

**AASB Standard**

**AASB 9**  
December 2009

## Financial Instruments



**Australian Government**  
**Australian Accounting Standards Board**

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ILLUSTRATIVE EXAMPLES  
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BASIS FOR CONCLUSIONS ON IFRS 9  
(available on the AASB website)

Australian Accounting Standard AASB 9 *Financial Instruments* is set out in paragraphs 1.1 – 8.2.13 and Appendices A and B. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. AASB 9 is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation and Application of Standards*, which identifies the Australian Accounting Interpretations. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

## **PREFACE**

### **Introduction**

The Australian Accounting Standards Board (AASB) makes Australian Accounting Standards, including Interpretations, to be applied by:

- (a) entities required by the *Corporations Act 2001* to prepare financial reports;
- (b) governments in preparing financial statements for the whole of government and the General Government Sector (GGS); and
- (c) entities in the private or public for-profit or not-for-profit sectors that are reporting entities or that prepare general purpose financial statements.

Australian Accounting Standards incorporate International Financial Reporting Standards (IFRSs), including Interpretations, issued by the International Accounting Standards Board (IASB), with the addition of paragraphs on the applicability of each Standard in the Australian environment.

Australian Accounting Standards also include requirements that are specific to Australian entities. These requirements may be located in Australian Accounting Standards that incorporate IFRSs or in other Australian Accounting Standards. In most instances, these requirements are either restricted to the not-for-profit or public sectors or include additional disclosures that address domestic, regulatory or other issues. In developing requirements for public sector entities, the AASB considers the requirements of International Public Sector Accounting Standards (IPSASs), as issued by the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants.

Private sector for-profit entities complying with Australian Accounting Standards will simultaneously comply with IFRSs. Many other entities complying with Australian Accounting Standards will also simultaneously comply with IFRSs.

## Differences between this Standard and AASB 139

AASB 9 includes requirements for the classification and measurement of financial assets resulting from the first part of Phase 1 of the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement* (AASB 139 *Financial Instruments: Recognition and Measurement*). These requirements improve and simplify the approach for classification and measurement of financial assets compared with the requirements of AASB 139. The IASB plans to complete its work on financial liabilities during 2010 and will issue requirements for financial liabilities that will be included in AASB 9 in due course.

The main changes from AASB 139 are described below.

- (a) Financial assets are classified based on (a) the objective of the entity's business model for managing the financial assets; and (b) the characteristics of the contractual cash flows. This replaces the numerous categories of financial assets in AASB 139, each of which had its own classification criteria. Application guidance has been included in AASB 9 on how to apply the conditions necessary for amortised cost measurement.
- (b) AASB 9 allows an irrevocable election on initial recognition to present gains and losses on investments in equity instruments that are not held for trading in other comprehensive income. Dividends in respect of these investments that are a return on investment can be recognised in profit or loss and there is no impairment or recycling on disposal of the instrument.
- (c) Financial assets can be designated and measured at fair value through profit or loss at initial recognition if doing so eliminates or significantly reduces a measurement or recognition inconsistency that would arise from measuring assets or liabilities, or recognising the gains and losses on them, on different bases.
- (d) Hybrid contracts with financial asset hosts are classified and measured in their entirety in accordance with the classification criteria. Embedded derivative assets that are separated from financial liability or non-financial hosts in accordance with AASB 139 are to be accounted for in accordance with AASB 9.
- (e) Investments in unquoted equity instruments (and contracts on those investments that must be settled by delivery of the unquoted equity instrument) must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value.

- (f) Investments in contractually linked instruments that create concentrations of credit risk (tranches) are classified and measured using a 'look through' approach. Such an approach looks to the underlying assets generating cash flows and assesses the cash flows against the classification criteria (discussed in (a) above) to determine whether the investment is measured at fair value or amortised cost.
- (g) Financial assets are reclassified when there is a relevant change in the entity's business model changes.

## **COMPARISON WITH IFRS 9**

AASB 9 *Financial Instruments* incorporates IFRS 9 *Financial Instruments* issued by the International Accounting Standards Board (IASB). Paragraphs that have been added to this Standard (and do not appear in the text of IFRS 9) are identified with the prefix “Aus”, followed by the number of the preceding IASB paragraph and decimal numbering. Paragraphs that apply only to not-for-profit entities begin by identifying their limited applicability.

Entities that comply with AASB 9 will simultaneously be in compliance with IFRS 9.



## ACCOUNTING STANDARD AASB 9

The Australian Accounting Standards Board makes Accounting Standard AASB 9 *Financial Instruments* under section 334 of the *Corporations Act 2001*.

Dated 7 December 2009

Kevin M. Stevenson  
Chair – AASB

## ACCOUNTING STANDARD AASB 9

### *FINANCIAL INSTRUMENTS*

#### Chapter 1 Objective and Application

1.1 The objective of this Standard is to establish principles for the financial reporting of *financial assets* that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of the entity's future cash flows.

