

Technical Note 01/2008 – Disclosure of the nature and extent of risks arising from financial instruments

Paragraphs 31 to 42 and B6 to B28 of HKFRS 7 “Financial Instruments – Disclosure” set out requirements for disclosure of the nature and extent of risks arising from financial instruments.

These requirements apply to financial instruments only. That is, assets and liabilities that are not financial instruments are not subject to these requirements.

Paragraphs 11 and AG3 to AG24 of HKAS 32 “Financial Instruments – Presentation” define financial instruments, financial assets and financial liabilities.

In general, the following items are **NOT** financial instruments, and therefore the disclosure requirements on the nature and extent of risks arising from financial instruments **DO NOT** apply to them:

- a) Assets that are not financial assets:
- Physical assets such as inventories, property, plant and equipment and intangible assets [AG10];
 - Deposits placed for purchase of inventories [Writer's interpretation of AG10];
 - Deposits placed for purchase of PPE [Writer's interpretation of AG10];
 - Deposits placed for purchase of an associate or a subsidiary [Writer's Interpretation of HKAS 32.4];
 - Obligations under an operating lease (except for payments currently due and payable) [AG8];
 - Prepaid expenses [AG11]; and
 - Income tax recoverable, current or deferred [AG12].
- b) Liabilities that are not financial liabilities:
- Deposits received for future delivery of goods or services [AG11];
 - Provisions for warranty obligations [AG11];
 - Provisions for constructive obligations [AG12]; and
 - Income tax payables, current or deferred [AG12].

In general, the following items are financial instruments, and therefore the nature and extent of risks arising from these financial instruments should be disclosed in accordance with paragraphs 31 to 42 and B6 to B28 of HKFRS 7:

a) Financial assets:

- Cash and deposit of cash in a bank or a similar financial institution [AG3];
- Deposits for utilities, provided that they represent a right to receive cash refund [Writer's interpretation of AG4];
- Trade receivables, notes receivables, and loans receivables [AG4]; and
- Equity investments, other than interests in associates, jointly controlled entities and subsidiaries [AG 13].

b) Financial liabilities:

- Trade payables, notes payables, and loans payables [AG4];
- Liabilities under a finance lease [AG8]; and
- Accruals for liabilities, such as salaries payable [Writer's interpretation of AG4].

c) Derivatives [AG15]

HKAS 1 requires disclosure of how the reporting entity manages capital and how it monitors and measures its performance in this respect.

The debt-to-equity ratio is a commonly used measure of the performance of capital management.

While the reporting entity is free to determine what should be included as a "debt", the most straight forward approach is to define a debt as a financial liability under HKAS 32, the composition of which will be disclosed under the requirements of HKFRS 7 on the disclosure of the nature and extent of risks arising from financial instruments.