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Approval by the Board of IFRS 9 issued in November 2009

International Financial Reporting Standard 9 *Financial Instruments* was approved for issue by thirteen of the fifteen members of the International Accounting Standards Board. Mr Leisenring and Ms McConnell dissented from the issue of the IFRS. Their dissenting opinions are set out after the Basis for Conclusions.

Sir David Tweedie Chairman

Stephen Cooper

Philippe Danjou

Jan Engström

Patrick Finnegan

Robert P Garnett

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Prabhakar Kalavacherla

James J Leisenring

Patricia McConnell

Warren J McGregor

John T Smith

Tatsumi Yamada

Wei-Guo Zhang

Approval by the Board of the requirements added to IFRS 9 in October 2010

The requirements added to International Financial Reporting Standard 9 *Financial Instruments* in October 2010 were approved for issue by fourteen of the fifteen members of the International Accounting Standards Board. Mr Scott abstained in view of his recent appointment to the Board.

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Stephen Cooper

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Approval by the Board of *Mandatory Effective Date of IFRS 9 and Transition Disclosures* (Amendments to IFRS 9 (2009), IFRS 9 (2010) and IFRS 7) issued in December 2011

Mandatory Effective Date of IFRS 9 and Transition Disclosures (Amendments to IFRS 9 (2009), IFRS 9 (2010) and IFRS 7) was approved for publication by fourteen of the fifteen members of the International Accounting Standards Board. Ms McConnell dissented from the issue of the amendments. Her dissenting opinion is set out after the Basis for Conclusions.

Hans Hoogervorst

Chairman

Ian Mackintosh

Vice-Chairman

Stephen Cooper

Philippe Danjou

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Patrick Finnegan

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Prabhakar Kalavacherla

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Basis for Conclusions on IFRS 9 Financial Instruments

This Basis for Conclusions accompanies, but is not part of, IFRS 9.

The Board expects that IFRS 9 will replace IAS 39 Financial Instruments: Recognition and Measurement in its entirety. When revised in 2003 IAS 39 was accompanied by a Basis for Conclusions summarising the considerations of the Board, as constituted at the time, in reaching some of its conclusions in that Standard. That Basis for Conclusions was subsequently updated to reflect amendments to the Standard. For convenience the Board has incorporated into its Basis for Conclusions on IFRS 9 material from the Basis for Conclusions on IAS 39 that discusses matters that the Board has not reconsidered. That material is contained in paragraphs denoted by numbers with the prefix BCZ. In those paragraphs cross-references to the IFRS have been updated accordingly and minor necessary editorial changes have been made. In 2003 and later some Board members dissented from the issue of IAS 39 and subsequent amendments, and portions of their dissenting opinions relate to requirements that have been carried forward to IFRS 9. Those dissenting opinions are set out after the Basis for Conclusions on IAS 39.

Paragraphs describing the Board's considerations in reaching its own conclusions on IFRS 9 are numbered with the prefix BC.

Introduction

- BCIN.1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in developing IFRS 9 *Financial Instruments*. Individual Board members gave greater weight to some factors than to others.
- BCIN.2 The Board has long acknowledged the need to improve the requirements for financial reporting of financial instruments to enhance the relevance and understandability of information about financial instruments for users of financial statements. To meet the urgency of that need in the light of the financial crisis, the Board decided to replace IAS 39 *Financial Instruments: Recognition and Measurement* in its entirety as expeditiously as possible. To make progress quickly the Board divided the project into several phases. In adopting this approach, the Board acknowledged the difficulties that might be created by differences in timing between this project and others, in particular phase II of the project on insurance contracts. (Paragraphs BC7.2(b), BC7.4 and BC7.30–BC7.34 discuss issues relating to insurance contracts.)
- BCIN.3 IFRS 9 is a new standard dealing with the accounting for financial instruments. In developing IFRS 9, the Board considered the responses to its exposure draft *Financial Instruments: Classification and Measurement*, published in July 2009.
- BCIN.4 That exposure draft contained proposals for all items within the scope of IAS 39. However, some respondents said that the Board should finalise its proposals on classification and measurement of financial assets while retaining the existing requirements for financial liabilities (including the requirements for embedded derivatives and the fair value option) until the Board had more fully considered and debated the issues relating to financial liabilities. Those respondents pointed out that the Board accelerated its project on financial instruments because of the global financial crisis, which placed more emphasis on issues in the accounting for financial assets than for financial liabilities. They suggested that the Board should consider issues related to financial liabilities more fully before finalising the requirements for classification and measurement of financial liabilities.
- BCIN.5 The Board noted those concerns and, as a result, in November 2009 it finalised the first chapters of IFRS 9, dealing with classification and measurement of financial assets. In the Board's view, requirements on classification and measurement are the foundation for a financial reporting standard on accounting for financial instruments, and requirements on associated matters (for example, on impairment and hedge accounting) have to reflect those requirements. In addition, the Board noted that many of the application issues that have arisen in the financial crisis are related to the classification and measurement of financial assets in accordance with IAS 39.
- BCIN.6 Thus, financial liabilities, including derivative liabilities, remained within the scope of IAS 39. Taking that course enabled the Board to obtain further feedback on the accounting for financial liabilities, including how best to address accounting for changes in own credit risk.
- BCIN.7 Immediately after issuing IFRS 9, the Board began an extensive outreach programme to gather feedback on the classification and measurement of financial liabilities. The Board obtained information and views from its Financial Instruments Working Group (FIWG) and from users, regulators, preparers, auditors and others from a range of industries across different geographical regions. The primary messages that the Board received were that the requirements in IAS 39 for classifying and measuring financial liabilities are

generally working well but 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. As a result of the feedback received, the Board decided to retain almost all of the requirements in IAS 39 for the classification and measurement of financial liabilities and carry them forward to IFRS 9 (see paragraphs BC4.46–BC4.53).

- BCIN.8 By taking that course, the issue of credit risk does not arise for most liabilities and would remain only in the context of financial liabilities designated under the fair value option. Thus, in May 2010 the Board published an exposure draft *Fair Value Option for Financial Liabilities*, which proposed that the effects of changes in the credit risk of liabilities designated under the fair value option would be presented in other comprehensive income. The Board considered the responses to that exposure draft and finalised requirements that were added to IFRS 9 in October 2010.
- BCIN.9 The Board is committed to completing its project on financial instruments expeditiously. The Board is also committed to increasing comparability between IFRSs and US generally accepted accounting principles (GAAP) requirements for financial instruments.

Scope (chapter 2)

- BC2.1 The Board has not yet considered the scope of IFRS 9. The scope of IAS 39 and its interaction with other IFRSs have resulted in some application and interpretation issues. However, the Board believes that it should address the issue of scope comprehensively rather than only in the context of classification and measurement. The scope of IAS 39 has not been raised as a matter of concern during the financial crisis and, hence, the Board believes that the scope of IFRS 9 should be based on that of IAS 39 until it considers the scope more generally in a later phase of the project to replace IAS 39.

Recognition and derecognition (chapter 3)

Derecognition of a financial asset

The original IAS 39¹

- BCZ3.1 Under the original IAS 39, several concepts governed when a financial asset should be derecognised. It was not always clear when and in what order to apply those concepts. As a result, the derecognition requirements in the original IAS 39 were not applied consistently in practice.
- BCZ3.2 As an example, the original IAS 39 was unclear about the extent to which risks and rewards of a transferred asset should be considered for the purpose of determining whether derecognition is appropriate and how risks and rewards should be assessed. In some cases (eg transfers with total returns swaps or unconditional written put options), the Standard specifically indicated whether derecognition was appropriate, whereas in others (eg credit guarantees) it was unclear. Also, some questioned whether the assessment should focus on risks and rewards or only risks and how different risks and rewards should be aggregated and weighed.
- BCZ3.3 To illustrate, assume an entity sells a portfolio of short-term receivables of CU100² and provides a guarantee to the buyer for credit losses up to a specified amount (say CU20) that is less than the total amount of the receivables, but higher than the amount of expected losses (say CU5). In this case, should (a) the entire portfolio continue to be recognised, (b) the portion that is guaranteed continue to be recognised or (c) the portfolio be derecognised in full and a guarantee be recognised as a financial liability? The original IAS 39 did not give a clear answer and the IAS 39 Implementation Guidance Committee—a group set up by the Board's predecessor body to resolve interpretative issues raised in practice—was unable to reach an agreement on how IAS 39 should be applied in this case. In developing proposals for improvements to IAS 39, the Board concluded that it was important that IAS 39 should provide clear and consistent guidance on how to account for such a transaction.

Exposure draft of proposed amendments to IAS 39 published in 2002

- BCZ3.4 To resolve the problems, the exposure draft published in 2002 proposed an approach to derecognition under which a transferor of a financial asset continues to recognise that asset to the extent the transferor has a continuing involvement in it. Continuing involvement could be established in two ways: (a) a reacquisition provision (such as a call option, put option or repurchase agreement) and (b) a provision to pay or receive

¹ In this Basis for Conclusions, the phrase 'the original IAS 39' refers to the Standard issued by the Board's predecessor body, the International Accounting Standards Committee (IASC) in 1999 and revised in 2000.

² In this Basis for Conclusions, monetary amounts are denominated in 'currency units (CU)'.

compensation based on changes in value of the transferred asset (such as a credit guarantee or net cash-settled option).

- BCZ3.5 The purpose of the approach proposed in the exposure draft was to facilitate consistent implementation and application of IAS 39 by eliminating conflicting concepts and establishing an unambiguous, more internally consistent and workable approach to derecognition. The main benefits of the proposed approach were that it would greatly clarify IAS 39 and provide transparency on the balance sheet about any continuing involvement in a transferred asset.

Comments received

- BCZ3.6 Many respondents to the exposure draft agreed that there were inconsistencies in the existing derecognition requirements in IAS 39. However, there was limited support for the proposed continuing involvement approach. Respondents expressed conceptual and practical concerns, including:
- (a) any benefits of the proposed changes did not outweigh the burden of adopting a different approach that had its own set of (as yet unidentified and unsolved) problems;
 - (b) the proposed approach was a fundamental change from that in the original IAS 39;
 - (c) the proposal did not achieve convergence with US GAAP;
 - (d) the proposal was untested; and
 - (e) the proposal was not consistent with the *Framework for the Preparation and Presentation of Financial Statements*.
- BCZ3.7 Many respondents expressed the view that the basic approach in the original IAS 39 should be retained and the inconsistencies removed. The reasons included: (a) the existing IAS 39 had proven to be reasonable in concept and operational in practice and (b) the approach should not be changed until the Board developed an alternative comprehensive approach.

Revisions to IAS 39

- BCZ3.8 In response to the comments received, the Board decided to revert to the derecognition concepts in the original IAS 39 and to clarify how and in what order the concepts should be applied. In particular, the Board decided that an evaluation of the transfer of risks and rewards should precede an evaluation of the transfer of control for all types of transactions.
- BCZ3.9 Although the structure and wording of the derecognition requirements were substantially amended, the Board concluded that the requirements in the revised IAS 39 should not be substantially different from those in the original IAS 39. In support of this conclusion, it noted that the application of the requirements in the revised IAS 39 generally resulted in answers that could have been obtained under the original IAS 39. In addition, although there would be a need to apply judgement to evaluate whether substantially all risks and rewards had been retained, this type of judgement was not new compared with the original IAS 39. However, the revised requirements clarified the application of the concepts in circumstances in which it was previously unclear how IAS 39 should be applied (this guidance is now in IFRS 9). The Board concluded that it would be inappropriate to revert to the original IAS 39 without such clarifications.
- BCZ3.10 The Board also decided to include guidance in the Standard that clarified how to evaluate the concepts of risks and rewards and of control. The Board regarded such guidance as important to provide a framework for applying the concepts in IAS 39 (this guidance is now in IFRS 9). Although judgement was still necessary to apply the concepts in practice, the guidance was expected to increase consistency in how the concepts were applied.
- BCZ3.11 More specifically, the Board decided that the transfer of risks and rewards should be evaluated by comparing the entity's exposure before and after the transfer to the variability in the amounts and timing of the net cash flows of the transferred asset. If the entity's exposure, on a present value basis, had not changed significantly, the entity would conclude that it had retained substantially all risks and rewards. In this case, the Board concluded that the asset should continue to be recognised. This accounting treatment was consistent with the treatment of repurchase transactions and some assets subject to deep in-the-money options under the original IAS 39. It was also consistent with how some interpreted the original IAS 39 when an entity sells a portfolio of short-term receivables but retains all substantive risks through the issue of a guarantee to compensate for all expected credit losses (see the example in paragraph BCZ3.3).
- BCZ3.12 The Board decided that control should be evaluated by looking to whether the transferee has the practical ability to sell the asset. If the transferee could sell the asset (eg because the asset was readily obtainable in the market and the transferee could obtain a replacement asset if it needed to return the asset to the transferor), the transferor had not retained control because the transferor did not control the transferee's use of the asset. If the transferee could not sell the asset (eg because the transferor had a call option and the asset

was not readily obtainable in the market, so that the transferee could not obtain a replacement asset), the transferor had retained control because the transferee was not free to use the asset as its own.

BCZ3.13 The original IAS 39 also did not contain guidance on when a part of a financial asset could be considered for derecognition. The Board decided to include such guidance in the Standard to clarify the issue (this guidance is now in IFRS 9). It decided that an entity should apply the derecognition principles to a part of a financial asset only if that part contained no risks and rewards relating to the part not being considered for derecognition. Accordingly, a part of a financial asset would be considered for derecognition only if it comprised:

- (a) only specifically identified cash flows from a financial asset (or a group of similar financial assets);
- (b) only a fully proportionate (pro rata) share of the cash flows from a financial asset (or a group of similar financial assets); or
- (c) only a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets).

In all other cases the derecognition principles would be applied to the financial asset in its entirety.

Arrangements under which an entity retains the contractual rights to receive the cash flows of a financial asset but assumes a contractual obligation to pay the cash flows to one or more recipients

BCZ3.14 The original IAS 39 did not provide explicit guidance about the extent to which derecognition is appropriate for contractual arrangements in which an entity retains its contractual right to receive the cash flows from an asset, but assumes a contractual obligation to pay those cash flows to another entity (a 'pass-through arrangement'). Questions were raised in practice about the appropriate accounting treatment and divergent interpretations evolved for more complex structures.

