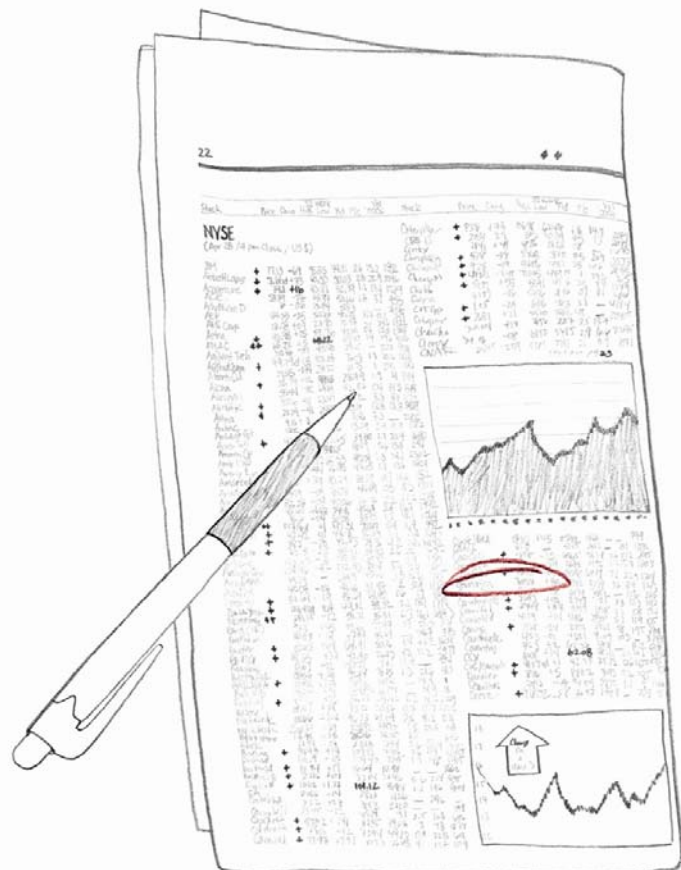


Changes to IFRS 7/FRS 29 affecting investment funds

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IFRS 7/FRS 29

The International Accounting Standards Board has published **Improving Disclosures about Financial Instruments (Amendments to IFRS 7)**. In order to improve the disclosure of how entities measure the fair value of their financial instruments, the disclosure requirements in IFRS 7 have been extended to introduce a fair value hierarchy and enhanced liquidity risk disclosures. The new disclosures are effective for annual periods beginning on or after 1 January 2009. The amendments to IFRS 7 are part of the IASB's response to the credit crisis. Similar amendments to FRS 29 are in place for Irish and UK GAAP funds.

1. Fair value measurement disclosures

a) The three-level fair value hierarchy

The improved disclosure of how entities measure the fair value of their financial instruments, the amendments to IFRS 7/FRS 29 introduces a fair value hierarchy, similar (**but not identical**) to that which is required under US GAAP FAS 157.

The fair value hierarchy consists of the following three levels:

- level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;
- level 2 - inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The disclosures required

For financial instruments (within the scope of IFRS 7/FRS 29), which are measured at fair value in the balance sheet (statement of financial position), an entity shall disclose the following for each class of financial instruments:

- the level in the fair value hierarchy into which the fair value measurements are categorised in their entirety;
- any significant transfers between level 1 and level 2 of the fair value hierarchy and the reasons for those transfers;
- for fair value measurements in level 3 of the hierarchy, a reconciliation from the beginning balances to the ending balances. As well as highlighting purchases, sales, and gains and losses, this reconciliation will identify transfers into or out of level 3 and the reasons for those transfers.

In addition, for any fair value measurements in level 3 where changing one or more inputs to reasonably possible alternative assumptions would change fair value significantly, entities are required to disclose that fact and the effect of those changes.

The quantitative disclosures are to be provided in a tabular format unless another format is more appropriate.

Determination of hierarchy level

The determination of which of the levels in the fair value hierarchy into which an asset or liability is categorised is based on the lowest level input that is significant to the fair value measurement of the instrument.