**Aus1.2 This Standard applies to:**

- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;
- (b) general purpose financial statements of each other reporting entity; and
- (c) financial statements that are, or are held out to be, general purpose financial statements.

**Aus1.3 This Standard applies to annual reporting periods beginning on or after 1 January 2013.**

**Aus1.4 This Standard may be applied to annual reporting periods ending on or after 31 December 2009 that begin before 1 January 2013. When an entity applies this Standard to an annual reporting period beginning before 1 January 2013 it shall disclose that fact and at the same time apply the amendments in AASB 2009-11 *Amendments to Australian Accounting Standards arising from AASB 9*.**

**Aus1.5** The requirements specified in this Standard apply to the financial statements where information resulting from their application is material in accordance with AASB 1031 *Materiality*.

Aus1.6 When applied or operative, this Standard supersedes the classification and measurement requirements for financial assets in AASB 139 *Financial Instruments: Recognition and Measurement* issued in July 2004.

## **Chapter 2 Scope**

2.1 An entity shall apply this Standard to all assets within the scope of AASB 139 *Financial Instruments: Recognition and Measurement*.

## **Chapter 3 Recognition and derecognition**

### **3.1 Initial recognition of financial assets**

**3.1.1** An entity shall recognise a financial asset in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument (see paragraphs AG34 and AG35 of AASB 139). When an entity first recognises a financial asset, it shall classify it in accordance with paragraphs 4.1-4.5 and measure it in accordance with paragraph 5.1.1.

3.1.2 A *regular way purchase or sale* of a financial asset shall be recognised and derecognised in accordance with paragraphs 38 and AG53-AG56 of AASB 139.

## **Chapter 4 Classification**

**4.1** Unless paragraph 4.5 applies, an entity shall classify financial assets as subsequently measured at either *amortised cost* or *fair value* on the basis of both:

- (a) the entity's business model for managing the financial assets; and
- (b) the contractual cash flow characteristics of the financial asset.

- 4.2 A financial asset shall be measured at amortised cost if both of the following conditions are met:**
- (a) the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows.**
  - (b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.**

Paragraphs B4.1-B4.26 provide guidance on how to apply these conditions.

- 4.3 For the purpose of this Standard, interest is consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time.**
- 4.4 A financial asset shall be measured at fair value unless it is measured at amortised cost in accordance with paragraph 4.2.**

#### **Option to designate a financial asset at fair value through profit or loss**

- 4.5 Notwithstanding paragraphs 4.1-4.4, an entity may, at initial recognition, designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an ‘accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs AG4D-AG4G of AASB 139).**

#### **Embedded derivatives**

- 4.6 An embedded *derivative* is a component of a hybrid contract that also includes a non-derivative host – with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. A derivative that is attached to a *financial instrument* but is contractually transferable independently of that instrument, or has a**

different counterparty, is not an embedded derivative, but a separate financial instrument.

- 4.7** If a hybrid contract contains a host that is within the scope of this Standard, an entity shall apply the requirements in paragraphs 4.1-4.5 to the entire hybrid contract.
- 4.8** If a hybrid contract contains a host that is not within the scope of this Standard, an entity shall apply the requirements in paragraphs 11-13 and AG27-AG33B of AASB 139 to determine whether it must separate the embedded derivative from the host. If the embedded derivative must be separated from the host, the entity shall:
- (a) classify the derivative in accordance with either paragraphs 4.1-4.4 for derivative assets or paragraph 9 of AASB 139 for all other derivatives; and
  - (b) account for the host in accordance with other Australian Accounting Standards.

## **Reclassification**

- 4.9** When, and only when, an entity changes its business model for managing financial assets it shall reclassify all affected financial assets in accordance with paragraphs 4.1-4.4.

## **Chapter 5 Measurement**

### **5.1 Initial measurement of financial assets**

- 5.1.1** At initial recognition, an entity shall measure a financial asset at its fair value (see paragraphs 48, 48A and AG69-AG82 of AASB 139) plus, in the case of a financial asset not at fair value through profit or loss, *transaction costs* that are directly attributable to the acquisition of the financial asset.

### **5.2 Subsequent measurement of financial assets**

- 5.2.1** After initial recognition, an entity shall measure a financial asset in accordance with paragraphs 4.1-4.5 at fair value (see paragraphs 48, 48A and AG69-AG82 of AASB 139) or amortised cost.

**5.2.2** An entity shall apply the impairment requirements in paragraphs 58-65 and AG84-AG93 of AASB 139 to financial assets measured at amortised cost.

**5.2.3** An entity shall apply the hedge accounting requirements in paragraphs 89-102 of AASB 139 to a financial asset that is designated as a *hedged item* (see paragraphs 78-84 and AG98-AG101 of AASB 139).

### **5.3 Reclassification**

**5.3.1** If an entity reclassifies financial assets in accordance with paragraph 4.9, it shall apply the reclassification prospectively from the *reclassification date*. The entity shall not restate any previously recognised gains, losses or interest.