BCZ3.15 To illustrate the issue using a simple example, assume the following. Entity A makes a five-year interest-bearing loan (the 'original asset') of CU100 to Entity B. Entity A then enters into an agreement with Entity C in which, in exchange for a cash payment of CU90, Entity A agrees to pass to Entity C 90 per cent of all principal and interest payments collected from Entity B (as, when and if collected). Entity A accepts no obligation to make any payments to Entity C other than 90 per cent of exactly what has been received from Entity B. Entity A provides no guarantee to Entity C about the performance of the loan and has no rights to retain 90 per cent of the cash collected from Entity B nor any obligation to pay cash to Entity C if cash has not been received from Entity B. In the example above, does Entity A have a loan asset of CU100 and a liability of CU90 or does it have an asset of CU10? To make the example more complex, what if Entity A first transfers the loan to a consolidated special purpose entity (SPE), which in turn passes through to investors the cash flows from the asset? Does the accounting treatment change because Entity A first sold the asset to an SPE?³

BCZ3.16 To address these issues, the exposure draft of proposed amendments to IAS 39 in 2002 included guidance to clarify under which conditions pass-through arrangements could be treated as a transfer of the underlying financial asset. The Board concluded that an entity does not have an asset and a liability, as defined in the *Framework*⁴, when it enters into an arrangement to pass through cash flows from an asset and that arrangement meets specified conditions. In these cases, the entity acts more as an agent of the eventual recipients of the cash flows than as an owner of the asset. Accordingly, to the extent that those conditions are met the arrangement is treated as a transfer and considered for derecognition even though the entity may continue to collect cash flows from the asset. Conversely, to the extent the conditions are not met, the entity acts more as an owner of the asset with the result that the asset should continue to be recognised.

BCZ3.17 Respondents to the exposure draft (2002) were generally supportive of the proposed changes. Some respondents asked for further clarification of the requirements and the interaction with the requirements for consolidation of special purpose entities (in SIC-12 *Consolidation—Special Purpose Entities*). Respondents in the securitisation industry noted that under the proposed guidance many securitisation structures would not qualify for derecognition.

³ SIC-12 *Consolidation—Special Purpose Entities* was withdrawn and superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. There is no longer specific accounting guidance for special purpose entities because IFRS 10 applies to all types of entities.

⁴ References to the *Framework* are to IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

- BCZ3.18 Considering these and other comments, the Board decided to proceed with its proposals to issue guidance on pass-through arrangements and to clarify that guidance in finalising the revised IAS 39 (this guidance is now in IFRS 9).
- BCZ3.19 The Board concluded that the following three conditions must be met for treating a contractual arrangement to pass through cash flows from a financial asset as a transfer of that asset:
- (a) The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. However, the entity is allowed to make short-term advances to the eventual recipient so long as it has the right of full recovery of the amount lent plus accrued interest.
 - (b) The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.
 - (c) The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, during the short settlement period, the entity is not entitled to reinvest such cash flows except for investments in cash or cash equivalents and where any interest earned from such investments is remitted to the eventual recipients.
- BCZ3.20 These conditions followed from the definitions of assets and liabilities in the *Framework*. Condition (a) indicates that the transferor has no liability (because there is no present obligation to pay cash), and conditions (b) and (c) indicate that the transferor has no asset (because the transferor does not control the future economic benefits associated with the transferred asset).
- BCZ3.21 The Board decided that the derecognition tests that apply to other transfers of financial assets (ie the tests of transferring substantially all the risks and rewards and control) should also apply to arrangements to pass through cash flows that meet the three conditions but do not involve a fully proportional share of all or specifically identified cash flows. Thus, if the three conditions are met and the entity passes on a fully proportional share, either of all cash flows (as in the example in paragraph BCZ3.15) or of specifically identified cash flows (eg 10 per cent of all interest cash flows), the proportion sold is derecognised, provided the entity has transferred substantially all the risks and rewards of ownership. Thus, in the example in paragraph BCZ3.15, Entity A would report a loan asset of CU10 and derecognise CU90. Similarly, if an entity enters into an arrangement that meets the three conditions above, but the arrangement is not on a fully proportionate basis, the contractual arrangement would have to meet the general derecognition conditions to qualify for derecognition. This ensures consistency in the application of the derecognition model, whether a transaction is structured as a transfer of the contractual right to receive the cash flows of a financial asset or as an arrangement to pass through cash flows.
- BCZ3.22 To illustrate a disproportionate arrangement using a simple example, assume the following. Entity A originates a portfolio of five-year interest-bearing loans of CU10,000. Entity A then enters into an agreement with Entity C in which, in exchange for a cash payment of CU9,000, Entity A agrees to pay to Entity C the first CU9,000 (plus interest) of cash collected from the loan portfolio. Entity A retains rights to the last CU1,000 (plus interest), ie it retains a subordinated residual interest. If Entity A collects, say, only CU8,000 of its loans of CU10,000 because some debtors default, Entity A would pass on to Entity C all of the CU8,000 collected and Entity A keeps nothing of the CU8,000 collected. If Entity A collects CU9,500, it passes CU9,000 to Entity C and retains CU500. In this case, if Entity A retains substantially all the risks and rewards of ownership because the subordinated retained interest absorbs all of the likely variability in net cash flows, the loans continue to be recognised in their entirety even if the three pass-through conditions are met.
- BCZ3.23 The Board recognised that many securitisations might fail to qualify for derecognition either because one or more of the three conditions (now in paragraph 3.2.5 of IFRS 9) were not met or because the entity has retained substantially all the risks and rewards of ownership.
- BCZ3.24 Whether a transfer of a financial asset qualifies for derecognition does not differ depending on whether the transfer is direct to investors or through a consolidated SPE or trust that obtains the financial assets and, in turn, transfers a portion of those financial assets to third-party investors.

Transfers that do not qualify for derecognition

- BCZ3.25 The original IAS 39 did not provide guidance about how to account for a transfer of a financial asset that does not qualify for derecognition. The amendments included such guidance (that guidance is now in IFRS 9). To ensure that the accounting reflects the rights and obligations that the transferor has in relation to the transferred asset, there is a need to consider the accounting for the asset as well as the accounting for the associated liability.
- BCZ3.26 When an entity retains substantially all the risks and rewards of the asset (eg in a repurchase transaction), there are generally no special accounting considerations because the entity retains upside and downside

exposure to gains and losses resulting from the transferred asset. Therefore, the asset continues to be recognised in its entirety and the proceeds received are recognised as a liability. Similarly, the entity continues to recognise any income from the asset along with any expense incurred on the associated liability.

Continuing involvement in a transferred asset

- BCZ3.27 The Board decided that if the entity determines that it has neither retained nor transferred substantially all of the risks and rewards of an asset and that it has retained control, the entity should continue to recognise the asset to the extent of its continuing involvement. This is to reflect the transferor's continuing exposure to the risks and rewards of the asset and that this exposure is not related to the entire asset, but is limited in amount. The Board noted that precluding derecognition to the extent of the continuing involvement is useful to users of financial statements in such cases, because it reflects the entity's retained exposure to the risks and rewards of the financial asset better than full derecognition.
- BCZ3.28 When the entity transfers some significant risks and rewards and retains others and derecognition is precluded because the entity retains control of the transferred asset, the entity no longer retains all the upside and downside exposure to gains and losses resulting from the transferred asset. Therefore, the revised IAS 39 required (and IFRS 9 now requires) the asset and the associated liability to be measured in a way that ensures that any changes in value of the transferred asset that are not attributed to the entity are not recognised by the entity.
- BCZ3.29 For example, special measurement and income recognition issues arise if derecognition is precluded because the transferor has retained a call option or written a put option and the asset is measured at fair value. In those situations, in the absence of additional guidance, application of the general measurement and income recognition requirements for financial assets and financial liabilities may result in accounting that does not represent the transferor's rights and obligations related to the transfer.

Improved disclosure requirements issued in October 2010

- BC3.30 In March 2009 the Board published an exposure draft *Derecognition* (proposed amendments to IAS 39 and IFRS 7 *Financial Instruments: Disclosures*). In June 2009 the Board held public round tables in North America, Asia and Europe to discuss the proposals in the exposure draft. In addition to the round tables, the Board undertook an extensive outreach programme with users, preparers, regulators, auditors, trade associations and others.
- BC3.31 However, in June 2010 the Board revised its strategy and work plan. The Board and the US Financial Accounting Standards Board (FASB) decided that their near-term priority should be to increase the transparency and comparability of their standards by improving and aligning US GAAP and IFRS disclosure requirements for financial assets transferred to another entity. The boards also decided to conduct additional research and analysis, including a post-implementation review of the FASB's recently amended requirements, as a basis for assessing the nature and direction of any further efforts to improve or align IFRSs and US GAAP. As a result, the Board finalised the disclosure requirements that were included in the exposure draft with a view to aligning the disclosure requirements in IFRSs with US GAAP requirements for transfers of financial assets. Those disclosure requirements were issued in October 2010 as an amendment to IFRS 7. In October 2010 the requirements in IAS 39 for derecognition of financial assets and financial liabilities were carried forward unchanged to IFRS 9.

Classification (chapter 4)

Classification of financial assets

- BC4.1 In IFRS 9 as issued in 2009 the Board aimed to help users to understand the financial reporting of financial assets by:
- (a) reducing the number of classification categories and providing a clearer rationale for measuring financial assets in a particular way that replaces the numerous categories in IAS 39, each of which has specific rules dictating how an asset can or must be classified;
 - (b) applying a single impairment method to all financial assets not measured at fair value, which replaces the many different impairment methods that are associated with the numerous classification categories in IAS 39; and
 - (c) aligning the measurement attribute of financial assets with the way the entity manages its financial assets ('business model') and their contractual cash flow characteristics, thus providing relevant and

useful information to users for their assessment of the amounts, timing and uncertainty of the entity's future cash flows.

- BC4.2 The Board believes that IFRS 9 both helps users to understand and use the financial reporting of financial assets and eliminates much of the complexity in IAS 39. The Board disagrees with the assertion made by a dissenting Board member that IFRS 9 does not meet the objective of reducing the number of classification categories for financial assets and eliminating the specific rules associated with those categories. Unlike IAS 39, IFRS 9 provides a clear rationale for measuring a financial asset at either amortised cost or fair value, and hence helps users to understand the financial reporting of financial assets. IFRS 9 aligns the measurement attribute of financial assets with the way the entity manages its financial assets ('business model') and their contractual cash flow characteristics. In so doing, IFRS 9 significantly reduces complexity by eliminating the numerous rules associated with each classification category in IAS 39. Consistently with all other financial assets, hybrid contracts with financial asset hosts are classified and measured in their entirety, thereby eliminating the complex and rule-based requirements in IAS 39 for embedded derivatives. Furthermore, IFRS 9 requires a single impairment method, which replaces the different impairment methods associated with the many classification categories in IAS 39. The Board believes that these changes will help users to understand the financial reporting of financial assets and to better assess the amounts, timing and uncertainty of future cash flows.

Measurement categories for financial assets

- BC4.3 Some users of financial statements support a single measurement method—fair value—for all financial assets. They view fair value as more relevant than other measurements in helping them to assess the effect of current economic events on an entity. They assert that having one measurement attribute for all financial assets promotes consistency in valuation, presentation and disclosure and improves the usefulness of financial statements.
- BC4.4 However, many users and others, including many preparers and auditors of financial statements and regulators, do not support the recognition in the statement of comprehensive income of changes in fair value for financial assets that are not held for trading or are not managed on a fair value basis. Some users say that they often value an entity on the basis of its business model and that in some circumstances cost-based information provides relevant information that can be used to predict likely actual cash flows.
- BC4.5 Some, including some of those who generally support the broad application of fair value for financial assets, raise concerns about the use of fair value when fair value cannot be determined within a narrow range. Those views were consistent with the general concerns raised during the financial crisis. Many also believe that other issues, including financial statement presentation, need to be addressed before a comprehensive fair value measurement requirement would be feasible.
- BC4.6 In response to those views, the Board decided that measuring all financial assets at fair value is not the most appropriate approach to improving the financial reporting for financial instruments. Accordingly, the exposure draft published in 2009 proposed that entities should classify financial assets into two primary measurement categories: amortised cost and fair value (the 'mixed attribute approach'). The Board noted that both of those measurement methods can provide useful information to users of financial statements for particular types of financial assets in particular circumstances.
- BC4.7 Almost all respondents to the exposure draft published in 2009 supported the mixed attribute approach, stating that amortised cost provides relevant and useful information about particular financial assets in particular circumstances because it provides information about the entity's likely actual cash flows. Some respondents said that fair value does not provide such information because it assumes that the financial asset is sold or transferred on the measurement date.
- BC4.8 Accordingly, IFRS 9 requires some financial assets to be measured at amortised cost if particular conditions are met.

Fair value information in the statements of financial position and financial performance

- BC4.9 Some respondents to the exposure draft published in 2009 proposed that fair value information should be presented in the statement of financial position for financial assets measured at amortised cost. Some of those supporting such presentation said that the information provided would be more reliable and timely if it were required to be presented in the statement of financial position rather than in the notes.
- BC4.10 The Board also considered whether the total gains and losses for the period related to fair value measurements in Level 3 of the fair value measurement hierarchy (paragraph 27A of IFRS 7 describes the

levels in the fair value hierarchy⁵) should be presented separately in the statement of comprehensive income. Those supporting such presentation said that its prominence would draw attention to how much of the total fair value gain or loss for the period was attributable to fair value measurements that are subject to more measurement uncertainty.

- BC4.11 The Board decided that it would reconsider both issues at a future date. The Board noted that the Level 3 gains or losses for the period are required to be disclosed in the notes to the financial statements in accordance with IFRS 7⁶. The Board also noted that neither proposal had been exposed for public comment and further consultation was required. The Board decided that these two issues should form part of convergence discussions with the FASB.

Approach to classifying financial assets

- BC4.12 The exposure draft published in 2009 proposed that an entity should classify its financial assets into two primary measurement categories on the basis of the financial assets' characteristics and the entity's business model for managing them. Thus, a financial asset would be measured at amortised cost if two conditions were met:

- (a) the financial asset has only basic loan features; and
- (b) the financial asset is managed on a contractual yield basis.

A financial asset that did not meet both conditions would be measured at fair value.

- BC4.13 Most respondents supported classification on the basis of the contractual terms of the financial asset and how an entity manages groups of financial assets. Although they agreed with the principles proposed in the exposure draft, some did not agree with the way the approach was described and said that more application guidance was needed, in particular to address the following issues:

- (a) the order in which the two conditions are considered;
- (b) how the 'managed on a contractual yield basis' condition should be applied; and
- (c) how the 'basic loan features' condition should be applied.

- BC4.14 Most respondents agreed that the two conditions for determining how financial assets are measured were necessary. However, many questioned the order in which the two conditions should be considered. The Board agreed with those who commented that it would be more efficient for an entity to consider the business model condition first. Therefore, the Board clarified that entities would consider the business model first. However, the Board noted that the contractual cash flow characteristics of any financial asset within a business model that has the objective of collecting contractual cash flows must also be assessed to ensure that amortised cost provides relevant information to users.

