International Financial Reporting Standard IFRS 9

Financial Instruments

July 2014

INTRODUCTION

Introduction

Reasons for issuing IFRS 9

IN1 IFRS 9 *Financial Instruments* sets out the requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This Standard replaces IAS 39 *Financial Instruments: Recognition and Measurement*.

IN2 Many users of financial statements and other interested parties told the International Accounting Standards Board (IASB) that the requirements in IAS 39 were difficult to understand, apply and interpret. They urged the IASB to develop a new Standard for the financial reporting of financial instruments that was principle-based and less complex. Although the IASB amended IAS 39 several times to clarify requirements, add guidance and eliminate internal inconsistencies, it had not previously undertaken a fundamental reconsideration of the reporting for financial instruments.

IN3 In 2005 the IASB and the US national standard-setter, the Financial Accounting Standards Board (FASB), began working towards a long-term objective of improving and simplifying the reporting for financial instruments. This work resulted in the publication of the Discussion Paper, *Reducing Complexity in Reporting Financial Instruments*, in March 2008. Focusing on the measurement of financial instruments and hedge accounting, the Discussion Paper identified several possible approaches for improving and simplifying the accounting for financial instruments. The responses to the Discussion Paper indicated support for a significant change in the requirements for reporting financial instruments. In November 2008 the IASB added this project to its active agenda.

IN4 In April 2009, in response to the feedback received on its work responding to the global financial crisis, and following the conclusions of the G20 leaders and the recommendations of international bodies such as the Financial Stability Board, the IASB announced an accelerated timetable for replacing IAS 39.

The IASB's approach to replacing IAS 39

IN5 The IASB had always intended that IFRS 9 would replace IAS 39 in its entirety. However, in response to requests from interested parties that the accounting for financial instruments be improved quickly, the IASB divided its project to replace IAS 39 into three main phases. As the IASB completed each phase, it created chapters in IFRS 9 that replaced the corresponding requirements in IAS 39.

IN6 The three main phases of the IASB's project to replace IAS 39 were:

(a) **Phase 1: classification and measurement of financial assets and financial liabilities.** In November 2009 the IASB issued the chapters of IFRS 9 relating to the classification and measurement of financial assets. Those chapters require financial assets to be classified on the basis of the business model within which they are held and their contractual cash flow characteristics. In October 2010 the IASB added to IFRS 9 the requirements related to the classification and measurement of financial liabilities. Those additional requirements are described further in paragraph IN7. In July 2014 the IASB made limited amendments to the classification and measurement requirements in IFRS 9 for financial assets. Those amendments are described further in paragraph IN8.

(b) **Phase 2: impairment methodology.** In July 2014 the IASB added to IFRS 9 the impairment requirements related to the accounting for expected credit losses on an entity's financial assets and commitments to extend credit. Those requirements are described further in paragraph IN9.

(c) **Phase 3: hedge accounting.** In November 2013 the IASB added to IFRS 9 the requirements related to hedge accounting. Those additional requirements are described further in paragraph IN10.

Classification and measurement

IN7 In November 2009 the IASB issued the chapters of IFRS 9 relating to the classification and measurement of financial assets. Financial assets are classified on the basis of the business model within which they are held and their contractual cash flow characteristics. In October 2010 the IASB added to IFRS 9 the requirements for the classification and measurement of financial liabilities. Most of those requirements were carried forward unchanged from IAS 39. However, the requirements related to the fair value option for financial liabilities were changed to address own credit risk. Those improvements respond to consistent feedback from users of financial statements and others that the effects of changes in a liability's credit risk ought not to affect profit or loss unless the liability is held for trading. In November 2013 the IASB amended IFRS 9 to permit entities to early apply those requirements without applying the other requirements of IFRS 9 at the same time.

IN8 In July 2014 the IASB made limited amendments to the requirements in IFRS 9 for the classification and measurement of financial assets. Those amendments addressed a narrow range of application questions and introduced a 'fair value through other comprehensive income' measurement category for particular simple debt instruments. The introduction of that third measurement category responded to feedback from interested parties, including many insurance companies, that this is the most relevant measurement basis for financial assets that are held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

Impairment methodology

IN9 Also in July 2014 the IASB added to IFRS 9 the impairment requirements relating to the accounting for an entity's expected credit losses on its financial assets and commitments to extend credit. Those requirements eliminate the threshold that was in IAS 39 for the recognition of credit losses. Under the impairment approach in IFRS 9 it is no longer necessary for a credit event to have occurred before credit losses are recognised. Instead, an entity always accounts for expected credit losses, and changes in those expected credit losses. The amount of expected credit losses is updated at each reporting date to reflect changes in credit risk since initial recognition and, consequently, more timely information is provided about expected credit losses.

Hedge accounting

IN10 In November 2013 the IASB added to IFRS 9 the requirements related to hedge accounting. These requirements align hedge accounting more closely with risk management, establish a more principle-based approach to hedge accounting and address inconsistencies and weaknesses in the hedge accounting model in IAS 39. In its discussion of these general hedge accounting requirements, the IASB did not address specific accounting for open portfolios or macro hedging. Instead, the IASB is discussing proposals for those items as part of its current active agenda and in April 2014 published a Discussion Paper *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging*. Consequently, the exception in IAS 39 for a fair value hedge of an interest rate exposure of a portfolio of financial assets or financial liabilities continues to apply. The IASB also provided entities with an accounting policy choice between applying the hedge accounting requirements of IFRS 9 or continuing to apply the existing hedge accounting requirements in IAS 39 for all hedge accounting because it had not yet completed its project on the accounting for macro hedging.

Other requirements

IN11 In addition to the three phases described above, in March 2009 the IASB published the Exposure Draft *Derecognition* (Proposed amendments to IAS 39 and IFRS 7). However, in June 2010 the IASB revised its strategy and work plan and decided to retain the existing requirements in IAS 39 for the derecognition of financial assets and financial liabilities but to finalise improved disclosure requirements. Those new disclosure requirements were issued in October 2010 as an amendment to IFRS 7 *Financial Instruments: Disclosures* and had an effective date of 1 July 2011. In October 2010 the requirements in IAS 39 for the derecognition of financial assets and financial liabilities were carried forward unchanged to IFRS 9.

IN12 As a result of the added requirements described in paragraphs IN7 and IN11, IFRS 9 and its Basis for Conclusions (as issued in 2009) were restructured in 2010. Many paragraphs were renumbered and some were re-sequenced. New paragraphs were added to accommodate the guidance that was carried forward unchanged from IAS 39. In addition, new sections were added to IFRS 9. Otherwise, the restructuring did not change the requirements in IFRS 9 (2009). In addition, the Basis for Conclusions on IFRS 9 was expanded in 2010 to include material from the Basis for Conclusions on IAS 39 that discusses guidance that was carried forward without being reconsidered. Minor editorial changes were made to that material.

IN13 In 2014, as a result of the added requirements described in paragraph IN9, additional minor structural changes were made to the application guidance on Chapter 5 (Measurement) of IFRS 9. Specifically, the paragraphs related to the measurement of investments in equity instruments and contracts on those investments were renumbered as paragraphs B5.2.3–B5.2.6. These requirements were not otherwise changed. This renumbering made it possible to add the requirements for amortised cost and impairment as Sections 5.4 and 5.5.