

INFINZ

Issues on mark-to-market for IAS 39
and IFRS 7 disclosures
September 2008

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NZ IAS 39 Explainer

Valuation

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Our background

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Focus on financial instruments and derivatives

- This talk is about NZ IAS 39 and NZ IFRS 7, out of 49 NZ equivalent standards.
- Our assessment is about the practice of preparing annual or interim financial reports.
- The measurement of fair value has gone well.
- The processes for hedge accounting have been okay.
- The planning for risk disclosures has been a struggle.

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Hedge accounting explained in one page



- Derivatives to be measured at fair value;
- Document your hedging intent for derivatives;
- Test the effectiveness of hedge relationships at reporting dates; and
- Make adjustments to equity reserves or hedged item at fair value.

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Measurement at Fair Value

- The measurement of most derivatives at fair value has been achieved in good time to finish the financial statements.
- Entities are getting reasonable fair value numbers from:
 - Bank mark-to-market reports;
 - Local specialist providers; or
 - Treasury systems.

Fair Value Problems

- Bank mark-to-market still needs common-sense check:
 - Currency of valuation; and
 - Corporate or bank perspective
- Electricity CfDs are not physical supply contracts
- Valuation of illiquid securities
- Valuation and materiality of “crossing the spread”
- Planning who will provide valuation of exotic “barrier” option products

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Hedge effectiveness testing is being done

- Most entities have talked with their auditors and put in place template documentation.
- Effectiveness testing through dollar offset or regression methods is being largely applied without material misstatement.

Hedge accounting processes can improve

- Hedge accounting requires hedge documentation.
- Common problem of unnoticed changes to hedged items, i.e semi-annual debt replaced by monthly debt.
- Some don't want hedge accounting at period start, but do want it after seeing the reporting date numbers.
- Common problem of asserting 100% effectiveness, without underlying evidence of effectiveness testing.
- Adjustment of inventory for currency hedges is time-consuming.
- Planning enough time for the accounting of CFHR, hedged item fair value, and ineffectiveness.

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Background to NZ IFRS 7: Financial Instruments: Disclosures

- Why NZ IFRS 7 disclosures are becoming more important
- Application of standard
 - Applies for years beginning on or after 1 January 2007:
 - Requires comparatives; and
 - Differential reporting exemptions available
- Requirements of standard:

Provide disclosures that enable financial report users to evaluate:

- The significance of financial instruments to the entity
- The nature and extent of risks arising from financial instruments