The entity's business model

- BC4.15 The Board concluded that an entity's business model affects the predictive quality of contractual cash flows—ie whether the likely actual cash flows will result primarily from the collection of contractual cash flows. Accordingly, the exposure draft published in 2009 proposed that a financial asset should be measured at amortised cost only if it is 'managed on a contractual yield basis'. This condition was intended to ensure that the measurement of a financial asset provides information that is useful to users of financial statements in predicting likely actual cash flows.

- BC4.16 Almost all respondents to the exposure draft agreed that classification and measurement should reflect how an entity manages its financial assets. However, most expressed concern that the term 'managed on a contractual yield basis' would not adequately describe that principle and that more guidance was needed.

- BC4.17 In August 2009 the FASB posted on its website a description of its tentative approach to classification and measurement of financial instruments. That approach also considers the entity's business model. Under that approach, financial instruments would be measured at fair value through profit or loss unless:

... an entity's business strategy is to hold debt instruments with principal amounts for collection or payment(s) of contractual cash flows rather than to sell or settle the financial instruments with a third party ...

⁵ IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains requirements for measuring fair value and for disclosing information about fair value measurements. IFRS 13 contains a three-level fair value hierarchy for the inputs used in valuation techniques to measure fair value and for the related disclosures. As a consequence paragraph 27A of IFRS 7 has been deleted.

⁶ IFRS 13, issued in May 2011, requires disclosures about fair value measurements. As a consequence paragraph 27B(c) and (d) of IFRS 7 has been deleted.

The FASB also provided explanatory text:

... an entity's business strategy for a financial instrument would be evaluated based on how the entity manages its financial instruments rather than based on the entity's intent for an individual financial instrument. The entity also would demonstrate that it holds a high proportion of similar instruments for long periods of time relative to their contractual terms.

- BC4.18 The Board had intended 'managed on a contractual yield basis' to describe a similar condition. However, it decided not to use the FASB's proposed guidance because the additional guidance included would still necessitate significant judgement. In addition, the Board noted that the FASB's proposed approach might be viewed as very similar to the notion of 'held to maturity' in IAS 39, which could result in 'bright line' guidance on how to apply it. Most respondents believed the Board should avoid such bright lines and that an entity should be required to exercise judgement.
- BC4.19 Therefore, in response to the concerns noted in paragraph BC4.16, the Board clarified the condition by requiring an entity to measure a financial asset at amortised cost only if the objective of the entity's business model is to hold the financial asset to collect the contractual cash flows. The Board also clarified in the application guidance that:
- (a) it is expected that an entity may sell some financial assets that it holds with an objective of collecting the contractual cash flows. Very few business models entail holding all instruments until maturity. However, frequent buying and selling of financial assets is not consistent with a business model of holding financial assets to collect contractual cash flows.
 - (b) an entity needs to use judgement to determine at what level this condition should be applied. That determination is made on the basis of how an entity manages its business. It is not made at the level of an individual financial asset.
- BC4.20 The Board noted that an entity's business model does not relate to a choice (ie it is not a voluntary designation) but rather it is a matter of fact that can be observed by the way an entity is managed and information is provided to its management.
- BC4.21 For example, if an investment bank uses a trading business model, it could not easily become a savings bank that uses an 'originate and hold' business model. Therefore, a business model is very different from 'management intentions', which can relate to a single instrument. The Board concluded that sales or transfers of financial instruments before maturity would not be inconsistent with a business model with an objective of collecting contractual cash flows, as long as such transactions were consistent with that business model, rather than with a business model that has the objective of realising changes in fair values.

Contractual cash flow characteristics

- BC4.22 The exposure draft published in 2009 proposed that only financial instruments with basic loan features could be measured at amortised cost. It specified that a financial instrument has basic loan features if its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. For the purposes of this condition, interest is consideration for the time value of money and the credit risk associated with the principal amount outstanding during a particular period of time, which may include a premium for liquidity risk.
- BC4.23 The objective of the effective interest method for financial instruments measured at amortised cost is to allocate interest revenue or expense to the relevant period. Cash flows that are interest always have a close relation to the amount advanced to the debtor (the 'funded' amount) because interest is consideration for the time value of money and the credit risk associated with the issuer of the instrument and with the instrument itself. The Board noted that the effective interest method is not an appropriate method to allocate cash flows that are not principal or interest on the principal amount outstanding. The Board concluded that if a financial asset contains contractual cash flows that are not principal or interest on the principal amount outstanding then a valuation overlay to contractual cash flows (fair value) is required to ensure that the reported financial information provides useful information.
- BC4.24 Most respondents to the exposure draft agreed with the principle that classification should reflect the contractual terms of the financial asset. However, many objected to the label 'basic loan features' and requested more guidance to apply the principle to particular financial assets. Respondents were also concerned that the exposure draft did not discuss 'immaterial' or 'insignificant' features that they believed ought not to affect classification.
- BC4.25 The Board decided to clarify how contractual cash flow characteristics should affect classification and improve the examples that illustrate how the condition should be applied. It decided not to add application guidance clarifying that the notion of materiality applies to this condition, because that notion applies to every item in the financial statements. However, it did add application guidance that a contractual cash flow characteristic does not affect the classification of a financial asset if it is 'not genuine'.

Application of the two classification conditions to particular financial assets

Investments in contractually linked instruments (tranches)

- BC4.26 A structured investment vehicle may issue different tranches to create a ‘waterfall’ structure that prioritises the payments by the issuer to the holders of the different tranches. In typical waterfall structures, multiple contractually linked instruments effect concentrations of credit risk in which payments to holders are prioritised. Such structures specify the order in which any losses that the issuer incurs are allocated to the tranches. The exposure draft published in 2009 concluded that tranches providing credit protection (albeit on a contingent basis) to other tranches are leveraged because they expose themselves to higher credit risk by writing credit protection to other tranches. Hence their cash flows do not represent solely payments of principal and interest on the principal amount outstanding. Thus, only the most senior tranche could have basic loan features and might qualify for measurement at amortised cost, because only the most senior tranche would receive credit protection in all situations.
- BC4.27 The exposure draft proposed that the classification principle should be based on whether a tranche could provide credit protection to any other tranches in *any* possible scenario. In the Board’s view, a contract that contains credit concentration features that create ongoing subordination (not only in a liquidation scenario) would include contractual cash flows that represent a premium for providing credit protection to other tranches. Only the most senior tranche does not receive such a premium.
- BC4.28 In proposing this approach, the Board concluded that subordination in itself should not preclude amortised cost measurement. The ranking of an entity’s instruments is a common form of subordination that affects almost all lending transactions. Commercial law (including bankruptcy law) typically sets out a basic ranking for creditors. This is required because not all creditors’ claims are contractual (eg claims regarding damages for unlawful behaviour and for tax liabilities or social insurance contributions). Although it is often difficult to determine exactly the degree of leverage resulting from this subordination, the Board believes that it is reasonable to assume that commercial law does not intend to create leveraged credit exposure for general creditors such as trade creditors. Thus, the Board believes that the credit risk associated with general creditors does not preclude the contractual cash flows representing the payments of principal and interest on the principal amount outstanding. Consequently, the credit risk associated with any secured or senior liabilities ranking above general creditors should also not preclude the contractual cash flows from representing payments of principal and interest on the principal amount outstanding.
- BC4.29 Almost all respondents disagreed with the approach in the exposure draft for investments in contractually linked instruments for the following reasons:
- (a) It focused on form and legal structure rather than the economic characteristics of the financial instruments.
 - (b) It would create structuring opportunities because of the focus on the existence of a waterfall structure, without consideration of the characteristics of the underlying instruments.
 - (c) It would be an exception to the overall classification model, driven by anti-abuse considerations.
- BC4.30 In particular, respondents argued that the proposals in the exposure draft would conclude that some tranches provide credit protection and therefore were ineligible for measurement at amortised cost, even though that tranche might have a lower credit risk than the underlying pool of instruments that would themselves be eligible for measurement at amortised cost.
- BC4.31 The Board did not agree that the proposals in the exposure draft were an exception to the overall classification model. In the Board’s view, those proposals were consistent with many respondents’ view that any financial instrument that creates contractual subordination should be subject to the proposed classification criteria and no specific guidance should be required to apply the classification approach to these instruments. However, it noted that, for contractually linked instruments that effect concentrations of credit risk, many respondents did not agree that the contractual cash flow characteristics determined by the terms and conditions of the financial asset in isolation best reflected the economic characteristics of that financial asset.
- BC4.32 Respondents proposed other approaches in which an investor ‘looks through’ to the underlying pool of instruments of a waterfall structure and measures the instruments at fair value if looking through is not possible. They made the following points:
- (a) *Practicability*: The securitisation transactions intended to be addressed were generally over-the-counter transactions in which the parties involved had sufficient information about the assets to perform an analysis of the underlying pool of instruments.
 - (b) *Complexity*: Complex accounting judgement was appropriate to reflect the complex economic characteristics of the instrument. In particular, in order to obtain an understanding of the effects of the contractual terms and conditions, an investor would have to understand the underlying pool of

instruments. Also, requiring fair value measurement if it were not practicable to look through to the underlying pool of instruments would allow an entity to avoid such complexity.

- (c) *Mechanics:* Amortised cost measurement should be available only if all of the instruments in the underlying pool of instruments had contractual cash flows that represented payments of principal and interest on the principal amount outstanding. Some also suggested that instruments that change the cash flow variability of the underlying pool of instruments in a way that is consistent with representing solely payments of principal and interest on the principal amount outstanding, or aligned currency/interest rates with the issued notes, should not preclude amortised cost measurement.
 - (d) *Relative exposure to credit risk:* Many favoured use of a probability-weighted approach to assess whether an instrument has a lower or higher exposure to credit risk than the average credit risk of the underlying pool of instruments.
- BC4.33 The Board was persuaded that classification solely on the basis of the contractual features of the financial asset being assessed for classification would not capture the economic characteristics of the instruments when a concentrated credit risk arises through contractual linkage. Therefore, the Board decided that, unless it is impracticable, an entity should ‘look through’ to assess the underlying cash flow characteristics of the financial assets and to assess the exposure to credit risk of those financial assets relative to the underlying pool of instruments.
- BC4.34 The Board concluded that the nature of contractually linked instruments that effect concentrations of credit risk justifies this approach because the variability of cash flows from the underlying pool of instruments is a reference point, and tranching only reallocates credit risk. Thus, if the contractual cash flows of the assets in the underlying pool represent payments of principal and interest on the principal amount outstanding, any tranche that is exposed to the same or lower credit risk (as evidenced by the cash flow variability of the tranche relative to the overall cash flow variability of the underlying instrument pool) would also be deemed to represent payments of principal and interest on the principal amount outstanding. The Board also took the view that such an approach would address many of the concerns raised in the comment letters with regard to structuring opportunities and the focus on the contractual form of the financial asset, rather than its underlying economic characteristics. The Board also noted that in order to understand and make the judgement about whether particular types of financial assets have the required cash flow characteristics, an entity would have to understand the characteristics of the underlying issuer to ensure that the instrument’s cash flows are solely payments of principal and interest on the principal amount outstanding.
- BC4.35 To apply this approach, the Board decided that an entity should:
- (a) determine whether the contractual terms of the issued instrument (the financial asset being classified) give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding. The Board concluded that the issued instrument must have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.
 - (b) look through to the underlying pool of instruments until it can identify the instruments that are creating (rather than simply passing through) the cash flows.
 - (c) determine whether one or more of the instruments in the underlying pool has contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. The Board concluded that 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.
 - (d) assess whether any other instruments in the underlying pool only:
 - (i) reduce the cash flow variability of the underlying pool of instruments in a way that is consistent with representing solely payments of principal and interest on the principal amount outstanding, or
 - (ii) align the cash flows of the issued financial assets with the underlying pool of financial instruments.

The Board concluded that the existence of such instruments does not preclude the cash flows from representing solely payments of principal and interest on the principal amount outstanding. The Board determined that the existence of other instruments in the pool would, however, preclude the cash flows representing solely payments of principal and interest on the principal amount outstanding. For example, an underlying pool that contains government bonds and an instrument that swaps government credit risk for (riskier) corporate credit risk would not have cash flows that represent solely principal and interest on the principal amount outstanding.

- (e) measure at fair value any issued instrument in which any of the financial instruments in the underlying pool:
 - (i) have cash flows that do not represent solely payments of principal and interest on the principal amount outstanding; or
 - (ii) could change so that cash flows may not represent solely payments of principal and interest on the principal amount outstanding at any point in the future.
 - (f) measure at fair value any issued instrument whose exposure to credit risk in the underlying pool of financial instruments is greater than the exposure to credit risk of the underlying pool of financial instruments. The Board decided that if the range of expected losses on the issued instrument is greater than the weighted average range of expected losses on the underlying pool of financial instruments, then the issued instrument should be measured at fair value.
- BC4.36 The Board also decided that if it were not practicable to look through to the underlying pool of financial instruments, entities should measure the issued instrument at fair value.

Financial assets acquired at a discount that reflects incurred credit losses

- BC4.37 The exposure draft published in 2009 proposed that if a financial asset is acquired at a discount that reflects incurred credit losses, it cannot be measured at amortised cost because:
- (a) the entity does not hold such financial assets to collect the cash flows arising from those assets' contractual terms; and
 - (b) an investor acquiring a financial asset at such a discount believes that the actual losses will be less than the losses that are reflected in the purchase price. Thus, that asset creates exposure to significant variability in actual cash flows and such variability is not interest.
- BC4.38 Almost all respondents disagreed with the Board's conclusion that these assets cannot be held to collect the contractual cash flows. They regarded that conclusion as an exception to a classification approach based on the entity's business model for managing the financial assets. In particular, they noted that entities could acquire and subsequently manage such assets as part of an otherwise performing asset portfolio for which the objective of the entity's business model is to hold the assets to collect contractual cash flows.
- BC4.39 Respondents also noted that an entity's expectations about actual future cash flows are not the same as the contractual cash flows of the financial asset. Those expectations are irrelevant to an assessment of the financial asset's contractual cash flow characteristics.
- BC4.40 The Board agreed that the general classification approach in IFRS 9 should apply to financial assets acquired at a discount that reflects incurred credit losses. Thus, when such assets meet the conditions in paragraph 4.1.2, they are measured at amortised cost.