**5.3.2** If, in accordance with paragraph 4.9, an entity reclassifies a financial asset so that it is measured at fair value, its fair value is determined at the reclassification date. Any gain or loss arising from a difference between the previous carrying amount and fair value is recognised in profit or loss.

**5.3.3** If, in accordance with paragraph 4.9, an entity reclassifies a financial asset so that it is measured at amortised cost, its fair value at the reclassification date becomes its new carrying amount.

### **5.4 Gains and losses**

**5.4.1** A gain or loss on a financial asset that is measured at fair value and is not part of a hedging relationship (see paragraphs 89-102 of AASB 139) shall be recognised in profit or loss unless the financial asset is an investment in an *equity instrument* and the entity has elected to present gains and losses on that investment in other comprehensive income in accordance with paragraph 5.4.4.

**5.4.2** A gain or loss on a financial asset that is measured at amortised cost and is not part of a hedging relationship (see paragraphs 89-102 of AASB 139) shall be recognised in profit or loss when the financial asset is derecognised, impaired or reclassified in accordance with paragraph 5.3.2, and through the amortisation process.

**5.4.3 A gain or loss on financial assets that are:**

- (a) **hedged items (see paragraphs 78-84 and AG98-AG101 of AASB 139) shall be recognised in accordance with paragraphs 89-102 of AASB 139.**
- (b) **accounted for using settlement date accounting shall be recognised in accordance with paragraph 57 of AASB 139.**

**Investments in equity instruments**

**5.4.4 At initial recognition, an entity may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument within the scope of this Standard that is not *held for trading*.**

5.4.5 If an entity makes the election in paragraph 5.4.4, it shall recognise in profit or loss dividends from that investment when the entity's right to receive payment of the dividend is established in accordance with AASB 118 *Revenue*.

**Chapter 6 Hedge accounting – [not used]**

**Chapter 7 Disclosures – [not used]**

**Chapter 8 Effective date and transition**

**8.1 Effective date**

8.1.1 [Deleted by the AASB]

**8.2 Transition**

8.2.1 An entity shall apply this Standard retrospectively, in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs 8.2.4-8.2.13. This Standard shall not be applied to financial assets that have already been derecognised at the date of initial application.

- 8.2.2 For the purposes of the transition provisions in paragraphs 8.2.3-8.2.13, the date of initial application is the date when an entity first applies the requirements of this Standard. The date of initial application may be:
- (a) any date between the issue of this Standard and 31 December 2010, for entities initially applying this Standard before 1 January 2011; or
  - (b) the beginning of the first reporting period in which the entity adopts this Standard, for entities initially applying this Standard on or after 1 January 2011.
- 8.2.3 If the date of initial application is not at the beginning of a reporting period, the entity shall disclose that fact and the reasons for using that date of initial application.
- 8.2.4 At the date of initial application, an entity shall assess whether a financial asset meets the condition in paragraph 4.2(a) on the basis of the facts and circumstances that exist at the date of initial application. The resulting classification shall be applied retrospectively irrespective of the entity's business model in prior reporting periods.
- 8.2.5 If an entity measures a hybrid contract at fair value in accordance with paragraph 4.4 or paragraph 4.5 but the fair value of the hybrid contract had not been determined in comparative reporting periods, the fair value of the hybrid contract in the comparative reporting periods shall be the sum of the fair values of the components (i.e. the non-derivative host and the embedded derivative) at the end of each comparative reporting period.
- 8.2.6 At the date of initial application, an entity shall recognise any difference between the fair value of the entire hybrid contract at the date of initial application and the sum of the fair values of the components of the hybrid contract at the date of initial application:
- (a) in the opening retained earnings of the reporting period of initial application if the entity initially applies this Standard at the beginning of a reporting period; or
  - (b) in profit or loss if the entity initially applies this Standard during a reporting period.

8.2.7 At the date of initial application, an entity may designate:

- (a) a financial asset as measured at fair value through profit or loss in accordance with paragraph 4.5; or
- (b) an investment in an equity instrument as at fair value through other comprehensive income in accordance with paragraph 5.4.4.

Such designation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

8.2.8 At the date of initial application, an entity:

- (a) shall revoke its previous designation of a financial asset as measured at fair value through profit or loss if such financial asset does not meet the condition in paragraph 4.5.
- (b) may revoke its previous designation of a financial asset as measured at fair value through profit or loss if such financial asset meets the condition in paragraph 4.5.

Such revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

8.2.9 At the date of initial application, an entity shall apply paragraph 103M of AASB 139 to determine when it:

- (a) may designate a *financial liability* as measured at fair value through profit or loss; and
- (b) shall or may revoke its previous designation of a financial liability as measured at fair value through profit or loss.

Such revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.



