (b) a detailed explanation of the change in business model and a qualitative description of its effect on the entity's financial statements.
- (c) the amount reclassified into and out of each category.

For each reporting period following reclassification until derecognition, an entity is required to disclose for financial assets reclassified out of fair value through profit or loss to amortised cost or fair value through other comprehensive income in accordance with para 4.4.1 of HKFRS 9 (para 12C):

- (a) the effective interest rate determined on the date of reclassification; and
- (b) the interest revenue recognised.

If, since its last annual reporting date, an entity has reclassified financial assets out of the fair value through other comprehensive income to amortised cost or out of the fair value through profit or loss to amortised cost or fair value through other comprehensive income, it shall disclose (para 12D):

- (a) the fair value of the financial assets at the end of the reporting period; and
- (b) the fair value gain or loss that would have been recognised in profit or loss or other comprehensive income during the reporting period if the financial assets had not been reclassified.

Offsetting financial assets and financial liabilities

Paras 13B–13F provide the disclosures required for all recognised financial instruments that are set off in accordance with the offsetting criteria in para 42 of HKAS 32 "Financial Instruments: Presentation" and those that are subject to an enforceable **master netting arrangement* or similar agreement, irrespective of whether they are set off in accordance with the offsetting criteria in para 42 of HKAS 32 (para 13A).

*A *master netting agreement* provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract.

Para 13B requires an entity to 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 that are within the scope of para 13A.

Specifically, HKFRS 7 requires an entity to disclose, at the end of the reporting period, the following quantitative information separately for recognised financial assets and recognised financial liabilities in a tabular format (unless another format is more appropriate) (para 13C):

- (a) the gross amounts of those recognised financial assets and recognised financial liabilities under an enforceable master netting agreement or similar agreement;
- (b) the amounts that are set off in accordance with the offsetting criteria in para 42 of HKAS 32 when determining the net amounts in the statement of financial position;
- (c) the net amounts presented in the statement of financial position;
- (d) the amounts subject to an enforceable master netting arrangement or similar agreement that are not included in para 13C(b); and
- (e) the net amount after deducting the amounts in (d) from the amounts in (c) above.

The total amount that is disclosed in accordance with para 13C(d) for an instrument is limited to the amount in para 13C(c) for that instrument (para 13D).

An entity shall also include a description in the disclosures of the rights of set-off associated with the entity’s recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements that are disclosed in accordance with para 13C(d), including the nature of those rights (para 13E).

If the information required by paras 13B–13E is disclosed in more than one note, an entity shall cross-refer between those notes (para 13F).

Collateral

If there is any collateral, HKFRS 7 requires an entity to disclose (para 14):

- (a) 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 para 3.2.23(a) of HKFRS 9; and
- (b) the terms and conditions relating to its pledge.

Additionally, 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 (para 15):

- (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.

Allowance account for credit losses

The carrying amount of financial assets measured at fair value through other comprehensive income in accordance with para 4.1.2A of HKFRS 9 is not reduced by a loss allowance. An entity shall not present the loss allowance separately as a reduction of the carrying amount of the financial asset; instead, it shall disclose the loss allowance in the notes (para 16A).

Compound financial instruments with multiple embedded derivatives

If an entity has issued an instrument that contains both a liability and an equity component (see para 28 of HKAS 32) and the instrument has multiple embedded derivatives whose values are interdependent (such as a callable convertible debt instrument), HKFRS 7 requires the entity to disclose the existence of those features (para 17).

Defaults and breaches

For loans payable recognised at the end of the reporting period, HKFRS 7 requires disclosure of (para 18):

- (a) details of any defaults during the period of principal, interest, sinking fund or redemption terms of those loans payable;
- (b) the carrying amount of the loans payable in default at the end of the reporting period; and
- (c) whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.

If, during the period, there were breaches of loan agreement terms other than those described in para 18 above, HKFRS 7 requires disclosure of the same information as required by para 18 if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the end of the reporting period) (para 19).

¶9-320 Statement of profit or loss and other comprehensive income disclosures

HKFRS 7 requires disclosure of the following items of income, expense, gains or losses either in the statement of profit or loss and other comprehensive income or in the notes (para 20):

- (a) net gains or net losses on:
 - (i) financial assets or financial liabilities measured at fair value through profit or loss, showing separately those on financial assets or financial liabilities designated as such upon initial recognition or subsequently in accordance with para 6.7.1 of HKFRS 9, and those on financial assets or financial liabilities that are mandatorily measured at fair value in accordance with HKFRS 9 (e.g. financial liabilities that meet the definition of held for trading in HKFRS 9). For financial liabilities designated as at fair value through profit or loss, an entity shall show separately the amount of gain or loss recognised in other comprehensive income and the amount recognised in profit or loss;
 - (ii)-(iv) [deleted]
 - (v) financial liabilities measured at amortised cost;
 - (vi) financial assets measured at amortised cost;
 - (vii) investments in equity instruments designated at fair value through other comprehensive income in accordance with para 5.7.7 of HKFRS 9; and
 - (viii) financial assets measured at fair value through other comprehensive income in accordance with para 4.1.2A of HKFRS 9, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount reclassified upon derecognition from accumulated other comprehensive income to profit or loss for the period.
- (b) total interest revenue and total interest expense (calculated using the effective interest method) for financial assets that are measured at amortised cost or that are measured at fair value through other comprehensive income (showing these amounts separately); or financial liabilities that are not measured at fair value through profit or loss;
- (c) fee income and expense (other than amounts included in determining the effective interest rate) arising from:
 - (i) financial assets and financial liabilities that are not measured at fair value through profit or loss; and

- (ii) trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions.