Alternative approaches to classifying assets

- BC4.41 In its deliberations leading to the exposure draft published in 2009, the Board discussed alternative approaches to classification and measurement. In particular, it considered an approach in which financial assets that have basic loan features, are managed on a contractual yield basis and meet the definition of loans and receivables in IAS 39 would be measured at amortised cost. All other financial assets would be measured at fair value. The fair value changes for each period for those financial assets with basic loan features that are managed on a contractual yield basis would be disaggregated and presented as follows:
- (a) changes in recognised value determined on an amortised cost basis (including impairments determined using the incurred loss impairment requirements in IAS 39) would be presented in profit or loss; and
 - (b) any difference between the amortised cost measure in (a) and the fair value change for the period would be presented in other comprehensive income.
- BC4.42 The Board also considered variants in which all financial assets and financial liabilities would be measured at fair value. One variant would be to present both the amounts in paragraph BC4.41(a) and (b) in profit or loss, but separately. Another variant would be to measure all financial instruments (including financial assets that meet the two conditions specified in the exposure draft published in 2009 and meet the definition of loans and receivables in IAS 39) at fair value in the statement of financial position. All financial instruments (including financial liabilities) with basic loan features that are managed on a contractual yield basis would be disaggregated and presented as described in paragraph BC4.41(a) and (b).
- BC4.43 Respondents noted that the alternative approach described in paragraph BC4.41 and both variants described in paragraph BC4.42 would result in more financial assets and financial liabilities being measured at fair value. Respondents also noted that the alternative approach would apply only to financial assets. Lastly, almost all

respondents noted that splitting gains and losses between profit or loss and other comprehensive income would increase complexity and reduce understandability. The Board concluded that those approaches would not result in more useful information than the approach in IFRS 9 and did not consider them further.

BC4.44 The Board also considered and rejected the following approaches to classification:

- (a) *Classification based on the definition of held for trading:* A few respondents suggested that all financial assets and financial liabilities that are not 'held for trading' should be eligible for measurement at amortised cost. However, in the Board's view, the notion of 'held for trading' is too narrow and cannot appropriately reflect all situations in which amortised cost does not provide useful information.
- (b) *Three-category approach:* Some respondents suggested retaining a three-category approach, ie including a third category similar to the available-for-sale category in IAS 39. However, in the Board's view, such an approach would neither significantly improve nor reduce the complexity of the reporting for financial instruments.
- (c) *Classification based only on the business model:* A small number of respondents thought the contractual terms of the instrument condition was unnecessary and that classification should depend solely on the entity's business model for managing financial instruments. However, in the Board's view, determining classification solely on the basis of how an entity manages its financial instruments would result in misleading information that is not useful to a user in understanding the risks associated with complex or risky instruments. The Board concluded, as had almost all respondents, that the contractual cash flow characteristics condition is required to ensure that amortised cost is used only when it provides information that is useful in predicting the entity's future cash flows.
- (d) *Amortised cost as the default option:* The Board considered developing conditions that specified when a financial asset must be measured at fair value, with the requirement that all other financial instruments would be measured at amortised cost. The Board rejected that approach because it believes that new conditions would have to be developed in the future to address innovative financial products. In addition, the Board noted that such an approach would not be practical because an entity can apply amortised cost only to some types of financial instruments.
- (e) *Originated loan approach:* In developing an approach to distinguish between financial assets measured at fair value and amortised cost the Board considered a model in which only loans originated by the entity would qualify for amortised cost measurement. The Board acknowledged that for originated instruments the entity potentially has better information about the future contractual cash flows and credit risk than for purchased loans. However, the Board decided not to pursue that approach, mainly because some entities manage originated and purchased loans in the same portfolio. Distinguishing between originated and purchased loans, which would be done mainly for accounting purposes, would involve systems changes. In addition, the Board noted that 'originated loans' might easily be created by placing purchased loans into an investment vehicle. The Board also noted that the definition of loans and receivables in IAS 39 had created application problems in practice.

Tainting

BC4.45 The Board considered whether it should prohibit an entity from classifying a financial asset as measured at amortised cost if the entity had previously sold or reclassified financial assets rather than holding them to collect the contractual cash flows. A restriction of this kind is often called 'tainting'. However, the Board believes that classification based on the entity's business model for managing financial assets and the contractual cash flow characteristics of those financial assets provides a clear rationale for measurement. A tainting provision would increase the complexity of application, be unduly prohibitive in the context of that approach and could give rise to classification that is inconsistent with the classification approach in IFRS 9. However, in 2009 the Board amended IAS 1 *Presentation of Financial Statements* to require an entity to present separately in the statement of comprehensive income all gains and losses arising from the derecognition of financial assets measured at amortised cost. The Board also amended IFRS 7 in 2009 to require an entity to disclose an analysis of those gains and losses, including the reasons for derecognising those financial assets. Those requirements enable users of financial statements to understand the effects of derecognising before maturity instruments measured at amortised cost and also provides transparency in situations where an entity has measured financial assets at amortised cost on the basis of having an objective of managing those assets in order to collect the contractual cash flows but regularly sells them.

Classification of financial liabilities

- BC4.46 Immediately after issuing the first chapters of IFRS 9 in November 2009, the Board began an extensive outreach programme to gather feedback on the classification and measurement of financial liabilities, in particular how best to address the effects of changes in the fair value of a financial liability caused by changes in the risk that the issuer will fail to perform on that liability. The Board obtained information and views from its FIWG and from users, regulators, preparers, auditors and others from a range of industries across different geographical regions. The Board also developed a questionnaire to ask users of financial statements how they use information about the effects of changes in liabilities' credit risk (if at all) and what their preferred method of accounting is for selected financial liabilities. The Board received over 90 responses to that questionnaire.
- BC4.47 During the outreach programme, the Board explored several approaches for classification and subsequent measurement of financial liabilities that would exclude the effects of changes in a liability's credit risk from profit or loss, including:
- (a) measuring liabilities at fair value and presenting in other comprehensive income the portion of the change in fair value that is attributable to changes in the liability's credit risk. A variant of this alternative would be to present in other comprehensive income the entire change in fair value.
 - (b) measuring liabilities at an 'adjusted' fair value whereby the liability would be remeasured for all changes in fair value except for the effects of changes in its credit risk (ie 'the frozen credit spread method'). In other words, the effects of changes in its credit risk would be ignored in the primary financial statements.
 - (c) measuring liabilities at amortised cost. This would require estimating the cash flows over the life of the instrument, including those cash flows associated with any embedded derivative features.
 - (d) bifurcating liabilities into hosts and embedded features. The host contract would be measured at amortised cost and the embedded features (eg embedded derivatives) would be measured at fair value through profit or loss. The Board discussed either carrying forward the bifurcation requirements in IAS 39 for financial liabilities or developing new requirements.
- BC4.48 The primary message that the Board received from users of financial statements and others during its outreach programme was 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. That is because an entity generally will not realise the effects of changes in the liability's credit risk unless the liability is held for trading.
- BC4.49 In addition to that view, there were several other themes in the feedback that the Board received:
- (a) Symmetry between how an entity classifies and measures its financial assets and its financial liabilities is not necessary and often does not result in useful information. Most constituents said that in its deliberations on financial liabilities the Board should not be constrained or biased by the requirements in IFRS 9 for financial assets.
 - (b) Amortised cost is the most appropriate measurement attribute for many financial liabilities because it reflects the issuer's legal obligation to pay the contractual amounts in the normal course of business (ie on a going concern basis) and in many cases, the issuer will hold liabilities to maturity and pay the contractual amounts. However, if a liability has structured features (eg embedded derivatives), amortised cost is difficult to apply and understand because the cash flows can be highly variable.
 - (c) The bifurcation methodology in IAS 39 is generally working well and practice has developed since those requirements were issued. For many entities, bifurcation avoids the issue of own credit risk because the host is measured at amortised cost and only the derivative is measured at fair value through profit or loss. Many constituents, including users of financial statements, favoured retaining bifurcation for financial liabilities even though they supported eliminating it for financial assets. That was because bifurcation addresses the issue of own credit risk, which is only relevant for financial liabilities. Users preferred structured assets to be measured at fair value in their entirety. Many constituents were sceptical that a new bifurcation methodology could be developed that was less complex and provided more useful information than using the bifurcation methodology in IAS 39. Moreover, a new bifurcation methodology would be likely to have the same classification and measurement outcomes as the existing methodology in most cases.
 - (d) The Board should not develop a new measurement attribute. The almost unanimous view was that a 'full' fair value amount is more understandable and useful than an 'adjusted' fair value amount that ignores the effects of changes in the liability's credit risk.
 - (e) Even for preparers with sophisticated valuation expertise, it is difficult to determine the amount of change in the fair value of a liability that is attributable to changes in its credit risk. Under existing IFRSs only entities that elect to designate liabilities under the fair value option are required to

determine that amount. If the Board were to extend that requirement to more entities and to more financial liabilities, many entities would have significant difficulty determining that amount and could incur significant costs in doing so.

- BC4.50 Although there were common themes in the feedback received, there was no consensus on which of the alternative approaches being explored by the Board was the best way to address the effects of changes in liabilities' credit risk. Many constituents said that none of the alternatives being discussed was less complex or would result in more useful information than the existing bifurcation requirements.
- BC4.51 As a result of the feedback received, the Board decided to retain almost all of the existing requirements for the classification and measurement of financial liabilities. The Board decided that the benefits of changing practice at this point do not outweigh the costs of the disruption that such a change would cause. Accordingly, in October 2010 the Board carried forward almost all of the requirements unchanged from IAS 39 to IFRS 9.
- BC4.52 By retaining almost all of the existing requirements, the issue of credit risk is addressed for most liabilities because they would continue to be subsequently measured at amortised cost or would be bifurcated into a host, which would be measured at amortised cost, and an embedded derivative, which would be measured at fair value. Liabilities that are held for trading (including all derivative liabilities) would continue to be subsequently measured at fair value through profit or loss, which is consistent with the widespread view that all fair value changes for those liabilities should affect profit or loss.
- BC4.53 The issue of credit risk would remain only in the context of financial liabilities designated under the fair value option. Thus, in May 2010 the Board published an exposure draft *Fair Value Option for Financial Liabilities*, which proposed that the effects of changes in the credit risk of liabilities designated under the fair value option would be presented in other comprehensive income. The Board considered the responses to that exposure draft and finalised amendments to IFRS 9 in October 2010 (see paragraphs BC5.35–BC5.64). Those amendments also eliminated the cost exception for particular derivative liabilities that will be settled by delivering unquoted equity instruments⁷ whose fair values cannot be reliably determined (see paragraph BC5.20).

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

Background to the fair value option in IAS 39

- BCZ4.54 In 2003 the Board concluded that it could simplify the application of IAS 39 (as revised in 2000) for some entities by permitting the use of fair value measurement for any financial instrument. With one exception, this greater use of fair value is optional. The fair value measurement option does not require entities to measure more financial instruments at fair value.
- BCZ4.55 IAS 39 (as revised in 2000)⁸ did not permit an entity to measure particular categories of financial instruments at fair value with changes in fair value recognised in profit or loss. Examples included:
- (a) originated loans and receivables, including a debt instrument acquired directly from the issuer, unless they met the conditions for classification as held for trading (now in Appendix A of IFRS 9).
 - (b) financial assets classified as available for sale, unless as an accounting policy choice gains and losses on all available-for-sale financial assets were recognised in profit or loss or they met the conditions for classification as held for trading (now in Appendix A of IFRS 9).
 - (c) non-derivative financial liabilities, even if the entity had a policy and practice of actively repurchasing such liabilities or they formed part of an arbitrage/customer facilitation strategy or fund trading activities.

⁷ IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IFRS 9 refers to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

⁸ IFRS 9 eliminated the loans and receivables and available-for-sale categories.

- BCZ4.56 The Board decided in IAS 39 (as revised in 2003) to permit entities to designate irrevocably on initial recognition any financial instruments as ones to be measured at fair value with gains and losses recognised in profit or loss ('fair value through profit or loss'). To impose discipline on this approach, the Board decided that financial instruments should not be reclassified into or out of the category of fair value through profit or loss. In particular, some comments received on the exposure draft of proposed amendments to IAS 39 published in June 2002 suggested that entities could use the fair value option to recognise selectively changes in fair value in profit or loss. The Board noted that the requirement (now in IFRS 9) to designate irrevocably on initial recognition the financial instruments for which the fair value option is to be applied results in an entity being unable to 'cherry pick' in this way. This is because it will not be known at initial recognition whether the fair value of the instrument will increase or decrease.
- BCZ4.57 Following the issue of IAS 39 (as revised in 2003), as a result of continuing discussions with constituents on the fair value option, the Board became aware that some, including prudential supervisors of banks, securities companies and insurers, were concerned that the fair value option might be used inappropriately. These constituents were concerned that:
- (a) entities might apply the fair value option to financial assets or financial liabilities whose fair value is not verifiable. If so, because the valuation of these financial assets and financial liabilities is subjective, entities might determine their fair value in a way that inappropriately affects profit or loss.
 - (b) the use of the option might increase, rather than decrease, volatility in profit or loss, for example if an entity applied the option to only one part of a matched position.
 - (c) if an entity applied the fair value option to financial liabilities, it might result in an entity recognising gains or losses in profit or loss associated with changes in its own creditworthiness.
- BCZ4.58 In response to those concerns, the Board published in April 2004 an exposure draft of proposed restrictions to the fair value option contained in IAS 39 (as revised in 2003). After discussing comments received from constituents and a series of public round-table meetings, the Board issued an amendment to IAS 39 in June 2005 permitting entities to designate irrevocably on initial recognition financial instruments that meet one of three conditions as ones to be measured at fair value through profit or loss.
- BCZ4.59 In those amendment to the fair value option, the Board identified three situations in which permitting designation at fair value through profit or loss either results in more relevant information ((a) and (b) below) or is justified on the grounds of reducing complexity or increasing measurement reliability ((c) below). These are:
- (a) when such designation eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise (paragraphs BCZ4.61–BCZ4.63);
 - (b) when a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy (paragraphs BCZ4.64–BCZ4.66); and
 - (c) when an instrument contains an embedded derivative that meets particular conditions (paragraphs BCZ4.67–BCZ4.70).
- BCZ4.60 The ability for entities to use the fair value option simplifies the application of IAS 39 by mitigating some anomalies that result from the different measurement attributes. In particular, for financial instruments designated in this way:
- (a) it eliminates the need for hedge accounting for hedges of fair value exposures when there are natural offsets, and thereby eliminates the related burden of designating, tracking and analysing hedge effectiveness.
 - (b) it eliminates the burden of separating embedded derivatives.
 - (c) it eliminates problems arising from a mixed measurement model when financial assets are measured at fair value and related financial liabilities are measured at amortised cost. In particular, it eliminates volatility in profit or loss and equity that results when matched positions of financial assets and financial liabilities are not measured consistently.
 - (d) the option to recognise unrealised gains and losses on available-for-sale financial assets in profit or loss is no longer necessary.
 - (e) it de-emphasises interpretative issues around what constitutes trading.