- 8.2.10 If it is impracticable (as defined in AASB 108) for an entity to apply retrospectively the *effective interest method* or the impairment requirements in paragraphs 58-65 and AG84-AG93 of AASB 139, the entity shall treat the fair value of the financial asset at the end of each comparative period as its amortised cost. In those circumstances, the fair value of the financial asset at the date of initial application shall be treated as the new amortised cost of that financial asset at the date of initial application of this Standard.
- 8.2.11 If an entity previously accounted for an investment in an unquoted equity instrument (or a derivative that is linked to and must be settled by delivery of such an unquoted equity instrument) at cost in accordance with AASB 139, it shall measure that instrument at fair value at the date of initial application. Any difference between the previous carrying amount and fair value shall be recognised in the opening retained earnings of the reporting period that includes the date of initial application.
- 8.2.12 Notwithstanding the requirement in paragraph 8.2.1, an entity that adopts this Standard for reporting periods beginning before 1 January 2012 need not restate prior periods. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application in the opening retained earnings (or other component of equity, as appropriate) of the reporting period that includes the date of initial application.
- 8.2.13 If an entity prepares interim financial reports in accordance with AASB 134 *Interim Financial Reporting* the entity need not apply the requirements in this Standard to interim periods prior to the date of initial application if it is impracticable (as defined in AASB 108).

## **APPENDIX A**

### **DEFINED TERMS**

*This appendix is an integral part of AASB 9.*

**reclassification date**      The first day of the first reporting period following the change in business model that results in an entity reclassifying financial assets.

The following terms are defined in paragraph 11 of AASB 132 *Financial Instruments: Presentation* or paragraph 9 of AASB 139 and are used in this Standard with the meanings specified in AASB 132 or AASB 139:

- (a)      amortised cost of a financial asset or financial liability
- (b)      derivative
- (c)      effective interest method
- (d)      equity instrument
- (e)      fair value
- (f)      financial asset
- (g)      financial instrument
- (h)      financial liability
- (i)      hedged item
- (j)      hedging instrument
- (k)      held for trading
- (l)      regular way purchase or sale
- (m)      transaction costs.

## **APPENDIX B**

### **APPLICATION GUIDANCE**

*This appendix is an integral part of AASB 9.*

#### **Classification**

##### **The entity's business model for managing financial assets**

- B4.1 Paragraph 4.1(a) requires an entity to classify financial assets as subsequently measured at amortised cost or fair value on the basis of the entity's business model for managing the financial assets. An entity assesses whether its financial assets meet this condition on the basis of the objective of the business model as determined by the entity's key management personnel (as defined in AASB 124 *Related Party Disclosures*).
- B4.2 The entity's business model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. However, a single entity may have more than one business model for managing its financial instruments. Therefore, classification need not be determined at the reporting entity level. For example, an entity may hold a portfolio of investments that it manages in order to collect contractual cash flows and another portfolio of investments that it manages in order to trade to realise fair value changes.
- B4.3 Although the objective of an entity's business model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. Thus an entity's business model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur. For example, the entity may sell a financial asset if:
- (a) the financial asset no longer meets the entity's investment policy (e.g. the credit rating of the asset declines below that required by the entity's investment policy);
  - (b) an insurer adjusts its investment portfolio to reflect a change in expected duration (i.e. the expected timing of payouts); or
  - (c) an entity needs to fund capital expenditures.

However, if more than an infrequent number of sales are made out of a portfolio, the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows.

B4.4 The following are examples of when the objective of an entity's business model may be to hold financial assets to collect the contractual cash flows. This list of examples is not exhaustive.

<i>Example</i>	<i>Analysis</i>
<p><b>Example 1</b></p> <p>An entity holds investments to collect their contractual cash flows but would sell an investment in particular circumstances.</p>	<p>Although an entity may consider, among other information, the financial assets' fair values from a liquidity perspective (i.e. the cash amount that would be realised if the entity needs to sell assets), the entity's objective is to hold the financial assets and collect the contractual cash flows. Some sales would not contradict that objective.</p>
<p><b>Example 2</b></p> <p>An entity's business model is to purchase portfolios of financial assets, such as loans. Those portfolios may or may not include financial assets with incurred credit losses. If payment on the loans is not made on a timely basis, the entity attempts to extract the contractual cash flows through various means – for example, by making contact with the debtor by mail, telephone or other methods.</p> <p>In some cases, the entity enters into interest rate swaps to change the interest rate on particular financial assets in a portfolio from a floating interest rate to a fixed interest rate.</p>	<p>The objective of the entity's business model is to hold the financial assets and collect the contractual cash flows. The entity does not purchase the portfolio to make a profit by selling them.</p> <p>The same analysis would apply even if the entity does not expect to receive all of the contractual cash flows (e.g. some of the financial assets have incurred credit losses).</p> <p>Moreover, the fact that the entity has entered into derivatives to modify the cash flows of the portfolio does not in itself change the entity's business model. If the portfolio is not managed on a fair value basis, the objective of the business model could be to hold the assets to collect the contractual cash flows.</p>