Assessing whether a particular input to the fair value measurement is significant may require judgement. The amendments to IFRS 7 make clear that when the fair value of an instrument is measured using some observable inputs, but these inputs require significant adjustment based on unobservable inputs, that fair value measurement should be categorised in level 3 of the hierarchy.

Materiality

There is limited guidance in the standards as to when transfers between categories, or indeed categories themselves, are sufficiently significant as to warrant disclosure. In general, accounting standards do not apply to items that are immaterial, by reference to whether or not information would influence the economic decisions of users of the financial statements. Consideration would need to be given to the investment strategy of the fund on an ongoing basis as well as the significance of categories relative to NAV in order to determine whether level 2 and level 3 investments might be immaterial.

Current market conditions

The new disclosures have the primary aim of improving transparency in what have been challenging market conditions. Investors will be able to compare investment companies more than they have in the past in terms of the types of fair value measurements being made. Having said that, true comparability will only be achieved if the boundaries between the different levels of the hierarchy are interpreted consistently across the industry. As with most new accounting standards it may be that this will take time to settle down. Care will need to be taken in current market conditions. If for example it is determined that a market for a particular security is inactive and significant adjustments need to be made to transactions or quoted prices to measure fair value, such adjustments may well be level 3 inputs in many cases. Even if no adjustments are considered necessary, the absence of an active market would preclude the investment from being categorised in level 1. The introduction of a fair value disclosure hierarchy does not affect the measurement requirements of IAS 39 or FRS 26. When implementing the new disclosures we would however recommend that companies take the opportunity to review their existing accounting policy disclosures relating to the use of valuation techniques. A full and clear description of the techniques used is important if the reader of the financial statements is to understand the basis of valuation and any critical assumptions which may have been made.

b) Liquidity risk disclosures

The second part of the amendments to IFRS 7/FRS 29 improves the liquidity risk disclosures required by IFRS 7/FRS 29.

In accordance with the amendments an entity discloses:

- a a maturity analysis for non-derivative financial liabilities 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; and
- c a description of how it manages the liquidity risk inherent in (a) and (b).

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.

The most important change compared to the previous IFRS 7/FRS 29 liquidity risk disclosures relates to derivative financial liabilities. Under the previous version of IFRS 7/FRS 29, entities were required to disclose a quantitative maturity analysis for all derivative financial liabilities according to their remaining contractual maturities. The change is a response to comments that the requirement to provide disclosures based on the remaining contractual maturities was difficult to apply for some derivative financial liabilities and did not always result in information that reflects how many entities manage liquidity risk for such instruments. As a result, the amendments to IFRS 7/FRS 29 retain the requirement to disclose the remaining contractual maturities of derivative financial liabilities only where the information is essential for an understanding of the timing of the cash flows.

2. Effective date

Fair value hierarchy disclosures will be required in investment company financial statements for annual accounting periods beginning on or after 1 January 2009.

In the first year of application comparative information is not required. This exemption is however not quite as labour-saving as it first appears as companies with level 3 investments will need to establish which investments fall into this category at the beginning of the period in order to be able to produce level 3 reconciliation. Similar considerations apply if companies are to be able to disclose any significant transfers between level 1 and level 2.

For entities applying full disclosure in their interim financial statements they must comply with IFRS 7/FRS 29 for interim accounting periods beginning on or after 1 January 2009.

3. Conclusion

Investment company boards and their administrators will want to consider these new disclosure requirements ahead of the first applicable year end in order to ensure that they can be incorporated into the annual financial statements in a timely manner. As highlighted above, one of the principal challenges which will be faced by some companies will be that of distinguishing level 2 and level 3 investments. Also, in order to be able to disclose transfers between categories and a level 3 reconciliation it will be necessary to establish the opening position - this is an area where the relevant analysis could be performed ahead of the year end. Addressing this early would also enable any 'in principle' discussions with auditors regarding materiality to take place before the year end.

Attached in the appendices to this report are an example guide level matrix and example disclosures.