Designation eliminates or significantly reduces an accounting mismatch

BCZ4.61 IAS 39, like comparable standards in some national jurisdictions, imposed (and IFRS 9 now imposes) a mixed attribute measurement model. It required some financial assets and liabilities to be measured at fair value, and others to be measured at amortised cost. It required some gains and losses to be recognised in profit or loss, and others to be recognised initially as a component of equity.⁹ This combination of measurement and recognition requirements could result in inconsistencies, which some refer to as ‘accounting mismatches’, between the accounting for an asset (or group of assets) and a liability (or group of liabilities). The notion of an accounting mismatch necessarily involves two propositions. First, an entity has particular assets and liabilities that are measured, or on which gains and losses are recognised, inconsistently; second, there is a perceived economic relationship between those assets and liabilities. For example, a liability may be considered to be related to an asset when they share a risk that gives rise to opposite changes in fair value that tend to offset, or when the entity considers that the liability funds the asset.

BCZ4.62 Some entities could overcome measurement or recognition inconsistencies by using hedge accounting or, in the case of insurers, shadow accounting. However, the Board recognised that those techniques are complex and do not address all situations. In developing the amendment to the fair value option in 2004, the Board considered whether it should impose conditions to limit the situations in which an entity could use the option to eliminate an accounting mismatch. For example, it considered whether entities should be required to demonstrate that particular assets and liabilities are managed together, or that a management strategy is effective in reducing risk (as is required for hedge accounting to be used), or that hedge accounting or other ways of overcoming the inconsistency are not available.

BCZ4.63 The Board concluded that accounting mismatches arise in a wide variety of circumstances. In the Board’s view, financial reporting is best served by providing entities with the opportunity to eliminate perceived accounting mismatches whenever that results in more relevant information. Furthermore, the Board concluded that the fair value option may validly be used in place of hedge accounting for hedges of fair value exposures, thereby eliminating the related burden of designating, tracking and analysing hedge effectiveness. Hence, the Board decided not to develop detailed prescriptive guidance about when the fair value option could be applied (such as requiring effectiveness tests similar to those required for hedge accounting) in the amendment on the fair value option. Rather, the Board decided to require disclosures (now in IFRS 7) about:

- the criteria an entity uses for designating financial assets and financial liabilities as at fair value through profit or loss
- how the entity satisfies the conditions for such designation
- the nature of the assets and liabilities so designated
- the effect on the financial statement of using this designation, namely the carrying amounts and net gains and losses on assets and liabilities so designated, information about the effect of changes in a financial liability’s credit quality on changes in its fair value, and information about the credit risk of loans or receivables and any related credit derivatives or similar instruments.

A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis

BCZ4.64 IAS 39 required financial instruments to be measured at fair value through profit or loss in only two situations, namely when an instrument is held for trading or when it contains an embedded derivative that the entity is unable to measure separately. However, the Board recognised that some entities manage and evaluate the performance of financial instruments on a fair value basis in other situations. Furthermore, for instruments managed and evaluated in this way, users of financial statements may regard fair value measurement as providing more relevant information. Finally, it is established practice in some industries in some jurisdictions to recognise all financial assets at fair value through profit or loss. (This practice was permitted for many assets in IAS 39 (as revised in 2000) as an accounting policy choice in accordance with which gains and losses on all available-for-sale financial assets were reported in profit or loss.)

BCZ4.65 In the amendment to IAS 39 relating to the fair value option issued in June 2005, the Board permitted financial instruments managed and evaluated on a fair value basis to be measured at fair value through profit or loss. The Board also introduced two requirements to make this category operational. These requirements are that the financial instruments are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy, and that information about the financial instruments is provided internally on that basis to the entity’s key management personnel.

⁹ As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 these other gains and losses are recognised in other comprehensive income.

BCZ4.66 In looking to an entity's documented risk management or investment strategy, the Board made no judgement on what an entity's strategy should be. However, the Board noted that users, in making economic decisions, would find useful both a description of the chosen strategy and how designation at fair value through profit or loss is consistent with it. Such disclosures are required (now in IFRS 7). The Board also noted that the required documentation of the entity's strategy need not be item by item, nor need it be in the level of detail required for hedge accounting. However, it should be sufficient to demonstrate that using the fair value option is consistent with the entity's risk management or investment strategy. In many cases, the entity's existing documentation, as approved by its key management personnel, should be sufficient for this purpose.

The instrument contains an embedded derivative that meets particular conditions

BCZ4.67 IAS 39 required virtually all derivative financial instruments to be measured at fair value. This requirement extended to derivatives that are embedded in an instrument that also includes a non-derivative host if the embedded derivative met particular conditions. Conversely, if the embedded derivative did not meet those conditions, separate accounting with measurement of the embedded derivative at fair value is prohibited. Therefore, to satisfy these requirements, the entity must:

- (a) identify whether the instrument contains one or more embedded derivatives,
- (b) determine whether each embedded derivative is one that must be separated from the host instrument or one for which separation is prohibited, and
- (c) if the embedded derivative is one that must be separated, determine its fair value at initial recognition and subsequently.

BCZ4.68 For some embedded derivatives, like the prepayment option in an ordinary residential mortgage, this process is fairly simple. However, entities with more complex instruments have reported that the search for and analysis of embedded derivatives (steps (a) and (b) in paragraph BCZ4.67) significantly increase the cost of complying with the IFRS. They report that this cost could be eliminated if they had the option to fair value the combined contract.

BCZ4.69 Other entities report that one of the most common uses of the fair value option is likely to be for structured products that contain several embedded derivatives. Those structured products will typically be hedged with derivatives that offset all (or nearly all) of the risks they contain, whether or not the embedded derivatives that give rise to those risks are separated for accounting purposes. Hence, the simplest way to account for such products is to apply the fair value option so that the combined contract (as well as the derivatives that hedge it) is measured at fair value through profit or loss. Furthermore, for these more complex instruments, the fair value of the combined contract may be significantly easier to measure and hence be more reliable than the fair value of only those embedded derivatives that are required to be separated.

BCZ4.70 The Board sought to strike a balance between reducing the costs of complying with the embedded derivatives provisions and the need to respond to the concerns expressed regarding possible inappropriate use of the fair value option. The Board determined that allowing the fair value option to be used for *any* instrument with an embedded derivative would make other restrictions on the use of the option ineffective, because many financial instruments include an embedded derivative. In contrast, limiting the use of the fair value option to situations in which the embedded derivative must otherwise be separated would not significantly reduce the costs of compliance and could result in less reliable measures being included in the financial statements. Therefore, the Board decided to specify situations in which an entity cannot justify using the fair value option in place of assessing embedded derivatives—when the embedded derivative does not significantly modify the cash flows that would otherwise be required by the contract or is one for which it is clear with little or no analysis when a similar hybrid instrument is first considered that separation is prohibited.

The role of prudential supervisors

BCZ4.71 The Board considered the circumstances of regulated financial institutions such as banks and insurers in determining the extent to which conditions should be placed on the use of the fair value option. The Board recognised that regulated financial institutions are extensive holders and issuers of financial instruments and so are likely to be among the largest potential users of the fair value option. However, the Board noted that some of the prudential supervisors that oversee these entities expressed concern that the fair value option might be used inappropriately.

BCZ4.72 The Board noted that the primary objective of prudential supervisors is to maintain the financial soundness of individual financial institutions and the stability of the financial system as a whole. Prudential supervisors achieve this objective partly by assessing the risk profile of each regulated institution and imposing a risk-based capital requirement.

BCZ4.73 The Board noted that these objectives of prudential supervision differ from the objectives of general purpose financial reporting. The latter is intended to provide information about the financial position, performance

and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. However, the Board acknowledged that for the purposes of determining what level of capital an institution should maintain, prudential supervisors may wish to understand the circumstances in which a regulated financial institution has chosen to apply the fair value option and evaluate the rigour of the institution's fair value measurement practices and the robustness of its underlying risk management strategies, policies and practices. Furthermore, the Board agreed that certain disclosures would assist both prudential supervisors in their evaluation of capital requirements and investors in making economic decisions. In particular, the Board decided to require an entity to disclose how it has satisfied the conditions for using the fair value option, including, for instruments that are now within paragraph 4.2.2(b) of IFRS 9, a narrative description of how designation at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.

Application of the fair value option to a component or a proportion (rather than the entirety) of a financial asset or a financial liability

- BCZ4.74 Some comments received on the exposure draft of proposed amendments to IAS 39 published in June 2002 argued that the fair value option should be extended so that it could also be applied to a component of a financial asset or a financial liability (eg changes in fair value attributable to one risk such as changes in a benchmark interest rate). The arguments included (a) concerns regarding inclusion of own credit risk in the measurement of financial liabilities and (b) the prohibition on using non-derivatives as hedging instruments (cash instrument hedging).
- BCZ4.75 The Board concluded that IAS 39 should not extend the fair value option to components of financial assets or financial liabilities. It was concerned (a) about difficulties in measuring the change in value of the component because of ordering issues and joint effects (ie if the component is affected by more than one risk, it may be difficult to isolate accurately and measure the component); (b) that the amounts recognised in the balance sheet would be neither fair value nor cost; and (c) that a fair value adjustment for a component might move the carrying amount of an instrument away from its fair value. In finalising the 2003 amendments to IAS 39, the Board separately considered the issue of cash instrument hedging (see paragraphs BC144 and BC145 of the Basis for Conclusions on IAS 39).
- BCZ4.76 Other comments received on the April 2004 exposure draft of proposed restrictions on the fair value option contained in IAS 39 (as revised in 2003) suggested that the fair value option should be extended so that it could be applied to a proportion (ie a percentage) of a financial asset or financial liability. The Board was concerned that such an extension would require prescriptive guidance on how to determine a proportion. For example, if an entity were to issue a bond totalling CU100 million in the form of 100 certificates each of CU1 million, would a proportion of 10 per cent be identified as 10 per cent of each certificate, CU10 million specified certificates, the first (or last) CU10 million certificates to be redeemed, or on some other basis? The Board was also concerned that the remaining proportion, not being subject to the fair value option, could give rise to incentives for an entity to 'cherry pick' (ie to realise financial assets or financial liabilities selectively so as to achieve a desired accounting result). For these reasons, the Board decided not to allow the fair value option to be applied to a proportion of a single financial asset or financial liability (that restriction is now in IFRS 9). However, if an entity simultaneously issues two or more identical financial instruments, it is not precluded from designating only some of those instruments as being subject to the fair value option (for example, if doing so achieves a significant reduction in a recognition or measurement inconsistency). Thus, in the above example, the entity could designate CU10 million specified certificates if to do so would meet one of the three criteria in paragraph BCZ4.59.

Option to designate a financial asset at fair value

- BC4.77 As noted above, IAS 39 allowed entities an option to designate on initial recognition any financial asset or financial liability as measured at fair value through profit or loss if one (or more) of the following three conditions is met:
- (a) 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 on different bases or recognising the gains and losses on them on different bases.
 - (b) A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel.
 - (c) The financial asset or financial liability contains one or more embedded derivatives (and particular other conditions now described in paragraph 4.3.5 of IFRS 9 are met) and the entity elects to account for the hybrid contract in its entirety.

BC4.78 However, in contrast to IAS 39, IFRS 9 requires:

- (a) any financial asset that is not managed within a business model that has the objective of collecting contractual cash flows to be measured at fair value; and
- (b) hybrid contracts with financial asset hosts to be classified in their entirety, hence eliminating the requirement to identify and account for embedded derivatives separately.

Accordingly, the Board concluded that the conditions described in paragraph BC4.77(b) and (c) are unnecessary for financial assets.

BC4.79 The Board retained the eligibility condition described in paragraph BC4.77(a) because it mitigates some anomalies that result from the different measurement attributes used for financial instruments. In particular, it eliminates the need for fair value hedge accounting of fair value exposures when there are natural offsets. It also avoids problems arising from a mixed measurement model when some financial assets are measured at amortised cost and related financial liabilities are measured at fair value. A separate phase of the project is considering hedge accounting, and the fair value option will be better considered in that context. The Board also noted that particular industry sectors believe it is important to be able to mitigate such anomalies until other IASB projects are completed (eg insurance contracts). The Board decided to defer consideration of changes to the eligibility condition set out in paragraph BC4.77(a) as part of the future exposure draft on hedge accounting.

BC4.80 Almost all the respondents to the exposure draft published in 2009 supported the proposal to retain the fair value option if such designation eliminates or significantly reduces an accounting mismatch. Although some respondents would prefer an unrestricted fair value option, they acknowledged that an unrestricted fair value option has been opposed by many in the past and it is not appropriate to pursue it now.

Option to designate a financial liability at fair value

Eligibility conditions

BC4.81 During its discussions about subsequent classification and measurement of financial liabilities in 2010 (see paragraphs BC4.46–BC4.53), the Board considered whether it was necessary to propose any changes to the eligibility conditions for designating financial liabilities under the fair value option. However, the Board decided that such changes were not necessary because the Board was not changing the underlying classification and measurement approach for financial liabilities. Therefore, the exposure draft published in May 2010 proposed to carry forward the three eligibility conditions.

BC4.82 Most respondents agreed with that proposal in the exposure draft. The Board confirmed the proposal and decided to carry forward to IFRS 9 the three eligibility conditions in October 2010. Some would have preferred an unrestricted fair value option. However, they acknowledged that an unrestricted fair value option had been opposed by many in the past and it was not appropriate to pursue it now.

Embedded derivatives

Hybrid contracts with a host that is an asset within the scope of IFRS 9

BC4.83 An embedded derivative is a derivative component of a hybrid contract that also includes a non-derivative host, with the effect that some of the cash flows of the combined contract vary like the cash flows of a stand-alone derivative contract. IAS 39 required an entity to assess all contracts to determine whether they contain one or more embedded derivatives that are required to be separated from the host and accounted for as stand-alone derivatives.

BC4.84 Many respondents to the discussion paper *Reducing Complexity in Reporting Financial Instruments* commented that the requirements and guidance in IAS 39 were complex, rule-based and internally inconsistent. Respondents, and others, also noted the many application problems that arose from requirements to assess all non-derivative contracts for embedded derivatives and, if required, to account for and measure those embedded derivatives separately as stand-alone derivatives.

BC4.85 In 2009 the Board discussed three approaches for accounting for embedded derivatives:

- (a) to maintain the requirements in IAS 39;
- (b) to use ‘closely related’ (used in IAS 39 to determine whether an embedded derivative is required to be separated from the host) to determine the classification for the contract in its entirety; and
- (c) to use the same classification approach for all financial assets (including hybrid contracts).