<i>Example</i>	<i>Analysis</i>
<p><b>Example 3</b></p> <p>An entity has a business model with the objective of originating loans to customers and subsequently to sell those loans to a securitisation vehicle. The securitisation vehicle issues instruments to investors.</p> <p>The originating entity controls the securitisation vehicle and thus consolidates it.</p> <p>The securitisation vehicle collects the contractual cash flows from the loans and passes them on to its investors.</p> <p>It is assumed for the purposes of this example that the loans continue to be recognised in the consolidated statement of financial position because they are not derecognised by the securitisation vehicle.</p>	<p>The consolidated group originated the loans with the objective of holding them to collect the contractual cash flows.</p> <p>However, the originating entity has an objective of realising cash flows on the loan portfolio by selling the loans to the securitisation vehicle, so for the purposes of its separate financial statements it would not be considered to be managing this portfolio in order to collect the contractual cash flows.</p>

- B4.5 One business model in which the objective is not to hold instruments to collect the contractual cash flows is if an entity manages the performance of a portfolio of financial assets with the objective of realising cash flows through the sale of the assets. For example, if an entity actively manages a portfolio of assets in order to realise fair value changes arising from changes in credit spreads and yield curves, its business model is not to hold those assets to collect the contractual cash flows. The entity's objective results in active buying and selling and the entity is managing the instruments to realise fair value gains rather than to collect the contractual cash flows.
- B4.6 A portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis (as described in paragraph 9(b)(ii) of AASB 139) is not held to collect contractual cash flows. Also, a portfolio of financial assets that meets the definition of held for trading is not held to collect contractual cash flows. Such portfolios of instruments must be measured at fair value through profit or loss.

## **Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding**

- B4.7 Paragraph 4.1 requires an entity (unless paragraph 4.5 applies) to classify a financial asset as subsequently measured at amortised cost or fair value on the basis of the contractual cash flow characteristics of the financial asset that is in a group of financial assets managed for the collection of the contractual cash flows.
- B4.8 An entity shall assess whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding for the currency in which the financial asset is denominated (see also paragraph B5.13).
- B4.9 Leverage is a contractual cash flow characteristic of some financial assets. Leverage increases the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest. Stand-alone option, forward and swap contracts are examples of financial assets that include leverage. Thus such contracts do not meet the condition in paragraph 4.2(b) and cannot be subsequently measured at amortised cost.
- B4.10 Contractual provisions that permit the issuer (i.e. the debtor) to prepay a debt instrument (e.g. a loan or a bond) or permit the holder (i.e. the creditor) to put a debt instrument back to the issuer before maturity result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding only if:
- (a) the provision is not contingent on future events, other than to protect:
    - (i) the holder against the credit deterioration of the issuer (e.g. defaults, credit downgrades or loan covenant violations), or a change in control of the issuer; or
    - (ii) the holder or issuer against changes in relevant taxation or law; and
  - (b) the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the early termination of the contract.

B4.11 Contractual provisions that permit the issuer or holder to extend the contractual term of a debt instrument (i.e. an extension option) result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding only if:

- (a) the provision is not contingent on future events, other than to protect:
  - (i) the holder against the credit deterioration of the issuer (e.g. defaults, credit downgrades or loan covenant violations), or a change in control of the issuer; or
  - (ii) the holder or issuer against changes in relevant taxation or law; and
- (b) the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest on the principal amount outstanding.

B4.12 A contractual term that changes the timing or amount of payments of principal or interest does not result in contractual cash flows that are solely principal and interest on the principal amount outstanding unless it:

- (a) is a variable interest rate that is consideration for the time value of money and the credit risk (which may be determined at initial recognition only, and so may be fixed) associated with the principal amount outstanding; and
- (b) if the contractual term is a prepayment option, meets the conditions in paragraph B4.10; or
- (c) if the contractual term is an extension option, meets the conditions in paragraph B4.11.

B4.13 The following examples illustrate contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

<i>Instrument</i>	<i>Analysis</i>
<p><b>Instrument A</b></p> <p>Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected.</p>	<p>The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest on the principal amount outstanding to an unleveraged inflation index resets the time value of money to a current level. In other words, the interest rate on the instrument reflects 'real' interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding.</p> <p>However, if the interest payments were indexed to another variable such as the debtor's performance (e.g. the debtor's net income) or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the interest payments are not consideration for the time value of money and for credit risk associated with the principal amount outstanding. There is variability in the contractual interest payments that is inconsistent with market interest rates.</p>



<i>Instrument</i>	<i>Analysis</i>
<p><b>Instrument B</b></p> <p>Instrument B is a variable interest rate instrument with a stated maturity date that permits the borrower to choose the market interest rate on an ongoing basis. For example, at each interest rate reset date, the borrower can choose to pay three-month LIBOR for a three-month term or one-month LIBOR for a one-month term.</p>	<p>The contractual cash flows are solely payments of principal and interest on the principal amount outstanding as long as the interest paid over the life of the instrument reflects consideration for the time value of money and for the credit risk associated with the instrument. The fact that the LIBOR interest rate is reset during the life of the instrument does not in itself disqualify the instrument.</p> <p>However, if the borrower is able to choose to receive one-month LIBOR for three months and that one-month LIBOR is not reset each month, the contractual cash flows are not payments of principal and interest.</p> <p>The same analysis would apply if the borrower is able to choose between the lender's published one-month variable interest rate and the lender's published three-month variable interest rate.</p> <p>However, if the instrument has a contractual interest rate that is based on a term that exceeds the instrument's remaining life, its contractual cash flows are not payments of principal and interest on the principal amount outstanding. For example, a constant maturity bond with a five-year term that pays a variable rate that is reset periodically but always reflects a five-year maturity does not result in contractual cash flows that are payments of principal and interest on the principal amount outstanding. That is because the interest payable in each period is disconnected from the term of the instrument (except at origination).</p>

