

1 IFRS 9 Financial Instruments (Lecture A688 – 9.54 minutes)

1.1 Application date

Reporting periods commencing on or after 1 January 2018. Early adoption was permitted subject to local endorsement requirements.

1.2 Overview

In July 2014, the IASB published the final version of IFRS 9 *Financial Instruments*, bringing together the classification and measurement, impairment and hedge accounting phases of its long-running project to replace IAS 39 *Financial Instruments: Recognition and Measurement*.

The package of improvements introduced by the new standard includes:

- adopting a principles-based approach to the classification and measurement of financial assets – driven by the business model in which the asset is held and its cash flow characteristics;
- adopting a more forward-looking ‘expected credit loss’ model to account for the impairment of financial assets;
- removing the counter-intuitive requirement that meant in certain instances an entity would recognise gains in the fair value of a financial liability in profit or loss when its own credit risk deteriorated and losses when it improved; and
- introducing a substantially-reformed approach to hedge accounting that better aligns the accounting treatment with an entity’s risk management activities.

All entities would have needed to carefully assess the extent to which their financial reporting would be affected by the new standard. While many of the changes will have the biggest impact on financial sector businesses (this area is not specifically considered in these notes), other corporates were advised not to underestimate the potential impact of the standard.

1.3 Key changes

The following table summarises the key changes made by IFRS 9:

| Changes in IFRS 9 | |
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| Scope | <p>IFRS 9 applies to all types of financial instrument except those that fall under the requirements of other standards.</p> <p>The scope is very similar to IAS 39. However, the scope of IFRS 9’s impairment requirements is broader than that of its predecessor and includes items such as financial guarantee contracts that were previously measured under IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> and contract assets under IFRS 15 <i>Revenue from Contracts with Customers</i> that are not</p> |

Changes in IFRS 9

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| Recognition and initial measurement | <p>otherwise within the scope of IFRS 9.</p> <p>Financial assets and financial liabilities are recognised when, and only when, the entity becomes party to the contractual provisions of the instrument.</p> <p>Generally, financial instruments are recognised initially at fair value plus or minus transaction costs. However, for financial instruments classified as measured at fair value through profit or loss, transaction costs are immediately expensed to profit or loss.</p> |
| Classification and measurement of financial assets | <p>These requirements are unchanged from IAS 39.</p> <p>Financial assets are classified and measured according to the business model in which they are held and their contractual cash flow characteristics. Accordingly, financial assets are classified and measured at amortised cost, fair value through other comprehensive income (FVTOCI) or fair value through profit or loss (FVTPL).</p> |
| Classification and measurement of financial liabilities | <p>The IAS 39 categories of held-to-maturity, loans and receivables, and available-for-sale are removed.</p> <p>Financial liabilities are classified and measured either at amortised cost or at FVTPL.</p> <p>This is unchanged from IAS 39. However, if an entity elects to take the fair value option, IFRS 9 requires – except in certain limited cases – gains or losses that are attributable to changes in the credit risk of the entity to be presented in other comprehensive income. Under IAS 39, all such gains and losses would have been recognised in profit or loss.</p> |
| Reclassification | <p>Under IFRS 9 it is clear that a gain or loss should be recognised at the time of a non-substantial modification whereas, under IAS 39, the required treatment was ambiguous and it was common practice to spread the difference over the remaining term of the liability.</p> <p>Except in the case of financial assets classified by irrevocable election, financial assets are reclassified if, and only if, the objective of the business model in which they are held changes significantly. Such changes are expected to be infrequent. Reclassifications of financial liabilities are not allowed.</p> |
| Impairment of financial assets | <p>IFRS 9 introduces a forward-looking 'expected loss' model, replacing IAS 39's 'incurred loss' model. Under</p> |

Changes in IFRS 9

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| | <p>IFRS 9, it is no longer necessary for a loss event to have occurred before credit losses are recognised. Instead, the standard requires an entity to recognise a loss allowance for financial assets (except those classified as FVTPL and equity investments designated as FVTOCI) based on expected credit losses. This means that there is generally a loss recognised in profit or loss at the first reporting date after initial recognition of the financial asset.</p> |
| Derecognition | <p>Financial assets are derecognised when, and only when, the contractual rights to the cash flows from the asset expire, or the asset is transferred and the transfer qualifies for derecognition.</p> <p>Financial liabilities are derecognised when, and only when, the obligation within the contract is discharged, cancelled or expires. Certain exchanges and modifications of financial liabilities may also result in derecognition. These requirements are largely unchanged from IAS 39, although there is clarification relating to the recognition of gains and losses following a non- substantial modification of a financial liability.</p> |
| Disclosures | <p>Disclosure requirements for financial instruments are detailed in IFRS 7 <i>Financial Instruments: Disclosures</i>, including numerous requirements for the reporting period that includes the date of initial application of IFRS 9.</p> |