- BC4.86 The Board rejected the first two approaches. The Board noted that both would rely on the assessment of whether an embedded derivative is ‘closely related’ to the host. The ‘closely related’ assessment is based on a list of examples that are inconsistent and unclear. That assessment is also a significant source of complexity. Both approaches would result in hybrid contracts being classified using conditions different from those that would be applied to all non-hybrid financial instruments. Consequently, some hybrid contracts whose contractual cash flows do not solely represent payments of principal and interest on the principal amount outstanding might be measured at amortised cost. Similarly, some hybrid contracts whose contractual cash flows do meet the conditions for measurement at amortised cost might be measured at fair value. The Board also believes that neither approach would make it easier for users of financial statements to understand the information that financial statements present about financial instruments.
- BC4.87 Therefore, the exposure draft published in 2009 proposed that entities should use the same classification approach for all financial instruments, including hybrid contracts with hosts within the scope of the proposed IFRS (‘financial hosts’). The Board concluded that a single classification approach for all financial instruments and hybrid contracts with financial hosts was the only approach that responded adequately to the criticisms described above. The Board noted that using a single classification approach improves comparability by ensuring consistency in classification, and hence makes it easier for users to understand the information that financial statements present about financial instruments.
- BC4.88 In the responses to the exposure draft, some respondents, mainly preparers, stated their preference for keeping or modifying the bifurcation model that was in IAS 39. They noted that:
- (a) eliminating the requirement to account for embedded derivatives as stand-alone derivatives would lead to increased volatility in profit or loss and result in accounting that did not reflect the underlying economics and risk management or business model considerations in a transaction. For example, the components of some hybrid financial instruments may be managed separately.
 - (b) structuring opportunities would be created, for example if an entity entered into two transactions that have the same economic effect as entering into a single hybrid contract.
- BC4.89 However, the Board confirmed the proposals in the exposure draft for the following reasons:
- (a) The elimination of the embedded derivatives guidance for hybrid contracts with financial hosts reduces the complexity in financial reporting of financial assets by eliminating another classification approach and improves the reporting for financial instruments. Many constituents agreed with this conclusion.
 - (b) In the Board’s view, the underlying rationale for separate accounting for embedded derivatives is not to reflect risk management activities, but to avoid entities circumventing the recognition and measurement requirements for derivatives. Accordingly it is an exception to the definition of the unit of account (the contract) motivated by a wish to avoid abuse. It would reduce complexity to eliminate an anti-abuse exception.
 - (c) The Board noted the concerns about structuring opportunities referred to in paragraph BC4.88(b). However, two contracts represent two units of account. Reconsideration of the unit of account forms part of a far broader issue for financial reporting that is outside the scope of the Board’s considerations in IFRS 9. In addition, embedded derivative features often do not have contractual cash flows that represent payments of principal and interest on the principal amount outstanding and thus the entire hybrid contract would not be eligible to be measured at amortised cost. However, the Board noted that this would provide more relevant information because the embedded derivative feature affects the cash flows ultimately arising from the hybrid contract. Thus, applying the classification approach to the hybrid contract in its entirety would depict more faithfully the amount, timing and uncertainty of future cash flows.
 - (d) In the Board’s view, accounting for the hybrid contract as one unit of account is consistent with the project’s objective—to improve the usefulness for users in their assessment of the timing, amount and uncertainty of future cash flows of financial instruments and to reduce the complexity in reporting financial instruments.
- This decision applies only to hybrid contracts with a host that is an asset within the scope of IFRS 9.
- BC4.90 The Board decided not to consider at this time changes to the requirements in IAS 39 for embedded derivatives in hybrid contracts with non-financial hosts. The Board acknowledged that those requirements are also complex and have resulted in some application problems, including the question of whether particular types of non-financial contracts are within the scope of IAS 39. The Board accepted the importance of ensuring that any proposals for hybrid contracts with non-financial hosts should also address which non-financial contracts should be within the scope of IFRS 9. The Board also noted the importance for many non-financial entities of hedge accounting for non-financial items, and the relationship to both scope and embedded derivative requirements. Therefore, the Board concluded that the requirements for hybrid contracts with non-financial hosts should be addressed in a later phase of the project to replace IAS 39.

Hybrid contracts with a host that is not an asset within the scope of IFRS 9

- BC4.91 As discussed in paragraphs BC4.46–BC4.53, in 2010 the Board decided to retain almost all of the requirements in IAS 39 for the classification and measurement of financial liabilities. Therefore, those requirements (including the requirements related to embedded derivatives) were carried forward unchanged to IFRS 9. Constituents told the Board that the bifurcation methodology in IAS 39 for financial liabilities is generally working well in practice and practice has developed since those requirements were issued. Many constituents, including users of financial statements, favoured retaining bifurcation for financial liabilities even though they supported eliminating it for financial assets. That was because bifurcation addresses the issue of own credit risk, which is only relevant for financial liabilities.

Embedded foreign currency derivatives

- BCZ4.92 A rationale for the embedded derivatives requirements is that an entity should not be able to circumvent the recognition and measurement requirements for derivatives merely by embedding a derivative in a non-derivative financial instrument or other contract, for example, a commodity forward in a debt instrument. To achieve consistency in accounting for such embedded derivatives, all derivatives embedded in financial instruments that are not measured at fair value with gains and losses recognised in profit or loss ought to be accounted for separately as derivatives. However, as a practical expedient, an embedded derivative need not be separated if it is regarded as closely related to its host contract. When the embedded derivative bears a close economic relationship to the host contract, such as a cap or a floor on the interest rate on a loan, it is less likely that the derivative was embedded to achieve a desired accounting result.
- BCZ4.93 The original IAS 39 specified that a foreign currency derivative embedded in a non-financial host contract (such as a supply contract denominated in a foreign currency) was not separated if it required payments denominated in the currency of the primary economic environment in which any substantial party to the contract operates (their functional currencies) or the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in international commerce (such as the US dollar for crude oil transactions). Such foreign currency derivatives are regarded as bearing such a close economic relationship to their host contracts that they do not have to be separated.
- BCZ4.94 The requirement to separate embedded foreign currency derivatives may be burdensome for entities that operate in economies in which business contracts denominated in a foreign currency are common. For example, entities domiciled in small countries may find it convenient to denominate business contracts with entities from other small countries in an internationally liquid currency (such as the US dollar, euro or yen) rather than the local currency of any of the parties to the transaction. In addition, an entity operating in a hyperinflationary economy may use a price list in a hard currency to protect against inflation, for example, an entity that has a foreign operation in a hyperinflationary economy that denominates local contracts in the functional currency of the parent.
- BCZ4.95 In revising IAS 39, the Board concluded that an embedded foreign currency derivative may be integral to the contractual arrangements in the cases mentioned in the previous paragraph. It decided that a foreign currency derivative in a contract should not be required to be separated if it is denominated in a currency that is commonly used in business transactions (that are not financial instruments) in the environment in which the transaction takes place (that guidance is now in IFRS 9). A foreign currency derivative would be viewed as closely related to the host contract if the currency is commonly used in local business transactions, for example, when monetary amounts are viewed by the general population not in terms of the local currency but in terms of a relatively stable foreign currency, and prices may be quoted in that foreign currency (see IAS 29 *Financial Reporting in Hyperinflationary Economies*).

Embedded prepayment penalties

- BCZ4.96 The Board identified an apparent inconsistency in the guidance in IAS 39 (as issued in 2003). The inconsistency related to embedded prepayment options in which the exercise price represented a penalty for early repayment (ie prepayment) of the loan. The inconsistency related to whether these are considered closely related to the loan.
- BCZ4.97 The Board decided to remove this inconsistency by amending paragraph AG30(g) in April 2009 (now paragraph B4.3.5(e) of IFRS 9). The amendment makes an exception to the examples in paragraph AG30(g) of embedded derivatives that are not closely related to the underlying. This exception is in respect of prepayment options, the exercise prices of which compensate the lender for the loss of interest income because the loan was prepaid. This exception is conditional on the exercise price compensating the lender for loss of interest by reducing the economic loss from reinvestment risk.

Reassessment of embedded derivatives

- BC4.98 In October 2010 the Board incorporated into IFRS 9 the consensus in IFRIC 9 *Reassessment of Embedded Derivatives*. This section summarises the considerations of the International Financial Reporting Interpretations Committee (IFRIC) in reaching that consensus, as approved by the Board, and the Board's consideration for amending IFRIC 9 in April 2009.
- BCZ4.99 When an entity first becomes a party to particular hybrid contracts it is required to assess whether any embedded derivative contained in the contract needs to be separated from the host contract and accounted for as a derivative. However, the issue arises whether an entity is required to continue to carry out this assessment after it first becomes a party to a contract, and if so, with what frequency.
- BCZ4.100 The question is relevant, for example, when the terms of the embedded derivative do not change but market conditions change and the market was the principal factor in determining whether the host contract and embedded derivative are closely related. Instances when this might arise are given in paragraph B4.3.8(d) of IFRS 9. Paragraph 4.3.8(d) states that an embedded foreign currency derivative is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:
- (a) the functional currency of any substantial party to that contract;
 - (b) the currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or
 - (c) a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (eg a relatively stable and liquid currency that is commonly used in local business transactions or external trade).
- BCZ4.101 Any of the currencies specified in (a)–(c) above may change. Assume that when an entity first became a party to a contract, it assessed the contract as containing an embedded derivative that was closely related and hence not accounted for separately. Assume that subsequently market conditions change and that if the entity were to reassess the contract under the changed circumstances it would conclude that the embedded derivative is not closely related and therefore requires separate accounting. (The converse could also arise.) The issue was whether the entity should make such a reassessment.
- BCZ4.102 When the IFRIC considered this issue in 2006, it noted that the rationale for the requirement to separate particular embedded derivatives is that an entity should not be able to circumvent the recognition and measurement requirements for derivatives merely by embedding a derivative in a non-derivative financial instrument or other contract (for example, by embedding a commodity forward in a debt instrument). Changes in external circumstances are not ways to circumvent the requirements. The IFRIC therefore concluded that reassessment was not appropriate for such changes.
- BCZ4.103 The IFRIC noted that as a practical expedient IAS 39 did not require the separation of embedded derivatives that are closely related (that guidance is now in IFRS 9 for hybrid contracts with a host that is not an asset within the scope of that IFRS). Many financial instruments contain embedded derivatives. Separating all of these embedded derivatives would be burdensome for entities. The IFRIC noted that requiring entities to reassess embedded derivatives in all hybrid instruments could be onerous because frequent monitoring would be required. Market conditions and other factors affecting embedded derivatives would have to be monitored continuously to ensure timely identification of a change in circumstances and amendment of the accounting treatment accordingly. For example, if the functional currency of the counterparty changes during the reporting period so that the contract is no longer denominated in a currency of one of the parties to the contract, then a reassessment of the hybrid instrument would be required at the date of change to ensure the correct accounting treatment in future.
- BCZ4.104 The IFRIC also recognised that although IAS 39 was silent on the issue of reassessment it gave relevant guidance when it stated that for the types of contracts now covered by paragraph B4.3.8(b) of IFRS 9 the assessment of whether an embedded derivative is closely related was required only at inception. Paragraph B4.3.8(b) of IFRS 9 states:

An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest *when the contract is issued*, and the cap or floor is not leveraged in relation to the host contract. Similarly, provisions included in a contract to purchase or sell an asset (eg a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money *at inception* and are not leveraged. [Emphasis added]

BCZ4.105 The IFRIC also considered the implications of requiring subsequent reassessment. For example, assume that an entity, when it first becomes a party to a contract, separately recognises a host asset¹⁰ and an embedded derivative liability. If the entity were required to reassess whether the embedded derivative was to be accounted for separately and if the entity concluded some time after becoming a party to the contract that the derivative was no longer required to be separated, then questions of recognition and measurement would arise. In the above circumstances, the IFRIC identified the following possibilities:

- (a) The entity could remove the derivative from its balance sheet and recognise in profit or loss a corresponding gain or loss. This would lead to recognition of a gain or loss even though there had been no transaction and no change in the value of the total contract or its components.
- (b) The entity could leave the derivative as a separate item in the balance sheet. The issue would then arise as to when the item was to be removed from the balance sheet. Should it be amortised (and, if so, how would the amortisation affect the effective interest rate of the asset), or should it be derecognised only when the asset is derecognised?
- (c) The entity could combine the derivative (which is recognised at fair value) with the asset (which is recognised at amortised cost). This would alter both the carrying amount of the asset and its effective interest rate even though there had been no change in the economics of the whole contract. In some cases, it could also result in a negative effective interest rate.

The IFRIC noted that, under its view that subsequent reassessment is appropriate only when there has been a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required by the contract, the above issues do not arise.

BCZ4.106 The IFRIC noted that IAS 39 required (and now IFRS 9 requires) an entity to assess whether particular embedded derivatives need to be separated from particular host contracts and accounted for as a derivative when it first becomes a party to a contract. Consequently, if an entity purchases a contract that contains an embedded derivative it assesses whether the embedded derivative needs to be separated and accounted for as a derivative on the basis of conditions at that date.

Improvements to IFRSs issued in April 2009

BCZ4.107 In 2009 the Board observed that the changes to the definition of a business combination in the revisions to IFRS 3 Business Combinations (as revised in 2008) caused the accounting for the formation of a joint venture by the venturer to be within the scope of IFRIC 9. Similarly, the Board noted that common control transactions might raise the same issue depending on which level of the group reporting entity is assessing the combination.

BCZ4.108 The Board observed that during the development of the revised IFRS 3, it did not discuss whether it intended IFRIC 9 to apply to those types of transactions. The Board did not intend to change existing practice by including such transactions within the scope of IFRIC 9. Accordingly, in *Improvements to IFRSs* issued in April 2009, the Board amended paragraph 5 of IFRIC 9 (now paragraph B4.3.12 of IFRS 9) to clarify that IFRIC 9 did not apply to embedded derivatives in contracts acquired in a combination between entities or businesses under common control or the formation of a joint venture.

BCZ4.109 Some respondents to the exposure draft Post-implementation Revisions to IFRIC Interpretations published in January 2009 expressed the view that investments in associates should also be excluded from the scope of IFRIC 9. Respondents noted that paragraphs 20–23 of IAS 28 *Investments in Associates*¹¹ state that the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate.

BCZ4.110 In its redeliberations, the Board confirmed its previous decision that no scope exemption in IFRIC 9 was needed for investments in associates. However, in response to the comments received, the Board noted that reassessment of embedded derivatives in contracts held by an associate is not required by IFRIC 9 in any event. The investment in the associate is the asset the investor controls and recognises, not the underlying assets and liabilities of the associate.

¹⁰ Hybrid contracts with a host that is an asset within the scope of IFRS 9 are now classified and measured in their entirety in accordance with section 4.1 of that IFRS.

¹¹ In May 2011, the Board amended IAS 28 and changed its title to *Investments in Associates and Joint Ventures*.