Further, HKFRS 7 requires an entity to disclose an analysis of the gain or loss recognised in the statement of profit or loss and other comprehensive income arising from the derecognition of financial assets measured at amortised cost, showing separately gains and losses arising from derecognition of those financial assets. This disclosure shall include the reasons for derecognising those financial assets (para 20A).

¶9-330 Other disclosures

HKFRS 7 requires the following additional disclosures:

Accounting policies

In accordance with para 117 of HKAS 1 “Presentation of Financial Statements”, HKFRS 7 requires disclosure of material accounting policy information. Information about the measurement basis (or bases) for financial instruments used in preparing the financial statements is expected to be material accounting policy information (para 21).

The disclosures required for financial instruments under para 21 may include (para B5 of Application Guidance):

- (a) for financial liabilities designated as at fair value through profit or loss:
 - (i) the nature of the financial liabilities the entity has designated as at fair value through profit or loss;
 - (ii) the criteria for such designation on initial recognition; and
 - (iii) how the entity has satisfied the conditions in para 4.2.2 of HKFRS 9 for such designation.
- (aa) for financial assets designated as measured at fair value through profit or loss:
 - (i) the nature of the financial assets the entity has designated as measured at fair value through profit or loss; and
 - (ii) how the entity has satisfied the criteria in para 4.1.5 of HKFRS 9 for such designation.
- (b) [deleted]
- (c) whether regular way purchases and sales of financial assets are accounted for at trade date or settlement date (see para 3.1.2 of HKFRS 9).
- (d) how net gains or net losses on each category of financial instrument are determined (see para 20(a) in ¶9-320), for example, whether the

net gains or net losses on items at fair value through profit or loss include interest or dividend income.

Para 122 of HKAS 1 also require entities to disclose, along with material accounting policy information or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity’s accounting policies and that have most significant effect on the amounts recognised in the financial statements.

Hedge accounting

HKFRS 7 requires that hedge accounting disclosures shall provide information about (para 21A):

- (a) an entity’s risk management strategy and how it is applied to manage risk;
- (b) how the entity’s hedging activities may affect the amount, timing and uncertainty of its future cash flows; and
- (c) the effect that hedge accounting has had on the entity’s statement of financial position, statement of profit or loss and other comprehensive income and statement of changes in equity.

An entity shall present the required disclosures in a single note or separate section in its financial statements (para 21B).

Where HKFRS 7 requires an entity to separate the information disclosed by risk category, an entity shall determine each risk category on the basis of the risk exposure it decides to hedge and for which hedge accounting is to be applied. An entity shall determine risk categories consistently for all hedge accounting disclosures (para 21C).

To meet the objectives in para 21A, an entity shall (except as specified otherwise by HKFRS 7) determine how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, the appropriate level of aggregation and disaggregation, and whether users of financial statements need additional explanations to evaluate the quantitative information disclosed. However, an entity must use the same level of aggregation or disaggregation it uses for hedge accounting disclosures under HKFRS 7 and related information disclosed under HKFRS 13 (para 21D).

The risk management strategy

HKFRS 7 requires additional information to be disclosed when hedge accounting is used.

Specifically, HKFRS 7 provides that an entity shall explain its risk management strategy for each risk category of risk exposures that it decides to hedge and for which hedge accounting is applied. This explanation should enable users of financial statements to evaluate (for example) (para 22A):

- (a) how each risk arises;
- (b) how the entity manages each risk. This includes whether the entity hedges an item in its entirety for all risks or hedges a risk component (or components) of an item and why; and
- (c) the extent of risk exposures that the entity manages.

To meet para 22A requirements, the information should include (but is not limited to) a description of (para 22B):

- (a) the hedging instruments that are used (and how they are used) to hedge risk exposures;
- (b) how the entity determines the economic relationship between the hedged item and the hedging instrument for the purpose of assessing hedge effectiveness; and
- (c) how the entity establishes the hedge ratio and what the sources of hedge ineffectiveness are.

The amount, timing and uncertainty of future cash flows

An entity shall disclose by risk category quantitative information to allow users of its financial statements to evaluate the terms and conditions of hedging instruments and how they affect the amount, timing and uncertainty of future cash flows of the entity (para 23A).

To meet the above requirement, an entity shall provide a breakdown that discloses (para 23B):

- (a) a profile of the timing of the nominal amount of the hedging instrument; and
- (b) if applicable, the average price or rate (for example, strike or forward prices etc.) of the hedging instrument.

An entity shall disclose by risk category a description of the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term (para 23D).

The effects of hedge accounting on financial position and performance

In respect of the effects of hedge accounting on financial position and performance, HKFRS 7 requires an entity to disclose, in a tabular format, the following amounts related to items designated as hedging instruments separately by risk category for each type of hedge (fair value hedge, cash flow hedge or hedge of a net investment in a foreign operation) (para 24A):

- (a) the carrying amount of the hedging instruments (financial assets separately from financial liabilities);
- (b) the line item in the statement of financial position that includes the hedging instrument;

- (c) the change in fair value of the hedging instrument used as the basis for recognising hedge ineffectiveness for the period; and
- (d) the nominal amounts (including quantities such as tonnes or cubic metres) of the hedging instruments.

HKFRS 7 further provides that an entity shall disclose, in a tabular format, the following amounts related to hedged items separately by risk category for the types of hedges as follows (para 24B):

- (a) for fair value hedges:
 - (i) the carrying amount of the hedged item recognised in the statement of financial position (presenting assets separately from liabilities);
 - (ii) the accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item recognised in the statement of financial position (presenting assets separately from liabilities);
 - (iii) the line item in the statement of financial position that includes the hedged item;
 - (iv) the change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period; and
 - (v) the accumulated amount of fair value hedge adjustments remaining in the statement of financial position for any hedged items that have ceased to be adjusted for hedging gains and losses in accordance with para 6.5.10 of HKFRS 9.
- (b) for cash flow hedges and hedges of a net investment in a foreign operation:
 - (i) the change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period;
 - (ii) the balances in the cash flow hedge reserve and the foreign currency translation reserve for continuing hedges that are accounted for in accordance with paras 6.5.11 and 6.5.13(a) of HKFRS 9; and
 - (iii) the balances remaining in the cash flow hedge reserve and the foreign currency translation reserve from any hedging relationships for which hedge accounting is no longer applied.