<i>Instrument</i>	<i>Analysis</i>
<p><b>Instrument C</b></p> <p>Instrument C is a bond with a stated maturity date and pays a variable market interest rate. That variable interest rate is capped.</p>	<p>The contractual cash flows of both:</p> <ul style="list-style-type: none"> <li>(a) an instrument that has a fixed interest rate; and</li> <li>(b) an instrument that has a variable interest rate;</li> </ul> <p>are payments of principal and interest on the principal amount outstanding as long as the interest reflects consideration for the time value of money and for the credit risk associated with the instrument during the term of the instrument.</p> <p>Therefore, an instrument that is a combination of (a) and (b) (e.g. a bond with an interest rate cap) can have cash flows that are solely payments of principal and interest on the principal amount outstanding. Such a feature may reduce cash flow variability by setting a limit on a variable interest rate (e.g. an interest rate cap or floor) or increase the cash flow variability because a fixed rate becomes variable.</p>
<p><b>Instrument D</b></p> <p>Instrument D is a full recourse loan and is secured by collateral.</p>	<p>The fact that a full recourse loan is collateralised does not in itself affect the analysis of whether the contractual cash flows are solely payments of principal and interest on the principal amount outstanding.</p>

B4.14 The following examples illustrate contractual cash flows that are not payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

<i>Instrument</i>	<i>Analysis</i>
<p><b>Instrument E</b></p> <p>Instrument E is a bond that is convertible into equity instruments of the issuer.</p>	<p>The holder would analyse the convertible bond in its entirety. The contractual cash flows are not payments of principal and interest on the principal amount outstanding because the interest rate does not reflect only consideration for the time value of money and the credit risk. The return is also linked to the value of the equity of the issuer.</p>
<p><b>Instrument F</b></p> <p>Instrument F is a loan that pays an inverse floating interest rate (i.e. the interest rate has an inverse relationship to market interest rates).</p>	<p>The contractual cash flows are not solely payments of principal and interest on the principal amount outstanding.</p> <p>The interest amounts are not consideration for the time value of money on the principal amount outstanding.</p>
<p><b>Instrument G</b></p> <p>Instrument G is a perpetual instrument but the issuer may call the instrument at any point and pay the holder the par amount plus accrued interest due.</p> <p>Instrument G pays a market interest rate but payment of interest cannot be made unless the issuer is able to remain solvent immediately afterwards.</p> <p>Deferred interest does not accrue additional interest.</p>	<p>The contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the issuer may be required to defer interest payments and additional interest does not accrue on those deferred interest amounts. As a result, interest amounts are not consideration for the time value of money on the principal amount outstanding.</p> <p>If interest accrued on the deferred amounts, the contractual cash flows could be payments of principal and interest on the principal amount outstanding.</p>

	<p>The fact that Instrument G is perpetual does not in itself mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding. In effect, a perpetual instrument has continuous (multiple) extension options. Such options may result in contractual cash flows that are payments of principal and interest on the principal amount outstanding if interest payments are mandatory and must be paid in perpetuity.</p> <p>Also, the fact that Instrument G is callable does not mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding unless it is callable at an amount that does not substantially reflect payment of outstanding principal and interest on that principal. Even if the callable amount includes an amount that compensates the holder for the early termination of the instrument, the contractual cash flows could be payments of principal and interest on the principal amount outstanding.</p>
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B4.15 In some cases a financial asset may have contractual cash flows that are described as principal and interest but those cash flows do not represent the payment of principal and interest on the principal amount outstanding as described in paragraphs 4.2(b) and 4.3 of this Standard.

B4.16 This may be the case if the financial asset represents an investment in particular assets or cash flows and hence the contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. For example, the contractual cash flows may include payment for factors other than consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time. As a result, the instrument would not satisfy the condition in paragraph 4.2(b). This could be the case when a creditor's claim is limited to specified assets of the debtor or the cash flows from specified assets (for example, a 'non-recourse' financial asset).