Reclassification

Reclassification of financial assets

- BC4.111 The exposure draft published in 2009 proposed to prohibit reclassification of financial assets between the amortised cost and fair value categories. The Board's rationale for that proposal was as follows:
- (a) Requiring (or permitting) reclassifications would not make it easier for users of financial statements to understand the information that financial statements provide about financial instruments.
 - (b) Requiring (or permitting) reclassifications would increase complexity because detailed guidance would be required to specify when reclassifications would be required (or permitted) and the subsequent accounting for reclassified financial instruments.
 - (c) Reclassification should not be necessary because classification is based on the entity's business model and that business model is not expected to change.
- BC4.112 In their responses, some users questioned the usefulness of reclassified information, noting concerns about the consistency and rigour with which any requirements would be applied. Some were also concerned that opportunistic reclassifications would be possible.
- BC4.113 However, almost all respondents (including most users) argued that prohibiting reclassification is inconsistent with a classification approach based on how an entity manages its financial assets. They noted that in an approach based on an entity's business model for managing financial assets, reclassifications would provide useful, relevant and comparable information to users because it would ensure that financial statements faithfully represent how those financial assets are managed at the reporting date. In particular, most users stated that, conceptually, reclassifications should not be prohibited when the classification no longer reflects how the instruments would be classified if the items were newly acquired. If reclassification were prohibited, the reported information would not reflect the amounts, timing and uncertainty of future cash flows.
- BC4.114 The Board was persuaded by these arguments and decided that reclassification should not be prohibited. The Board noted that prohibiting reclassification decreases comparability for like instruments managed in the same way.
- BC4.115 Some respondents contended that reclassifications should be permitted, rather than required, but did not explain their justification. However, the Board noted that permitting reclassification would decrease comparability, both between different entities and for instruments held by a single entity, and would enable an entity to manage its profit or loss by selecting the timing of when future gains or losses are recognised. Therefore, the Board decided that reclassification should be required when the entity's business model for managing those financial assets changes.
- BC4.116 The Board noted that, as highlighted by many respondents, such changes in business model would be very infrequent, significant and demonstrable and determined by the entity's senior management as a result of external or internal change.
- BC4.117 The Board considered arguments that reclassification should also be permitted or required when contractual cash flow characteristics of a financial asset vary (or may vary) over that asset's life based on its original contractual terms. However, the Board noted that, unlike a change in business model, the contractual terms of a financial asset are known at initial recognition. An entity classifies the financial asset at initial recognition on the basis of the contractual terms over the life of the instrument. Therefore the Board decided that reclassification on the basis of a financial asset's contractual cash flows should not be permitted.
- BC4.118 The Board considered how reclassifications should be accounted for. Almost all respondents said that reclassifications should be accounted for prospectively and should be accompanied by robust disclosures. The Board reasoned that if classification and reclassification are based on the business model within which they are managed, classification should always reflect the business model within which the financial asset was managed at the reporting date. To apply the reclassification retrospectively would not reflect how the financial assets were managed at the prior reporting dates.
- BC4.119 The Board also considered the date at which reclassifications could take effect. Some respondents stated that reclassifications should be reflected in the entity's financial statements as soon as the entity's business model for the relevant instruments changes. To do otherwise would be contradictory to the objective of reclassification—ie to reflect how the instruments are managed. However, the Board decided that reclassifications should take effect from the beginning of the following reporting period. In the Board's view, entities should be prevented from choosing a reclassification date to achieve an accounting result. The Board also noted that a change in an entity's business model is a significant and demonstrable event; therefore, an entity will most likely disclose such an event in its financial statements in the reporting period in which the change in business model takes place.

BC4.120 The Board also considered and rejected the following approaches:

- (a) *Disclosure approach:* Quantitative and qualitative disclosure (instead of reclassification) could be used to address when the classification no longer reflects how the financial assets would be classified if they were newly acquired. However, in the Board's view, disclosure is not an adequate substitute for recognition.
- (b) *One-way reclassification:* Reclassification would be required only to fair value measurement, ie reclassification to amortised cost measurement would be prohibited. Proponents of this approach indicated that such an approach might minimise abuse of the reclassification requirements and result in more instruments being measured at fair value. However, in the Board's view, there is no conceptual reason to require reclassification in one direction but not the other.

Reclassification of financial liabilities

BC4.121 Consistently with its decision in 2010 to retain most of the existing requirements for classifying and measuring financial liabilities (and relocate them to IFRS 9), the Board decided to retain the requirements that prohibit reclassifying financial liabilities between amortised cost and fair value. The Board noted that IFRS 9 requires reclassification of assets in particular circumstances. However, in line with the feedback received during the Board's outreach programme, the classification and measurement approaches for financial assets and financial liabilities are different; therefore the Board decided that it is unnecessary and inappropriate to have symmetrical requirements for reclassification. Moreover, although the reclassification of financial assets has been a controversial topic in recent years, the Board is not aware of any requests or views that support reclassifying financial liabilities.

Changes in circumstances that are not reclassifications

BCZ4.122 The definition of a financial asset or financial liability at fair value through profit or loss excludes derivatives that are designated and effective hedging instruments. Paragraph 50 of IAS 39 prohibited (and unless particular conditions are met, paragraphs 4.4.1 and 4.4.2 of IFRS 9 prohibit) the reclassification of financial instruments into or out of the fair value through profit or loss category after initial recognition. The Board noted that the prohibition on reclassification might be read as preventing a derivative financial instrument that becomes a designated and effective hedging instrument from being excluded from the fair value through profit or loss category in accordance with the definition. Similarly, it might be read as preventing a derivative that ceases to be a designated and effective hedging instrument from being accounted for at fair value through profit or loss.

BCZ4.123 The Board decided that the prohibition on reclassification should not prevent a derivative from being accounted for at fair value through profit or loss when it does not qualify for hedge accounting and vice versa. Therefore, in Improvements to IFRSs issued in May 2008, the Board addressed this point (now in paragraph 4.4.3 of IFRS 9).

Measurement (chapter 5)

Fair value measurement considerations¹²

BCZ5.1 The Board decided to include in the revised IAS 39 (published in 2002) expanded guidance about how to determine fair values (the guidance is now in IFRS 9), in particular for financial instruments for which no quoted market price is available (now paragraphs B5.4.6–B5.4.13 of IFRS 9). The Board decided that it is desirable to provide clear and reasonably detailed guidance about the objective and use of valuation techniques to achieve reliable and comparable fair value estimates when financial instruments are measured at fair value.

Use of quoted prices in active markets

BCZ5.2 The Board considered comments received that disagreed with the proposal in the exposure draft published in 2002 that a quoted price is the appropriate measure of fair value for an instrument quoted in an active market. Some respondents argued that (a) valuation techniques are more appropriate for measuring fair value than a

¹² IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence paragraphs 5.4.1–5.4.3 and B5.4.1–B5.4.13 of IFRS 9 have been deleted. *Annual Improvements to IFRSs 2010–2012 Cycle*, issued in December 2013, added paragraph BC138A to the Basis for Conclusions on IFRS 13 to clarify the IASB's reason for deleting paragraph B5.4.12.

quoted price in an active market (eg for derivatives) and (b) valuation models are consistent with industry best practice, and are justified because of their acceptance for regulatory capital purposes.

- BCZ5.3 However, the Board confirmed that a quoted price is the appropriate measure of fair value for an instrument quoted in an active market, notably because (a) in an active market, the quoted price is the best evidence of fair value, given that fair value is defined in terms of a price agreed by a knowledgeable, willing buyer and a knowledgeable, willing seller; (b) it results in consistent measurement across entities; and (c) fair value (now defined in IFRS 9) does not depend on entity-specific factors. The Board further clarified that a quoted price includes market-quoted rates as well as prices.

Entities that have access to more than one active market

- BCZ5.4 The Board considered situations in which entities operate in different markets. An example is a trader that originates a derivative with a corporate in an active corporate retail market and offsets the derivative by taking out a derivative with a dealer in an active dealers' wholesale market. The Board decided to clarify that the objective of fair value measurement is to arrive at the price at which a transaction would occur at the balance sheet date in the same instrument (ie without modification or repackaging) in the most advantageous active market¹³ to which an entity has immediate access. Thus, if a dealer enters into a derivative instrument with the corporate, but has immediate access to a more advantageously priced dealers' market, the entity recognises a profit on initial recognition of the derivative instrument. However, the entity adjusts the price observed in the dealer market for any differences in counterparty credit risk between the derivative instrument with the corporate and that with the dealers' market.

Bid-ask spreads in active markets

- BCZ5.5 The Board confirmed the proposal in the exposure draft published in 2002 that the appropriate quoted market price for an asset held or liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the asking price¹⁴. It concluded that applying mid-market prices to an individual instrument is not appropriate because it would result in entities recognising upfront gains or losses for the difference between the bid-ask price and the mid-market price.
- BCZ5.6 The Board discussed whether the bid-ask spread should be applied to the net open position of a portfolio containing offsetting market risk positions, or to each instrument in the portfolio. It noted the concerns raised by constituents that applying the bid-ask spread to the net open position better reflects the fair value of the risk retained in the portfolio. The Board concluded that for offsetting risk positions, entities could use mid-market prices to determine fair value, and hence may apply the bid or asking price to the net open position as appropriate. The Board believes that when an entity has offsetting risk positions, using the mid-market price is appropriate because the entity (a) has locked in its cash flows from the asset and liability and (b) potentially could sell the matched position without incurring the bid-ask spread.¹⁵
- BCZ5.7 Comments received on the exposure draft published in 2002 revealed that some interpret the term 'bid-ask spread' differently from others and from the Board. Thus, the Board clarified that the spread represents only transaction costs.

No active market

- BCZ5.8 The exposure draft published in 2002 proposed a three-tier fair value measurement hierarchy as follows:
- (a) For instruments traded in active markets, use a quoted price.
 - (b) For instruments for which there is not an active market, use a recent market transaction.
 - (c) For instruments for which there is neither an active market nor a recent market transaction, use a valuation technique.
- BCZ5.9 The Board decided to simplify the proposed fair value measurement hierarchy¹⁶ by requiring the fair value of financial instruments for which there is not an active market to be determined by using valuation techniques, including recent market transactions between knowledgeable, willing parties in an arm's length transaction.

¹³ IFRS 13, issued in May 2011, states that a fair value measurement assumes that the transaction to sell an asset or to transfer a liability takes place in the principal market, or in the absence of a principal market, the most advantageous market for the asset or liability.

¹⁴ IFRS 13, issued in May 2011, states that fair value is measured using the price within the bid-ask spread that is most representative of fair value in the circumstances.

¹⁵ IFRS 13, issued in May 2011, permits an exception to the fair value measurement requirements when an entity manages its financial assets and financial liabilities on the basis of the entity's net exposure to market risks or the credit risk of a particular counterparty, allowing the entity to measure the fair value of its financial instruments on the basis of the entity's net exposure to either of those risks.

¹⁶ IFRS 13, issued in May 2011, contains a three-level fair value hierarchy for the inputs used in the valuation techniques used to measure fair value.

BCZ5.10 The Board also considered constituents' comments regarding whether an instrument should always be recognised on initial recognition at the transaction price or whether gains or losses may be recognised on initial recognition when an entity uses a valuation technique to estimate fair value. The Board concluded that an entity may recognise a gain or loss at inception only if fair value is evidenced by comparison with other observable current market transactions in the same instrument (ie without modification or repackaging) or is based on a valuation technique incorporating only observable market data. The Board concluded that those conditions were necessary and sufficient to provide reasonable assurance that fair value was other than the transaction price for the purpose of recognising upfront gains or losses. The Board decided that in other cases, the transaction price gave the best evidence of fair value¹⁷. The Board also noted that its decision achieved convergence with US GAAP.¹⁸

Measurement of financial liabilities with a demand feature¹⁹

BCZ5.11–BCZ5.12 [Deleted]

Exception in IAS 39 from fair value measurement for some unquoted equity instruments²⁰ (and some derivative assets linked to those instruments)

BC5.13 The Board believes that measurement at amortised cost is not applicable to equity investments because such financial assets have no contractual cash flows and hence there are no contractual cash flows to amortise. IAS 39 contained an exception from fair value measurement for investments in equity instruments (and some derivatives linked to those investments) that do not have a quoted price in an active market and whose fair value cannot be reliably measured. Those equity investments were required to be measured at cost less impairment, if any. Impairment losses are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

BC5.14 The exposure draft published in 2009 proposed that all investments in equity instruments (and derivatives linked to those investments) should be measured at fair value for the following reasons:

- (a) For investments in equity instruments and derivatives, fair value provides the most relevant information. Cost provides little, if any, information with predictive value about the timing, amount and uncertainty of the future cash flows arising from the instrument. In many cases, fair value will differ significantly from historical cost (this is particularly true for derivatives measured at cost under the exception).
- (b) To ensure that a financial asset accounted for under the cost exception is not carried above its recoverable amount, IAS 39 required an entity to monitor instruments measured at cost for any impairment. Calculating any impairment loss is similar to determining fair value (ie the estimated future cash flows are discounted using the current market rate of return for a similar financial asset and compared with the carrying amount).
- (c) Removing the exception would reduce complexity because the classification model for financial assets would not have a third measurement attribute and would not require an additional impairment methodology. Although there might be an increase in the complexity of determining fair values on a recurring basis that complexity would be offset (at least partially) by the fact that all equity instruments and derivatives have one common measurement attribute; thus the impairment requirements would be eliminated.

BC5.15 Many respondents agreed that cost does not provide useful information about future cash flows arising from equity instruments and that conceptually such equity instruments should be measured using a current measurement attribute such as fair value. Some of those respondents generally agreed with the removal of

¹⁷ IFRS 13, issued in May 2011, describes when a transaction price might not represent the fair value of an asset or a liability at initial recognition.

¹⁸ FASB Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (SFAS 157) superseded EITF Issue No. 02-3 *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Involved in Energy Trading and Risk Management Activities* (Topic 820 *Fair Value Measurement* in the *FASB Accounting Standards Codification*[®] codified SFAS 157). As a result, IFRSs and US GAAP have different requirements for when an entity may recognise a gain or loss when there is a difference between fair value and the transaction price at initial recognition.

¹⁹ IFRS 13, issued in May 2011, resulted in the relocation of paragraphs BCZ5.11 and BCZ5.12 of IFRS 9 to paragraphs BCZ102 and BCZ103 of IFRS 13. As a consequence minor necessary edits have been made to that material.

²⁰ IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IFRS 9 refers to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

the exception, but suggested that disclosures would have to include information about the uncertainties surrounding measurement.