Furthermore, HKFRS 7 requires disclosure of the following amounts separately by risk category for the types of hedges, in a tabular format, as follows (para 24C):

- (a) for fair value hedges:
 - (i) hedge ineffectiveness, i.e. the difference between the hedging gains or losses of the hedging instrument and the hedged item,

- recognised in profit or loss (or other comprehensive income for hedges of an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income in accordance with para 5.7.5 of HKFRS 9); and
- (ii) the line item in the statement of profit or loss and other comprehensive income that includes the recognised hedge ineffectiveness.
- (b) for cash flow hedges and hedges of a net investment in a foreign operation:
- (i) hedging gains or losses of the reporting period that were recognised in other comprehensive income;
 - (ii) hedge ineffectiveness recognised in profit or loss;
 - (iii) the line item in the statement of profit or loss and other comprehensive income that includes the recognised hedge ineffectiveness;
 - (iv) the amount reclassified from the cash flow hedge reserve or the foreign currency translation reserve into profit or loss as a reclassification adjustment (see HKAS 1) (differentiating between amounts for which hedge accounting had previously been used, but for which the hedged future cash flows are no longer expected to occur, and amounts that have been transferred because the hedged item has affected profit or loss);
 - (v) the line item in the statement of profit or loss and other comprehensive income that includes the reclassification adjustment (see HKAS 1); and
 - (vi) for hedges of net positions, the hedging gains or losses recognised in a separate line item in the statement of profit or loss and other comprehensive income (see para 6.6.4 of HKFRS 9).

When the volume of hedging relationships to which the exemption in para 23C applies is unrepresentative of normal volumes during the period (i.e. the volume at the reporting date does not reflect the volumes during the period), an entity shall disclose that fact and the reason it believes the volumes are unrepresentative (para 24D).

An entity shall provide a reconciliation of each component of equity and an analysis of other comprehensive income separated by risk category for the items that relates to hedge accounting information. The reconciliation shall (para 24E):

- (a) differentiate, at a minimum, between the amounts that relate to the disclosures in para 24C(b)(i) and (b)(iv), as well as the amounts

- accounted for in accordance with para 6.5.11(d)(i) and (d)(iii) of HKFRS 9;
- (b) differentiates between the amounts associated with the time value of options that hedge transaction related hedged items and the amounts associated with the time value of options that hedge time-period related hedged items when the entity accounts for the time value of an option in accordance with para 6.5.15 of HKFRS 9; and
 - (c) differentiates between the amounts associated with forward elements of forward contracts and the foreign currency basis spreads of financial instruments that hedge transaction-related hedged items, and the amounts associated with the forward elements of forward contracts and the foreign currency basis spreads of financial instruments that hedge time period-related hedged items when an entity accounts for those amounts in accordance with para 6.5.16 of HKFRS 9.

An entity shall disclose the information required in para 24E separately by risk category. This aggregation by risk may be provided in the notes to the financial statements (para 24F).

Additional disclosures related to interest rate benchmark reform

“Interest Rate Benchmark Reform – Phase 2 (Amendments to HKFRS 7, HKFRS 9 and HKFRS 16)” address issues that might affect financial reporting when an entity replaces an existing interest rate benchmark with an alternative benchmark interest rate as a result of the interest rate benchmark reform. The amendments require an entity to disclose information that enable users of financial statements to understand (para 24I):

- (a) the nature and extent of risks to which the entity is exposed arising from financial instruments subject to interest rate benchmark reform, how the entity manages those risks; and
- (b) the entity’s progress in completing the transition to alternative benchmark interest rates, and how it manages the transition.

Fair value

Except for what set out in para 29, for each class of financial assets and financial liabilities (see para 6), HKFRS 7 requires an entity to disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount (para 25).

HKFRS 13 “Fair Value Measurement” requires enhanced disclosures about fair value measurements. (See the Chapter for HKFRS 13 for detail.)

Disclosures of fair value, however, are not required (para 29):

- (a) when the carrying amount is a reasonable approximation of fair value; for example, for financial instruments such as short-term trade receivables and payables; or

- (b) [deleted]
- (c) [deleted]
- (d) for lease liabilities.

In disclosing fair values, HKFRS 7 requires an entity to group financial assets and financial liabilities into classes, but it shall offset them only to the extent that their carrying amounts are offset in the statement of financial position (para 26).

In some cases, an entity does not recognise a gain or loss on initial recognition of a financial asset or financial liability because the fair value is neither evidenced by a quoted price in an active market for an identical asset or liability (i.e. a Level 1 input) nor based on a valuation technique that uses only data from observable markets (see para B5.1.2A of HKFRS 9). In such cases, HKFRS 7 requires an entity to disclose, by class of financial asset or financial liability (para 28):

- (a) its accounting policy for recognising in profit or loss the difference between the fair value at initial recognition and the transaction price to reflect a change in factors (including time) that market participants would take into account when pricing the asset or liability (see para B1.5.2A(b) of HKFRS 9);
- (b) the aggregate difference yet to be recognised in profit or loss at the beginning and end of the period and a reconciliation of changes in the balance of this difference; and
- (c) reasons for concluding the transaction price was not the best evidence of fair value, including a description of the evidence that supports the fair value.