Risk disclosure types

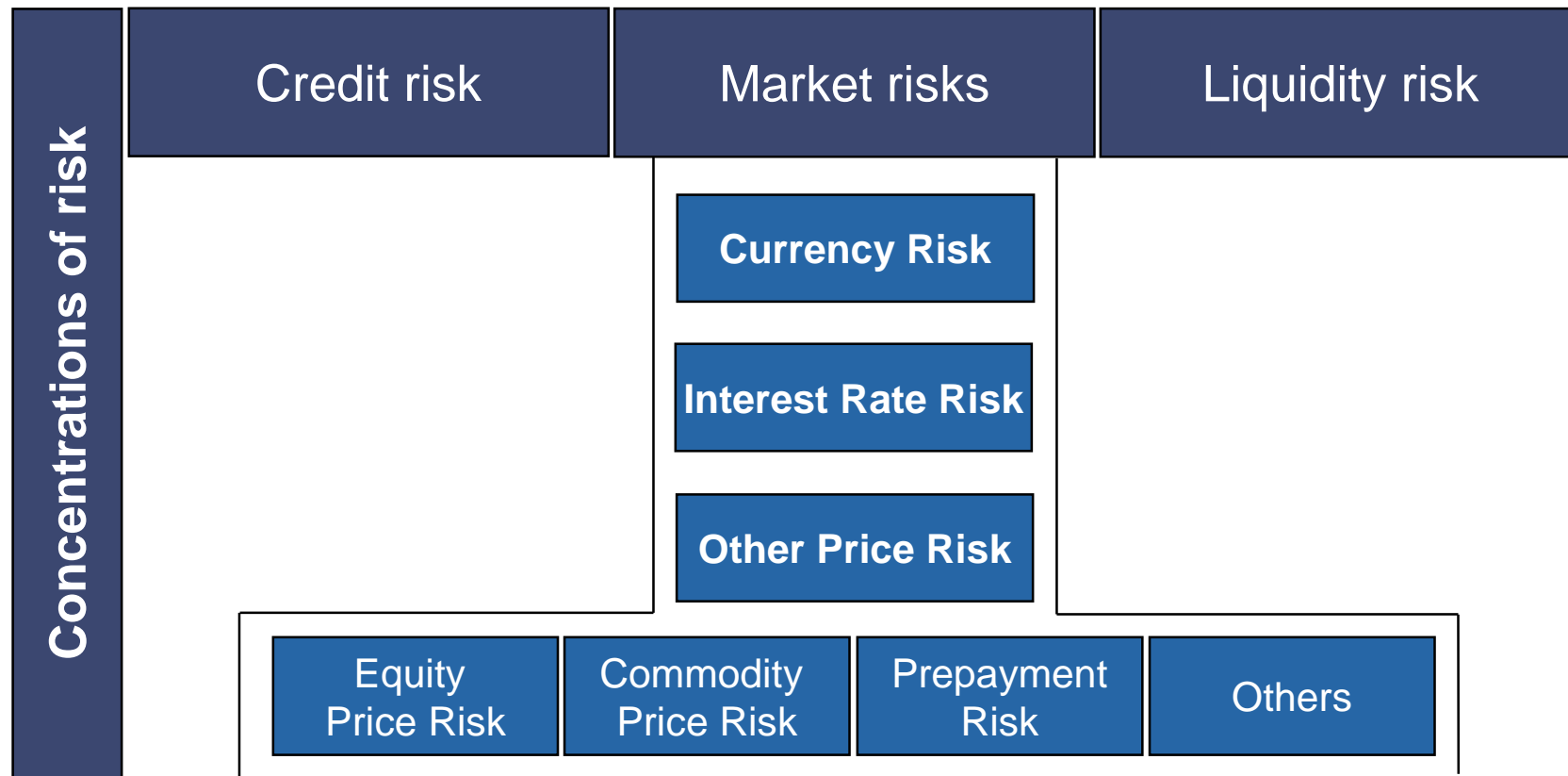
Qualitative disclosures

- Risk exposures and how they arise
- How the risks are managed
- Any changes from the previous reporting period

Quantitative disclosures

- Summary data for each type of risk
- Covers information provided to key management personnel
- Additional minimum disclosure requirements

Risk types arising from financial instruments



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Lessons learned in relation to NZ IFRS 7 risk disclosures

- Many companies did not appreciate the extent of the impact of NZ IFRS 7
- In some instances there was limited co-operation between finance and treasury / risk management teams
- Inappropriate use of “pro-forma” disclosures, particularly for qualitative data
- Sensitivity Analysis – banks’ mark-to-market currently does not include sensitivity analysis. Calculation of sensitivity is a basic problem.
- Credit Risk Analysis – coping with the increased volume of credit risk disclosures

Lessons learned in relation to NZ IFRS 7 risk disclosures

- Application of disclosures to parent entity as well as group
- NZ IFRS 7 adds significantly to the time and complexity of preparing financial reporting; more than a residual task.
- Companies and auditors are learning the key pressure points under the disclosure notes; 2009 will be different.

NZ IFRS 7 Action Points

- Debrief on the effectiveness and efficiency of adoption of the NZ IFRS 7 in the first year.
- Understand any changes to risk management processes made during the current year.
- Do not assume the content of the disclosures will be the same each year.
- Understand and respond to findings from the next cycle of Financial Reporting Surveillance by the Securities Commission.
- Update a set of pro-forma disclosures and engage with your auditor early to ensure agreement.

Questions