- B4.17 However, the fact that a financial asset is non-recourse does not in itself necessarily preclude the financial asset from meeting the condition in paragraph 4.2(b). In such situations, the creditor is required to assess ('look through to') the particular underlying assets or cash flows to determine whether the contractual cash flows of the financial asset being classified are payments of principal and interest on the principal amount outstanding. If the terms of the financial asset give rise to any other cash flows or limit the cash flows in a manner inconsistent with payments representing principal and interest, the financial asset does not meet the condition in paragraph 4.2(b). Whether the underlying assets are financial assets or non-financial assets does not in itself affect this assessment.
- B4.18 If a contractual cash flow characteristic is not genuine, it does not affect the classification of a financial asset. A cash flow characteristic is not genuine if it affects the instrument's contractual cash flows only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur.
- B4.19 In almost every lending transaction the creditor's instrument is ranked relative to the instruments of the debtor's other creditors. An instrument that is subordinated to other instruments may have contractual cash flows that are payments of principal and interest on the principal amount outstanding if the debtor's non-payment is a breach of contract and the holder has a contractual right to unpaid amounts of principal and interest on the principal amount outstanding even in the event of the debtor's bankruptcy. For example, a trade receivable that ranks its creditor as a general creditor would qualify as having payments of principal and interest on the principal amount outstanding. This is the case even if the debtor issued loans that are collateralised, which in the event of bankruptcy would give that loan holder priority over the claims of the general creditor in respect of the collateral but does not affect the contractual right of the general creditor to unpaid principal and other amounts due.

### **Contractually linked instruments**

- B4.20 In some types of transactions, an entity may prioritise payments to the holders of financial assets using multiple contractually linked instruments that create concentrations of credit risk (tranches). Each tranche has a subordination ranking that specifies the order in which any cash flows generated by the issuer are allocated to the tranche. In such situations, the holders of a tranche have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flows to satisfy higher-ranking tranches.

B4.21 In such transactions, a tranche has cash flow characteristics that are payments of principal and interest on the principal amount outstanding only if:

- (a) the contractual terms of the tranche being assessed for classification (without looking through to the underlying pool of financial instruments) give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding (e.g. the interest rate on the tranche is not linked to a commodity index);
- (b) the underlying pool of financial instruments has the cash flow characteristics set out in paragraphs B4.23 and B4.24; and
- (c) the exposure to credit risk in the underlying pool of financial instruments inherent in the tranche is equal to or lower than the exposure to credit risk of the underlying pool of financial instruments (for example, this condition would be met if the underlying pool of instruments were to lose 50 per cent as a result of credit losses and under all circumstances the tranche would lose 50 per cent or less).

B4.22 An entity must look through until it can identify the underlying pool of instruments that are creating (rather than passing through) the cash flows. This is the underlying pool of financial instruments.

B4.23 The underlying pool must contain one or more instruments that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

B4.24 The underlying pool of instruments may also include instruments that:

- (a) reduce the cash flow variability of the instruments in paragraph B4.23 and, when combined with the instruments in paragraph B4.23, result in cash flows that are solely payments of principal and interest on the principal amount outstanding (e.g. an interest rate cap or floor or a contract that reduces the credit risk on some or all of the instruments in paragraph B4.23); or
- (b) align the cash flows of the tranches with the cash flows of the pool of underlying instruments in paragraph B4.23 to address differences in and only in:
  - (i) whether the interest rate is fixed or floating;

- (ii) the currency in which the cash flows are denominated, including inflation in that currency; or
- (iii) the timing of the cash flows.

B4.25 If any instrument in the pool does not meet the conditions in either paragraph B4.23 or paragraph B4.24, the condition in paragraph B4.21(b) is not met.

B4.26 If the holder cannot assess the conditions in paragraph B4.21 at initial recognition, the tranche must be measured at fair value. If the underlying pool of instruments can change after initial recognition in such a way that the pool may not meet the conditions in paragraphs B4.23 and B4.24, the tranche does not meet the conditions in paragraph B4.21 and must be measured at fair value.

## **Measurement**

### **Initial measurement of financial assets**

B5.1 The fair value of a financial asset at initial recognition is normally the transaction price (i.e. the fair value of the consideration given, see also paragraph AG76 of AASB 139). However, if part of the consideration given is for something other than the financial instrument, the fair value of the financial instrument is estimated using a valuation technique (see paragraphs AG74-AG79 of AASB 139). For example, the fair value of a long-term loan or receivable that carries no interest can be estimated as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.

B5.2 If an entity originates a loan that bears an off-market interest rate (e.g. 5 per cent when the market rate for similar loans is 8 per cent), and receives an upfront fee as compensation, the entity recognises the loan at its fair value, i.e. net of the fee it receives.

### **Subsequent measurement of financial assets**

B5.3 If a financial instrument that was previously recognised as a financial asset is measured at fair value and its fair value decreases below zero, it is a financial liability measured in accordance with AASB 139. However, hybrid contracts with financial asset hosts are always measured in accordance with AASB 9.

B5.4 The following example illustrates the accounting for transaction costs on the initial and subsequent measurement of a financial asset measured at fair value with changes through other comprehensive income in accordance with paragraph 5.4.4. An entity acquires an asset for CU100<sup>1</sup> plus a purchase commission of CU2. Initially, the entity recognises the asset at CU102. The reporting period ends one day later, when the quoted market price of the asset is CU100. If the asset were sold, a commission of CU3 would be paid. On that date, the entity measures the asset at CU100 (without regard to the possible commission on sale) and recognises a loss of CU2 in other comprehensive income.