Illustration 9.1 (adapted from the example in para IG14 of Guidance on Implementing HKFRS 7)

Fact of the case

On 1 January 20x1, ABC Ltd purchases \$15 million of financial assets that are not traded in an active market. The company has only one class of such financial assets.

The transaction price of \$15 million is the fair value at initial recognition.

After initial recognition, the company will apply a valuation technique to establish the financial assets' fair value. This valuation technique includes variables other than data from observable markets.

At initial recognition, the same valuation technique would have resulted in an amount of \$14 million, which differs from fair value by \$1 million.

Application of requirements

ABC Ltd’s 20x1 financial statements disclosure would include the following:

Accounting policies

The company uses the net tangible asset per share (NTA) valuation technique to determine the fair value of financial instruments that are not traded in an active market. Differences may arise between the fair value at initial recognition (which, in accordance with HKFRS 9, is generally the transaction price) and the amount determined at initial recognition using the NTA valuation technique. Any such differences are recognised in profit or loss of the year of acquisition.

In the notes to the financial statements

As disclosed under significant accounting policies, the company uses the NTA valuation technique to measure the fair value of the financial instruments that are not traded in an active market. However, in accordance with HKFRS 9, the fair value of an instrument at inception is generally the transaction price. If the transaction price differs from the amount determined at inception using the NTA valuation technique, that difference is recognised in profit or loss of the year of acquisition. During 20x1, the loss of \$1 million is charged to profit or loss.

¶9-400 Risk disclosures

HKFRS 7 requires an entity to disclose information that enables users of the 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 (para 31).

The disclosures required focus on the risks that arose 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 (para 32).

It should be noted that HKFRS 7 does not specifically require the disclosure of significant terms and conditions of all financial instruments. An entity should exercise judgement whether to make such a disclosure, for example, covenants attaching to bank loans that would make the loans repayable on demand in certain circumstances, so as to assist users of the financial statements to evaluate the liquidity risk faced by the entity.

HKFRS 7 further provides that the risk disclosures can be either provided in the financial statements or incorporated by clear cross-reference from the financial statements to some other statement (e.g. a management commentary or risk report), provided that it is available to users of the

financial statements on the same terms as the financial statements and at the same time (para B6 of Application Guidance).

HKFRS 7 specifically requires disclosures of both qualitative information and quantitative information.

¶9-410 Qualitative disclosures

HKFRS 7 emphasises the interaction between qualitative and quantitative disclosures and specifically states that 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 (para 32A).

For each type of risk arising from financial instruments, HKFRS 7 requires an entity to disclose (para 33):

- (a) the exposure to risks and how they arise;
- (b) its objectives, policies and processes for managing the risks and the methods used to measure the risks; and
- (c) any changes in (a) and (b) from the previous period.

Disclosures of information about risk exposures may be provided on both gross and net of any risk transfer and other risk-mitigating transactions (para IG15(a) of *Guidance on Implementing HKFRS 7*). Information about the nature and extent of risks arising from financial instruments is useful if it highlights any relationship between financial instruments that can affect the amount, timing and uncertainty of an entity's future cash flows (para IG16 of *Guidance on Implementing HKFRS 7*).

Disclosure of an entity's policies and processes for accepting, measuring, monitoring and controlling risk may include (para IG15(b) of *Guidance on Implementing HKFRS 7*):

- (i) the structure and organisation of the entity's risk management function(s);
- (ii) the scope and nature of risk reporting or measurement systems;
- (iii) the entity's policies for hedging or mitigating risk, including policies and procedures for taking collateral; and
- (iv) the entity's processes for monitoring the continuing effectiveness of such hedges or mitigating devices.

An entity may also disclose its policies and procedures that are undertaken to avoid excessive concentrations of risk (para IG15(c) of *Guidance on Implementing HKFRS 7*).

¶9-420 Quantitative disclosures

For each type of risk arising from financial instruments, HKFRS 7 requires an entity to disclose (para 34):

- (a) summary quantitative data about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel (as defined in HKAS 24 “Related Party Disclosures”); for example, the entity’s board of directors or chief executive officer;
- (b) the disclosures required by paras 35A–42, to the extent not provided in accordance with item (a); and
- (c) concentrations of risk if not apparent from the disclosures made in accordance with items (a) and (b).

HKFRS 7 explains the advantages of risk disclosures based on information provided internally to key management personnel as such approach (para BC47 of Basis for Conclusions):

- (a) provides a useful insight into how the entity views and manages risk;
- (b) results in information that has a more predictive value than information based on assumptions and methods that management does not use, for instance, in considering the entity’s ability to react to adverse situations;
- (c) is more effective in adapting to changes in risk management and management techniques and developments in the external environment;
- (d) has practical advantages for preparers of financial statements because it allows them to use the data they use in managing risk; and
- (e) is consistent with the approach used in HKFRS 8 “Operating Segment”.

Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions. The identification of concentrations of risk requires judgment, taking into account the circumstances of the entity. Disclosure of concentrations of risk shall include (para B8 of Application Guidance):

- (a) a description of how management determines concentrations;
- (b) a description of the shared characteristic that identifies each concentration (e.g. counterparty, geographical area, currency or market); and
- (c) the amount of the risk exposure associated with all financial instruments sharing that characteristic.

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 (para 35). To meet this requirement, an entity might disclose the highest, lowest and average amount of risk to which it was exposed during the period. For example, if an entity typically has a large exposure to a particular currency, but at year-end unwinds the position, the entity might disclose a graph that shows the exposure at various times during the period, or disclose the highest, lowest and average exposures (para IG20 of *Guidance on Implementing HKFRS 7*).

Credit risk

'Credit risk' is defined as the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation (Appendix A).

