



Financial reporting and auditing alert

Updates on current issues

Issue 1 • February 2009

Dear members,

The Institute's Standards and Quality division is launching a series of alerts drawing members attention to topical financial reporting and auditing issues that should be given particular attention. In view of the current global financial crisis the first issue of the alerts will deal with the potential implications for our members involved in preparing and auditing financial statements. The focus of the alerts will change over time as circumstances change. The Institute believes that it is an important element of both its regulatory and member support functions that this channel of communication is established.

Financial statement disclosures relating to financial instruments

1. The new 2009 financial reporting season is here with us and we would like to take the opportunity, in this first issue of our new series of alerts, to remind members who are working as preparers or auditors of financial statements, of some potentially important disclosure issues that revolve around the application of HKFRS 7 *Financial Instruments: Disclosures*.
2. **In the context of the current global financial crisis it is clear that for this reporting season disclosure relating to financial instruments will take on an additional emphasis and be subjected to critical scrutiny by auditors, regulators and all other user groups. We would therefore urge members to take particular care, when preparing or auditing financial statements, to ensure that financial instrument disclosures have been adequately addressed.**
3. **The primary objective of HKFRS 7 is to ensure that sufficient disclosure is provided in the financial statements to enable users to evaluate the significance of financial instruments in an entity's financial position and performance and the nature and extent of the risks and exposure arising from those financial instruments.**
4. HKFRS 7 applies to the financial statements of all entities, including entities that have few financial instruments (e.g. a manufacturer whose only financial instruments are accounts receivable and accounts payable) and those that have many financial instruments (e.g. a financial institution most of whose assets and liabilities are financial instruments). The extent of disclosure required will depend on the extent of the entity's use of financial instruments and of its exposure to risk. Preparers of financial statements are therefore reminded of the need to review the financial instruments held by their companies and ensure that adequate disclosures are made, in particular in relation to complex financial instruments such as options and other hedging instruments.

5. HKFRS 7 requires disclosure of:

- a. the significance of financial instruments for an entity's financial position and performance.
- b. qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. Disclosure on market risk should include sensitivity analyses showing the potential effects of changes in the relevant risk variables that were reasonably possible at the reporting date. Qualitative disclosures describe management's objectives, policies and processes for managing those risks. Quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information available to the entity's key management personnel.

6. HKFRS 7 includes mandatory application guidance in appendix B that explains how to apply the requirements of the standard and is accompanied by useful non-mandatory implementation guidance that describes how an entity might provide the disclosures required by the standard. **We strongly recommend that appendix B is read carefully and in full.** We would also advise that, as the standard was revised in December 2008, care is taken to ensure that the current version of the standard is referred to.

7. HKFRS 7 is effective for annual periods beginning on or after 1 January 2007 and can be viewed at this website:

www.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumell/hkfrs7.pdf

Sincere regards,

A handwritten signature in black ink that reads "Chris Joy". The signature is written in a cursive style with a long horizontal stroke underneath the name.

Chris Joy
Executive Director
Hong Kong Institute of CPAs