**Investments in unquoted equity instruments (and contracts on those investments that must be settled by delivery of the unquoted equity instruments)**

B5.5 All investments in equity instruments and contracts on those instruments must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value. That may be the case if insufficient more recent information is available to determine fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

B5.6 Indicators that cost might not be representative of fair value include:

- (a) a significant change in the performance of the investee compared with budgets, plans or milestones.
- (b) changes in expectation that the investee's technical product milestones will be achieved.
- (c) a significant change in the market for the investee's equity or its products or potential products.
- (d) a significant change in the global economy or the economic environment in which the investee operates.
- (e) a significant change in the performance of comparable entities, or in the valuations implied by the overall market.
- (f) internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.

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<sup>1</sup> In this Standard monetary amounts are denominated in 'currency units (CU)'.



- (g) evidence from external transactions in the investee's equity, either by the investee (such as a fresh issue of equity), or by transfers of equity instruments between third parties.

B5.7 The list in paragraph B5.6 is not exhaustive. An entity shall use all information about the performance and operations of the investee that becomes available after the date of initial recognition. To the extent that any such relevant factors exist, they may indicate that cost might not be representative of fair value. In such cases, the entity must estimate fair value.

B5.8 Cost is never the best estimate of fair value for investments in quoted equity instruments (or contracts on quoted equity instruments).

### **Reclassification**

B5.9 Paragraph 4.9 requires an entity to reclassify financial assets if the objective of the entity's business model for managing those financial assets changes. Such changes are expected to be very infrequent. Such changes must be determined by the entity's senior management as a result of external or internal changes and must be significant to the entity's operations and demonstrable to external parties. Examples of a change in business model include the following:

- (a) An entity has a portfolio of commercial loans that it holds to sell in the short term. The entity acquires a company that manages commercial loans and has a business model that holds the loans in order to collect the contractual cash flows. The portfolio of commercial loans is no longer for sale, and the portfolio is now managed together with the acquired commercial loans and all are held to collect the contractual cash flows.
- (b) A financial services firm decides to shut down its retail mortgage business. That business no longer accepts new business and the financial services firm is actively marketing its mortgage loan portfolio for sale.

B5.10 A change in the objective of the entity's business model must be effected before the reclassification date. For example, if a financial services firm decides on 15 February to shut down its retail mortgage business and hence must reclassify all affected financial assets on 1 April (i.e. the first day of the entity's next reporting period), the entity must not accept new retail mortgage business or otherwise engage in activities consistent with its former business model after 15 February.

B5.11 The following are not changes in business model:

- (a) a change in intention related to particular financial assets (even in circumstances of significant changes in market conditions).
- (b) a temporary disappearance of a particular market for financial assets.
- (c) a transfer of financial assets between parts of the entity with different business models.

### **Gains and losses**

B5.12 Paragraph 5.4.4 permits an entity to make an irrevocable election to present in other comprehensive income changes in the fair value of an investment in an equity instrument that is not held for trading. This election is made on an instrument-by-instrument (i.e. share-by-share) basis. Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss. However, the entity may transfer the cumulative gain or loss within equity. Dividends on such investments are recognised in profit or loss in accordance with AASB 118 *Revenue* unless the dividend clearly represents a recovery of part of the cost of the investment.

B5.13 An entity applies AASB 121 *The Effects of Changes in Foreign Exchange Rates* to financial assets that are monetary items in accordance with AASB 121 and denominated in a foreign currency. AASB 121 requires any foreign exchange gains and losses on monetary assets to be recognised in profit or loss. An exception is a monetary item that is designated as a *hedging instrument* in either a cash flow hedge (see paragraphs 95-101 of AASB 139) or a hedge of a net investment (see paragraph 102 of AASB 139).

B5.14 Paragraph 5.4.4 permits an entity to make an irrevocable election to present in other comprehensive income changes in the fair value of an investment in an equity instrument that is not held for trading. Such an investment is not a monetary item. Accordingly, the gain or loss that is presented in other comprehensive income in accordance with paragraph 5.4.4 includes any related foreign exchange component.

B5.15 If there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component of those financial instruments are presented in profit or loss.

## **Transition**

### **Financial assets held for trading**

- B8.1 At the date of initial application of this Standard, an entity must determine whether the objective of the entity's business model for managing any of its financial assets meets the condition in paragraph 4.2(a) or if a financial asset is eligible for the election in paragraph 5.4.4. For that purpose, an entity shall determine whether financial assets meet the definition of held for trading as if the entity had acquired the assets at the date of initial application.

## **DELETED IFRS 9 TEXT**

*Deleted IFRS 9 text is not part of AASB 9*

### **Paragraph 8.1.1**

An entity shall apply this IFRS for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies this IFRS in its financial statements for a period beginning before 1 January 2013, it shall disclose that fact and at the same time apply the amendments in Appendix C.