For credit risk, HKFRS 7 requires the entity to apply the disclosure requirements in paras 35F-35N to financial instruments to which the impairment requirements in HKFRS 9 are applied, however (para 35A):

- (a) for trade receivables, contract assets and lease receivables, para 35J(a) applies to those trade receivables, contract assets or lease receivables on which lifetime expected credit losses are recognised in accordance with para 5.5.15 of HKFRS 9, if those financial assets are modified while more than 30 days past due; and
- (b) para 35K(b) does not apply to lease receivables.

Paras 35B-35D require finer credit risk disclosures. Specifically, HKFRS 7 requires an entity to disclose (para 35B):

- (a) information about an entity's credit risk management practices and how they relate to the recognition and measurement of expected credit losses (see paras 35F and 35G below);
- (b) quantitative and qualitative information that allows users of financial statements to evaluate the amounts in the financial statements arising from expected credit losses (see paras 35H-35L below); and
- (c) information about an entity's credit risk exposure (i.e. the credit risk inherent in an entity's financial assets and commitments to extend credit) including significant concentrations of credit risk (see paras 35M and 35N below).

Credit risk management practices

An entity is required to explain its credit risk management practices and how they relate to the recognition and measurement of expected credit losses. In particular, an entity shall disclose information that enables users of financial statements to understand and evaluate (para 35F):

- (a) how an entity determined whether the credit risk of financial instruments has increased significantly since initial recognition, including if and how:
 - (i) financial instruments are considered to have low credit risk in accordance with para 5.5.10 of HKFRS 9, including the classes of financial instruments to which it applies; and
 - (ii) the presumption in para 5.5.11 of HKFRS 9, that there has been significant increase in credit risk since initial recognition when financial assets are more than 30 days past due, has been rebutted.
- (b) an entity's definitions of default, including the reasons for selecting those definitions;
- (c) how the instruments were grouped if expected credit losses were measured on a collective basis;
- (d) how an entity determined that financial assets are credit-impaired financial assets;
- (e) an entity's write-off policy; and
- (f) how the requirements in para 5.5.12 of HKFRS 9 for the modification of contractual cash flows of financial assets have been applied.

An entity shall also explain the inputs, assumptions and estimation techniques used to apply the expected credit loss requirements in HKFRS 9. For this purpose, an entity shall disclose (para 35G):

- (a) the basis of inputs and assumptions and the estimation techniques used to:
 - (i) measure the 12-month and lifetime expected credit losses;
 - (ii) determine whether the credit risk of financial instruments have increased significantly since initial recognition; and
 - (iii) determine whether a financial asset is a credit-impaired financial asset.
- (b) how forward-looking information has been incorporated into the determination of expected credit losses, including the use of macroeconomic information; and
- (c) changes in the estimation techniques or significant assumptions made during the reporting period and the reasons for those changes.

Quantitative and qualitative information about amounts arising from expected credit losses

HKFRS 7 requires the entity to provide, by class of financial instrument, a reconciliation from the opening balance to the closing balance of the loss

allowance, in a table, showing separately the changes during the period for (para 35H):

- (a) the loss allowance measured at an amount equal to 12-month expected credit losses;
- (b) the loss allowance measured at an amount equal to lifetime expected credit losses for:
 - (i) financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;
 - (ii) financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and
 - (iii) trade receivables, contract assets or lease receivables for which the loss allowances are measured in accordance with para 5.5.15 of HKFRS 9.
- (c) financial assets that are purchased or originated credit-impaired. In addition to the reconciliation, an entity shall disclose the total amount of undiscounted expected credit losses at initial recognition on financial assets initially recognised during the reporting period.

It may be necessary to provide a narrative explanation of the change in the loss allowance during the period. This narrative explanation may include an analysis of the reasons for changes in loss allowance during the period, including (para B8D of Application Guidance):

- (a) the portfolio composition;
- (b) the volume of financial instruments purchased or originated; and
- (c) the severity of the expected credit losses.

To enable users of financial statements to understand the changes in the loss allowance disclosed in accordance with para 35H, an entity shall provide an explanation of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the loss allowance. The information shall be provided separately for financial instruments that represent the loss allowance as listed in para 35H(a)–(c) and shall include relevant qualitative and quantitative information. Examples of changes in the gross carrying amount of financial instruments that contributed to the changes in the loss allowance may include (para 35I):

- (a) changes because of financial instruments originated or acquired during the reporting period;
- (b) the modifications of contractual cash flows on financial assets that do not result in a derecognition of those financial assets in accordance with HKFRS 9;

- (c) changes because of financial instruments that were derecognised (including written-off) during the reporting period; and
- (d) changes arising from whether the loss allowance is measured at an amount equal to 12-month or lifetime expected credit losses.

To enable users of financial statements to understand the nature and effect of modifications of contractual cash flows on financial assets that have not resulted in derecognition and the effect of such modifications on the measurement of expected credit losses, HKFRS 7 requires an entity to disclose (para 35J):

- (a) the amortised cost before the modification and the net modification gain or loss recognised for financial assets for which the contractual cash flows have been modified during the reporting period while they had a loss allowance measured at an amount equal to lifetime expected credit losses; and
- (b) the gross carrying amount at the end of the reporting period of financial assets that have been modified since initial recognition at a time when the loss allowance was measured at an amount equal to lifetime expected credit losses and for which the loss allowance has changed during the reporting period to an amount equal to 12-month expected credit losses.

To enable an understanding of the effect collateral and other credit enhancements on the amount of expected credit losses, an entity shall disclose by class of financial instruments (para 35K):

- (a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (e.g. netting agreements that do not qualify for offset in accordance with HKAS 32);
- (b) a narrative description of collateral held as security and other credit enhancements, including:
 - (i) a description of the nature and quality of the collateral held;
 - (ii) an explanation of any significant changes in the quality of that collateral or credit enhancements, as a result of deterioration or changes in the collateral policies of the entity during the reporting period; and
 - (iii) information about financial instruments for which an entity has not recognised a loss allowance because of the collateral.
- (c) quantitative information about the collateral held as security and other credit enhancements (e.g. quantification of the extent to which collateral and other credit enhancements that mitigate credit risk) for financial assets that are credit-impaired at the reporting date.