Appendix 1 - IFRS 7/FRS 29 guide level matrix

Investment type	Level 1	Level 2	Level 3
Equity	Exchange listed price or a broker quote in an active market.	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices). Example: Broker quote in a non active market.	Fair values measured inputs for investment that are not based on observable market data. Example: Price calculated using internal model using information provided by the company for an unlisted equity.
Bond	Exchange listed price or a broker quote in an active market.	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices). Example: Broker quote in a non active market.	Fair values measured inputs for investment that are not based on observable market data. Example: Price calculated using internal model using information provided by the company for an unlisted bond. A defaulted bond valued using internal model.
Derivative	Broker trade in an active market. Priced using an independent pricing service where the inputs are provided by the independent pricing service.	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices). Example: Priced using an independent model which uses inputs provided by a broker. Also broker quote in a non active market.	Fair values measured inputs for investment that are not based on observable market data. Price calculated internally using information available via external data sources. Example: Valuation calculated internally based on a comparable yield curve (e.g. interest rate) or comparable credit curve (credit default). Based on the history of the volatility of an underlying share.
Fund of funds	Exchange traded fund.	If observable market for transactions for the limited partnership or offshore shares.	If no observable market.

The above matrix is for guidance purposes only. An examination of the facts and circumstances of each specific investment may result in a different categorisation level than the examples provided above.

Appendix 2

Fair value hierarchy disclosures - an illustrative example

The table below sets out fair value measurements using the IFRS 7/FRS 29 fair value hierarchies:

Financial assets at fair value through profit or loss				
At 31 December 2009				
	Total €000	Level 1 €000	Level 2 €000	Level 3 €000
Equity investments	75,850	63,250	-	12,600
Fixed interest investments	10,000	8,500	-	1,500
Derivatives	2,500	-	1,500	1,000
Money market funds	7,600	7,600	-	-
Total	95,950	79,350	1,500	15,100

Financial liabilities at fair value through profit or loss				
At 31 December 2009				
	Total €000	Level 1 €000	Level 2 €000	Level 3 €000
Derivatives	3,500	-	3,500	-
Total	3,500	-	3,500	-

Categorisation within the hierarchy has been determined on the basis of the lowest level input that is significant to the fair value measurement of the relevant asset as follows:

Level 1 - valued using quoted prices in active markets for identical assets.

Level 2 - valued by reference to valuation techniques using observable inputs other than quoted prices included within level 1.

Level 3 - valued by reference to valuation techniques using inputs that are not based on observable market data.

The valuation techniques used by the company are explained in the accounting policies note on page x.

There have been no transfers during the year between levels 1 and 2. A reconciliation of fair value measurements in level 3 is set out below.

Level 3 financial assets at fair value through profit or loss				
At 31 December 2009				
	Equity investments €000	Fixed interest investments €000	Derivatives €000	Total €000
Opening balance	9,200	-	5,200	14,400
Purchases	4,300	1,400	800	6,500
Sales	(750)	-	-	(750)
Settlements	-	-	(4,700)	(4,700)
Transfers into level 3	250	-	-	250
Transfers out of level 3	1,000	-	-	1,000
Total gains or losses included in Gains on investments in the statement of comprehensive income:				
- on assets sold	(200)	-	(500)	(700)
- on assets held at the end of the year	(1,600)	100	200	(1,300)
Closing balance	<u>12,600</u>	<u>1,500</u>	<u>100</u>	<u>15,100</u>

Transfers into level 3 relate to investments for which listing has been suspended during the year. Transfers out of level 3 relate to investments which have obtained a stock exchange listing during the year, having previously been unquoted.

[Footnotes -

1. In addition to the disclosures above for fair value measurements in level 3, if changing one or more of the inputs to reasonably possible alternative assumptions would change the fair value significantly, the entity shall state that fact and disclose the effect of those changes.
2. If there has been a change in valuation technique for any class of asset or liability, the company is required to disclose that change and the reasons for making it.
3. The above illustrations do not include comparative information. Comparatives are not required in the first year of application but will be needed thereafter.]

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