An entity shall disclose the contractual amount outstanding on financial assets that were written off during the reporting period and are still subject to enforcement activity (para 35L).

Credit risk exposure

An entity is required to disclose, by '*credit risk rating grades*' (as defined in Appendix A as the rating of credit risk based on the risk of a default occurring on the financial instrument), the gross carrying amount of financial assets and the exposure to credit risk on loan commitments and financial guarantee contracts. This information shall be provided separately for financial instruments (para 35M):

- (a) for which the loss allowance is measured at an amount equal to 12-month expected credit losses; and
- (b) for which the loss allowance is measured at an amount equal to lifetime expected credit losses and that are:
 - (i) financial instruments for which credit risk has increased significantly since initial recognition but that are not credit-impaired financial assets;
 - (ii) financial assets that are credit-impaired at the reporting date (but that are not purchased or originated credit-impaired); and
 - (iii) trade receivables, contract assets or lease receivables for which the loss allowances are measured in accordance with para 5.5.15 of HKFRS 9 (i.e. the loss allowance is measured at an amount equal to lifetime expected losses).
- (c) that are purchased or originated credit-impaired financial assets.

Where the loss allowance for trade receivables, contract assets and lease receivables are based on lifetime expected credit losses, the information required by para 35M may be based on a provision matrix (see the Chapter for HKFRS 9, para B5.5.35) (para 35N).

For all financial instruments within the scope of HKFRS 7 but to which the impairment requirements in HKFRS 9 are not applied (e.g. financial assets or derivative financial instruments measured at fair value through profit or loss), HKFRS 7 requires an entity to disclose by class of financial instrument (para 36):

- (a) the amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking into account any collateral held or other credit enhancements (e.g. netting agreements that do not qualify for offset in accordance with HKAS 32). This disclosure is only required for financial instruments whose carrying amount does not best represent the maximum exposure to credit risk (e.g. financial guarantee contracts and loan commitments); and

- (b) a description of collateral held as security and of other credit enhancement and their financial effect (e.g. a quantification of the extent to which credit risk is mitigated by the collateral and other credit enhancements) in respect of the amount that best represents the maximum exposure to credit risk (whether disclosed in accordance with item (a) or represented by the carrying amount of a financial instrument).

When an entity obtains financial or non-financial assets by taking possession of collateral or calling on other credit enhancements (e.g. financial guarantee contracts) and such assets are required to be recognised in accordance with other HKFRSs, HKFRS 7 requires the entity to disclose for such assets held at the reporting date (para 38):

- (a) the nature and carrying amount of the assets; and
- (b) when the assets are not readily convertible into cash, additional disclosure needs to be provided regarding the entity’s policies for disposing of such assets or for using them in its operations.

Liquidity risk

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

As mentioned above, HKFRS 7 requires an entity to disclose summary quantitative information provided internally to key management personnel regarding its exposure to liquidity risk and how this data is determined in accordance with para 34(a). An entity shall explain how those data are determined. In addition, if the outflows of cash (or another financial asset) included in those data could either (para B10A of Application Guidance):

- (a) occur significantly earlier than indicated in the data (e.g. if repayable on demand), or
- (b) be for significantly different amounts from those indicated in the data (e.g. for a derivative that is included in the data on a net settlement basis but for which the counterparty has the option to require gross settlement),

the entity shall state this fact and provide additional quantitative information to enable users of the financial statements to evaluate the extent of this risk (unless that information has already been included in the contractual maturity analysis required by para 39(a) or (b)).

For liquidity risk, HKFRS 7 requires an entity to disclose (para 39):

- (a) a maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.
- (b) a maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those

derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows.

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

In preparing the maturity analyses required by para 39 (a) and (b), an entity uses its judgments to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate (para B11 of Application Guidance):

- (i) not later than one month;
- (ii) later than one month and not later than three months;
- (iii) later than three months and not later than one year; and
- (iv) later than one year and not later than five years.

Paras B11A–F of Application Guidance contain further requirements concerning how any maturity analysis of contractual cash flows should be presented.

An entity shall not separate an embedded derivative from a hybrid (combined) financial instrument when preparing a contractual maturity analysis. For such an instrument, an entity shall apply para 39(a) (para B11A of Application Guidance).

Para 39(a) and (b) require an entity to disclose maturity analysis for financial liabilities that show the remaining contractual maturities for some financial liabilities. In this disclosure (para 11C of Application Guidance):

- (a) when a counterparty has a choice of when an amount is paid, the liability must be allocated to the earliest period in which the entity can be required to pay. For example, financial liabilities that an entity can be required to repay on demand (e.g. demand deposits) are included in the earliest time band.
- (b) when an entity is committed to make amounts available in instalments, each instalment must be allocated to the earliest period in which the entity can be required to pay. For example, an undrawn loan commitment is included in the time band containing the earliest date it can be drawn down.
- (c) for issued financial guarantee contracts the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

The contractual amounts to be disclosed in the contractual maturity analysis are the contractual undiscounted (i.e. gross) cash flows. These contractual amounts will differ from the amount included in the statement of financial position for financial liabilities because the amount in that statement is based on discounted cash flows. Examples of amounts included on an undiscounted basis include (para B11D of Application Guidance):

- (a) gross finance lease obligations (before deducting finance charges);
- (b) prices specified in forward agreements to purchase financial assets for cash;
- (c) net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged;
- (d) contractual amounts to be exchanged in a derivative financial instrument (e.g. a cross-currency swap) for which gross cash flows are exchanged; and
- (e) gross loan commitments.

When the contractual amount payable is not fixed, the amount disclosed in the maturity analysis is determined by reference to the conditions existing at the end of the reporting period. For example, if the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the end of the reporting period (para B11D of Application Guidance).

Para 39(c) requires an entity to describe how it manages the liquidity risk inherent in the items disclosed in the quantitative liquidity risk disclosures. An entity shall disclose a maturity analysis of financial assets it holds for managing liquidity risk (e.g. 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 (para B11E of Application Guidance).

Para B11F of Application Guidance lists out other factors that an entity may wish to disclose in describing how it manages its liquidity risk. Those factors include whether the entity:

- (a) has committed borrowing facilities (e.g. commercial paper facilities) or other lines of credit (e.g. stand-by credit facilities) that it can access to meet liquidity needs;
- (b) holds deposits at central banks to meet liquidity needs;
- (c) has very diverse funding sources;
- (d) has significant concentrations of liquidity risk in either its assets or its funding sources;
- (e) has internal control processes and contingency plans for managing liquidity risk;
- (f) has instruments that include accelerated repayment terms (e.g. on the downgrade of the entity's credit rating);
- (g) has instruments that could require the posting of collateral (e.g. margin calls for derivatives);

- (h) has instruments that allows the entity to choose whether it settles its financial liabilities by delivering cash (or another financial asset) or by delivering its own shares;
- (i) has instruments that are subject to master netting agreements; or
- (j) has accessed, or has access to, facilities under supplier finance arrangements that provide the entity with extended payment terms or the entity's suppliers with early payment terms.

Market risk

'Market 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 (Appendix A).

"Market risk" comprises three types of risk (Appendix A, and paras B22, B23 and B25 of Application Guidance):

- currency risk (or foreign exchange risk) (i.e. the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates).
- interest rate risk (i.e. the risk that the fair value or future cash flows of a interest-bearing financial instrument, for example, debt instruments acquired or issued and some loan commitments, will fluctuate because of changes in market interest rates).
- other price risk (i.e. 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)), for example, changes in commodity prices or equity prices, whether those changes are caused by factors specific to the individual financial instrument or its issuer, or by factors affecting all similar financial instruments traded in the market.

It should be noted that for the purpose of HKFRS 7, currency risk does not arise from financial instruments that are non-monetary items or from financial instruments denominated in the functional currency (para B23 of Application Guidance).

HKFRS 7 requires a sensitivity analysis to be disclosed for each currency to which an entity has significant exposure (para B24 of Application Guidance).

Market risk – sensitivity analysis

For each market risk (which includes interest rate risk, currency risk and other price risk), HKFRS 7 requires an entity to disclose a sensitivity analysis (para 40).

Specifically, HKFRS 7 requires an entity to disclose (para 40):

- (a) a sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how profit or loss and equity would have been affected by changes in

- the relevant risk variable (e.g. prevailing market interest rates, currency rates, equity prices or commodity prices) that were reasonably possible at that date;
- (b) the methods and assumptions used in preparing the sensitivity analysis; and
 - (c) changes from the previous period in the methods and assumptions used, and the reasons for such changes.

HKFRS 7 does not prescribe a format in which sensitivity should be presented. An entity will need to decide how it aggregates information to display the overall picture without combining information with different characteristics about exposures to risks from significantly different economic environments. For example (para B17 of Application Guidance):

- (a) an entity that trades financial instruments might disclose this information separately for financial instruments held for trading and those not held for trading; and
- (b) an entity would not aggregate its exposure to market risks from areas of hyperinflation with its exposure to the same market risks from areas of very low inflation.

If an entity has exposure to only one type of market risk in only one economic environment, it would not show disaggregated information.

The following example illustrates the disclosure requirement under para 40 using a narrative approach:

Illustration 9.2 (modified from the example in para IG36 of Guidance on Implementing HKFRS 7)

Interest rate risk

At 31 December 20x2, if interest rates at that date had been 10 basis points lower with all other variables held constant, post-tax profit for the year would have been \$1.7 million (20x1: \$2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings. If interest rates had been 10 basis points higher, with all other variables held constant, post-tax profit would have been \$1.5 million (20x1: \$2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings. Profit is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20x2 than in 20x1 because of a reduction in outstanding borrowings that has occurred as the entity’s debt has matured.

Foreign currency exchange rate risk

At 31 December 20x2, if the HK dollar had weakened 10% against the US dollar with all other variables held constant, post-tax profit for the year would have been \$2.8 million (20x1–\$6.4 million) lower, and other comprehensive income would have been \$1.2 million (20x1–\$1.1 million) higher. Conversely, if the HK dollar had strengthened 10% against the US dollar with all other variables held constant, post-tax profit would have been \$2.8 million (20x1–\$6.4 million) higher, and other comprehensive income would have been \$1.2 million (20x1–\$1.1 million) lower. The lower foreign currency exchange rate sensitivity in profit in 20x2 compared with 20x1 is attributable to a reduction in foreign currency denominated debt. Equity is more sensitive in 20x2 than in 20x1 because of the increased use of hedges of foreign currency purchases, offset by the reduction in foreign currency debt.

However, if an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (e.g. interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis specified in para 40. In such case, the entity is required to disclose (para 41):

- (a) an explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and
- (b) an explanation of the objective of the method used and the limitations that may result in the information not fully reflecting the fair value of the financial assets and financial liabilities involved.

Para 40(a) requires the sensitivity analysis to show the effect on profit or loss and equity of reasonably possible change in the relevant risk variable. For this purpose (para B18 of Application Guidance):

- (a) entities are not required to determine what the profit or loss for the period would have been if relevant risk variables had been different. Instead, entities disclose the effect on profit or loss and equity for exposures at the end of the reporting period, assuming that a reasonably possible change in the relevant risk variable had occurred at the end of the reporting period and had been applied to the risk exposures in existence on that date. Further guidance is provided in paras IG34–36 of *Guidance on Implementing HKFRS 7*.
- (b) entities are not required to disclose the effect on profit or loss and equity for each change within a range of reasonably possible changes of the relevant risk variable. It is sufficient to disclose the effects of the changes at the limits of the reasonably possible range (i.e. rather than an arbitrary amount, for example, “1% change in all variables”).

In determining what a reasonably possible change in the relevant risk variable is, an entity should consider (para B19 of Application Guidance):

- (a) the economic environment in which it operates. A reasonably possible change should not include “worse case” or “stress tests”. Moreover, if the rate of change in the underlying risk variable is stable, the entity needs not to alter the chosen reasonably possible change in the risk variable.
- (b) the time frame over which it is making the assessment. The sensitivity analysis shall show the effects of changes that are considered to be reasonably possible over the period until the entity will next present these disclosures, which is usually its next annual reporting period.

When the sensitivity analyses disclosed in accordance with paras 40 and 41 are unrepresentative of a risk inherent in a financial instrument (e.g. because the year-end exposure does not reflect the exposure during the period), HKFRS 7 requires the entity to disclose that fact and the reason it believes the sensitivity analyses are unrepresentative (para 42). Guidance in this respect can be found in paras IG37-40 of *Guidance on Implementing HKFRS 7*.

Transfers of financial assets

HKFRS 7 requires that an entity shall provide the required disclosures for all transferred financial assets that are not derecognised and for any continuing involvement in a transferred asset, existing at the end of the reporting period, irrespective of when the related transfer transaction occurred (para 42A).

An entity shall disclose information that enables users of its financial statements (para 42B):

- (a) to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and
- (b) to evaluate the nature of, and risks associated with, the entity’s continuing involvement in derecognised financial assets.

¶9-500 Sample disclosures

As described above, extensive disclosures are required under HKFRS 7, an example of accounting policy required for investments in debt and equity securities, other than investments in subsidiaries, associates and joint ventures required by (para B5(e) of Application Guidance — see ¶9-330) is shown below:

Other investments in debt and equity securities

Investments in debt and equity securities are recognised or derecognised on the date the group commits to purchase or sell the investments. The investments are initially measured at fair value, while in the case of a financial asset not at fair value through profit or loss, plus transaction

costs that are directly attributable to the acquisition or issue of the investments. Depending on the classification of the investments, they are subsequently measured as follows:

(a) *Investments other than equity investments*

Non-equity investments held by the group are classified into one of the following categories:

- (i) amortised cost — when the investment is held within a business model for the collection of contractual cash flows which comprise solely payments of principal and interest on the principal amount outstanding. Interest income from the investment is calculated using the effective interest method.
- (ii) fair value through other comprehensive income — when the contractual cash flows of the investment comprise solely payments of principal and interest on the principal amount outstanding and the investment is held within a business model whose objective is achieved by both the collection of contractual cash flows and selling the investments. Changes in fair value of the investment are recognised in other comprehensive income, except for impairment gains and losses, interest income calculated using the effective interest method and foreign exchange gains and losses. When the investment is derecognised, the amount accumulated in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment.
- (iii) fair value through profit or loss — if the investment does not meet the criteria of amortised cost or fair value through other comprehensive income. Changes in the fair value of the investment (including interest income) are recognised in profit or loss.

(b) *Equity investments*

An investment in equity securities is classified as fair value through profit or loss unless the equity investment is not held for trading and at initial recognition, the group makes an irrevocable election to designate the investment at fair value through other comprehensive income such that subsequent changes in fair value on that investment are recognised in other comprehensive income. Such an election is made on an instrument-by-instrument basis. Where the election is made, the amount accumulated in other comprehensive income remains in the fair value reserve until the investment is derecognised. When the investment is derecognised, the amount accumulated in the fair value reserve is transferred to retained earnings. Dividends on such investment are recognised in profit or loss.

For illustrative purposes, a simplified example of the risk disclosures required by HKFRS 7 is shown below:

Financial risk management objectives and policies

The Company operates globally and generates revenues in various currencies. The Company’s overall risk management programme focuses on the unpredictability and volatility of financial markets and seeks to minimise potential adverse effects on the financial position, performance and cash flows of the Company. No derivative financial instruments are used to hedge any exposures. Risk management is performed by the chief executive director and senior management under established policies laid down by the Board of Directors. The Board provides principles for overall risk management, policies and processes covering specific areas of interest rate risk, credit risk, foreign currency risk and liquidity risk.

(a) Interest rate risk

The Company’s operations are financed through a combination of retained earnings and bank borrowings at floating interest rates. This strategy allows the Company cheaper funding in a low interest rate environment. The interest rate risk is managed on an ongoing basis.

(b) Credit risk

The Company has detailed guidelines and procedures governing the process of granting credit to other business parties. Credit risk on receivables is managed through the application of a credit scoring system and stringent follow-up of receivables.

(c) Foreign currency risk

The Company does not have any significant exposure to foreign exchange risk. The majority of receivables are denominated in local currency and all purchases are transacted in local currency.

(d) Liquidity risk

The Company’s debt maturity profile, operating cash flows and the availability of external funding is actively managed. The Company maintains adequate bank facilities for financing the Company’s operating activities.

¶9-600 Comparison with International Financial Reporting Standards

HKFRS 7 is based on IFRS 7 “Financial Instruments: Disclosures”. There are no major textual differences between HKFRS 7 and IFRS 7. Compliance with HKFRS 7 will ensure compliance with IFRS 7.

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