BC5.16 However, many respondents (mainly preparers from non-financial entities and some auditors) disagreed with the proposal to eliminate the current cost exception on the grounds of the reliability and usefulness of fair value measurement and the cost and difficulty involved in determining fair value on a recurring basis. They generally preferred to keep a cost exception, similar to that in IAS 39. Some noted that the proposals would not reduce complexity, because they would increase complexity in measurement. Furthermore, a few believed that cost could provide useful information if the financial asset is held for the long term.

BC5.17 The Board considered those arguments as follows:

(a) *Reliability and usefulness of fair value measurement*

Respondents noted that IAS 39 included a cost exception because of the lack of reliability of fair value measurement for particular equity instruments and contended that this rationale is still valid. They believed that, given the lack of available reliable information, any fair value measurement would require significant management judgement or might be impossible. They also believed that comparability would be impaired by the requirement to measure such equity instruments at fair value. However, those respondents had considered the question of reliability of fair value for the instruments concerned in isolation. In the Board's view, the usefulness of information must be assessed against all four of the qualitative characteristics in the *Framework*: reliability, understandability, relevance and comparability. Thus, cost is a reliable (and objective) amount, but has little, if any, relevance. In the Board's view measuring all equity instruments at fair value, including those that are currently measured using the cost exception in IAS 39, meets the criteria in the *Framework* for information to be reliable if appropriate measurement techniques and inputs are employed. The Board noted that its project on fair value measurement will provide guidance on how to meet that objective.²¹

(b) *Cost and difficulty involved in determining fair value on a recurring basis*

Many respondents, particularly in emerging economies, said that they faced difficulty in obtaining information that might be relied on to use in valuation. Others said that they would inevitably rely heavily on external experts at significant cost. Many questioned whether the requirement to determine fair value on a recurring basis would involve significant costs and efforts that are not offset by the incremental benefit to usefulness from fair value. The Board considered the costs of requiring such equity investments to be measured at fair value from the perspectives of valuation methodology and expertise, as well as the ability to obtain the information required for a fair value measurement. The Board noted that valuation methods for equity investments are well-developed and are often far less complex than those required for other financial instruments that are required to be measured at fair value, including many complex derivative products. Although some expressed concern that smaller entities applying IFRSs might not have internal systems or expertise to determine easily the fair value of equity investments held, the Board noted that basic shareholder rights generally enable an entity to obtain the necessary information to perform a valuation. The Board acknowledged that there are circumstances in which the cost of determining fair value could outweigh the benefits from fair value measurement. In particular, the Board noted that, in some jurisdictions, entities hold high numbers of unquoted equity instruments that are currently accounted for under the cost exception and the value of a single investment is considered low. However, the Board concluded that if the volume of the investments individually or aggregated is material the incremental benefit of fair value generally outweighs the additional cost because of the impact of the investments on the financial performance and position of the entity.²²

BC5.18 The Board noted that there are some circumstances in which cost might be representative of fair value and decided to provide additional application guidance on those circumstances to alleviate some of the concerns expressed. However, the Board also noted that those circumstances would never apply to equity investments held by particular entities such as financial institutions and investment funds.

BC5.19 The Board considered whether a simplified approach to measurement should be provided for equity instruments when fair value measurement was impracticable. The Board also discussed possible simplified measurement approaches, including management's best estimate of the price it would accept to sell or buy the instrument, or changes in the share of net assets. However, the Board concluded that a simplified measurement approach would add complexity to the classification approach and reduce the usefulness of

²¹ IFRS 13, issued in May 2011, contains the requirements for measuring fair value.

²² IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IFRS 9 refers to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

information to users of financial statements. Those disadvantages would not be offset by the benefit of reduced cost to preparers of financial statements.

Elimination of the cost exception for particular derivative liabilities

- BC5.20 Consistently with the requirements in IFRS 9 for some investments in equity instruments and some derivative assets linked to those instruments (see paragraphs BC5.13–BC5.19), the Board decided in 2010 that the cost exception should be eliminated for derivative liabilities that will be physically settled by delivering unquoted equity instruments²³ whose fair values cannot be reliably determined. That proposal was included in the exposure draft published in July 2009.

Gains and losses

Investments in equity instruments

- BC5.21 IFRS 9 permits an entity to make an irrevocable election to present in other comprehensive income changes in the value of any investment in equity instruments that is not held for trading. The term ‘equity instrument’ is defined in IAS 32 *Financial Instruments: Presentation*. The Board noted that in particular circumstances a puttable instrument (or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation) is classified as equity. However, the Board noted that such instruments do not meet the definition of an equity instrument.
- BC5.22 In the Board’s view, fair value provides the most useful information about investments in equity instruments to users of financial statements. However, the Board noted arguments that presenting fair value gains and losses in profit or loss for some equity investments may not be indicative of the performance of the entity, particularly if the entity holds those equity instruments for non-contractual benefits, rather than primarily for increases in the value of the investment. An example could be a requirement to hold such an investment if an entity sells its products in a particular country.
- BC5.23 The Board also noted that, in their valuation of an entity, users of financial statements often differentiate between fair value changes arising from equity investments held for purposes other than generating investment returns and equity investments held for trading. Thus, the Board believes that separate presentation in other comprehensive income of gains and losses for some investments could provide useful information to users of financial statements because it would allow them to identify easily, and value accordingly, the associated fair value changes.
- BC5.24 Almost all respondents to the exposure draft published in 2009 supported recognition of fair value gains and losses in other comprehensive income for particular equity investments. They agreed that an entity should make an irrevocable election to identify those equity instruments. However, some users did not support these proposals in the exposure draft.
- BC5.25 The concerns expressed in the comment letters were as follows:
- (a) *Dividends:* The exposure draft proposed that dividends on equity instruments measured at fair value with changes recognised in other comprehensive income would also be recognised in other comprehensive income. Nearly all respondents objected to that proposal. They argued that dividends are a form of income that should be presented in profit or loss in accordance with IAS 18 *Revenue* and noted that those equity investments are sometimes funded with debt instruments whose interest expense is recognised in profit or loss. As a result, presenting dividends in other comprehensive income would create a ‘mismatch’. Some listed investment funds stated that without recognising dividend income in profit or loss their financial statements would become meaningless to their investors. The Board agreed with those arguments. The Board noted that structuring opportunities might remain because dividends could represent a return of investment, rather than a return on investment. Therefore, the Board decided that dividends that clearly represent a recovery of part of the cost of the investment are not recognised in profit or loss. However, in the Board’s view, those structuring opportunities would be limited because an entity with the ability to control or significantly influence the dividend policy of the investment would not account for those investments in

²³ IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IFRS 9 refers to such equity instruments as ‘an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)’.

accordance with IFRS 9²⁴. Furthermore, the Board decided to require disclosures that would allow a user to compare easily the dividends recognised in profit or loss and the other fair value changes.

- (b) *Recycling*: Many respondents, including many users, did not support the proposal to prohibit subsequent transfer ('recycling') of fair value changes to profit or loss (on derecognition of the investments in an equity instrument). Those respondents supported an approach that maintains a distinction between realised and unrealised gains and losses and said that an entity's performance should include all realised gains and losses. However, the Board concluded that a gain or loss on those investments should be recognised once only; therefore, recognising a gain or loss in other comprehensive income and subsequently transferring it to profit or loss is inappropriate. In addition, the Board noted that recycling of gains and losses to profit or loss would create something similar to the available-for-sale category in IAS 39 and would create the requirement to assess the equity instrument for impairment, which had created application problems. That would not significantly improve or reduce the complexity of the financial reporting for financial assets. Accordingly, the Board decided to prohibit recycling of gains and losses into profit or loss when an equity instrument is derecognised.
 - (c) *Scope of exception*: Some respondents asked the Board to identify a principle that defined the equity instruments to which the exception should apply. However, they did not specify what that principle should be. The Board previously considered developing a principle to identify other equity investments whose fair value changes should be presented in profit or loss (or other comprehensive income), including a distinction based on whether the equity instruments represented a 'strategic investment'. However, the Board decided that it would be difficult, and perhaps impossible, to develop a clear and robust principle that would identify investments that are different enough to justify a different presentation requirement. The Board considered whether a list of indicators could be used to support the principle, but decided that such a list would inevitably be rule-based and could not be comprehensive enough to address all possible situations and factors. Moreover, the Board noted that such an approach would create complexity in application without necessarily increasing the usefulness of information to users of financial statements.
 - (d) *Irrevocability of the exception*: A small number of respondents believed that an entity should be able to reclassify equity instruments into and out of the fair value through other comprehensive income category if an entity starts or ceases to hold the investments for trading purposes. However, the Board decided that the option must be irrevocable to provide discipline to its application. The Board also noted that the option to designate a financial asset as measured at fair value is also irrevocable.
- BC5.26 An entity may transfer the cumulative gain or loss within equity. In the light of jurisdiction-specific restrictions on components of equity, the Board decided not to provide specific requirements related to that transfer.
- BC5.27 IFRS 9 amended IFRS 7 in 2009 to require additional disclosures about investments in equity instruments that are measured at fair value through other comprehensive income. The Board believes those disclosures will provide useful information to users of financial statements about instruments presented in that manner and the effect of that presentation.
- BC5.28 The Board noted that permitting an option for entities to present some gains and losses in other comprehensive income is an exception to the overall classification and measurement approach and adds complexity. However, the Board believes that the requirement that the election is irrevocable, together with the additional disclosures required, addresses many of those concerns.

Liabilities designated as at fair value through profit or loss

Previous discussions related to the effects of changes in a liability's credit risk

- BCZ5.29 In 2003 the Board discussed the issue of including changes in the credit risk of a financial liability in its fair value measurement. It considered responses to the exposure draft of proposed amendments to IAS 39 published in June 2002 that expressed concern about the effect of including this component in the fair value measurement and that suggested the fair value option should be restricted to exclude all or some financial liabilities. However, the Board concluded that the fair value option could be applied to any financial liability, and decided not to restrict the option in IAS 39 (as revised in 2003) because to do so would negate some of the benefits of the fair value option set out in paragraph BCZ4.60.

²⁴ In October 2012 the Board issued *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), which required investment entities, as defined in IFRS 10 *Consolidated Financial Statements*, to measure their investments in subsidiaries, other than those providing investment-related services or activities, at fair value through profit or loss.

- BCZ5.30 The Board considered comments on the exposure draft published in 2002 that disagreed with the view that, in applying the fair value option to financial liabilities, an entity should recognise income as a result of deteriorating credit quality (and expense as a result of improving credit quality). Commentators noted that it is not useful to report lower liabilities when an entity is in financial difficulty precisely because its debt levels are too high, and that it would be difficult to explain to users of financial statements the reasons why income would be recognised when a liability's creditworthiness deteriorates. These comments suggested that fair value should exclude the effects of changes in the instrument's credit risk.
- BCZ5.31 However, the Board noted that because financial statements are prepared on a going concern basis, credit risk affects the value at which liabilities could be repurchased or settled. Accordingly, the fair value of a financial liability reflects the credit risk relating to that liability. Therefore, it decided to include credit risk relating to a financial liability in the fair value measurement of that liability for the following reasons:
- (a) Entities realise changes in fair value, including fair value attributable to the liability's credit risk, for example, by renegotiating or repurchasing liabilities or by using derivatives.
 - (b) Changes in credit risk affect the observed market price of a financial liability and hence its fair value.
 - (c) It is difficult from a practical standpoint to exclude changes in credit risk from an observed market price.
 - (d) The fair value of a financial liability (ie the price of that liability in an exchange between a knowledgeable, willing buyer and a knowledgeable, willing seller) on initial recognition reflects its credit risk. The Board believes that it is inappropriate to include credit risk in the initial fair value measurement of financial liabilities, but not subsequently.
- BCZ5.32 In 2003 the Board also considered whether the component of the fair value of a financial liability attributable to changes in credit quality should be specifically disclosed, separately presented in the income statement, or separately presented in equity. The Board decided that whilst separately presenting or disclosing such changes might be difficult in practice, disclosure of such information would be useful to users of financial statements and would help alleviate the concerns expressed. Therefore, it decided to require a disclosure to help identify the changes in the fair value of a financial liability that arise from changes in the liability's credit risk. The Board believes this is a reasonable proxy for the change in fair value that is attributable to changes in the liability's credit risk, in particular when such changes are large, and will provide users with information with which to understand the profit or loss effect of such a change in credit risk.
- BCZ5.33 The Board decided to clarify that this issue relates to the credit risk of the financial liability, rather than the creditworthiness of the entity. The Board noted that this more appropriately describes the objective of what is included in the fair value measurement of financial liabilities.
- BCZ5.34 The Board also noted that the fair value of liabilities secured by valuable collateral, guaranteed by third parties or ranking ahead of virtually all other liabilities is generally unaffected by changes in the entity's creditworthiness.
- BC5.34A IFRS 13, issued in May 2011, includes requirements for measuring the fair value of a liability issued with an inseparable third-party credit enhancement from the issuer's perspective.

Requirements added to IFRS 9 in October 2010 to address the effects of changes in credit risk for liabilities designated as at fair value through profit or loss

- BC5.35 As noted above, if an entity designates a financial liability under the fair value option, IAS 39 required the entire fair value change to be presented in profit or loss. However, many users and others told the Board over a long period of time that changes in a liability's credit risk ought not to affect profit or loss unless the liability is held for trading. That is because an entity generally will not realise the effects of changes in the liability's credit risk unless the liability is held for trading.
- BC5.36 To respond to that long-standing and widespread concern, in May 2010 the Board proposed that the effects of changes in a liability's credit risk should be presented in other comprehensive income. The proposals in the exposure draft would have applied to all liabilities designated under the fair value option.
- BC5.37 However, in its deliberations leading to the exposure draft published in 2010, the Board discussed whether such treatment would create or enlarge an accounting mismatch in profit or loss in some limited cases. The Board acknowledged that this might be the case if an entity holds large portfolios of financial assets that are measured at fair value through profit or loss and there is an economic relationship between changes in the fair value of those assets and the effects of changes in the credit risk of the financial liabilities designated under the fair value option. A mismatch would arise because the entire change in the fair value of the assets would be presented in profit or loss but only a portion of the change in the fair value of the liabilities would be presented in profit or loss. The portion of the liabilities' fair value change attributable to changes in their credit risk would be

presented in other comprehensive income. To address potential mismatches, the Board set out an alternative approach in the exposure draft whereby the effects of changes in the liabilities' credit risk would be presented in other comprehensive income unless such treatment would create or enlarge an accounting mismatch in profit or loss (in which case, the entire fair value change would be presented in profit or loss). The exposure draft stated that the determination about potential mismatches would be made when the liability is initially recognised and would not be reassessed. The Board asked respondents for feedback on the alternative approach.

- BC5.38 Many respondents preferred the alternative approach. They agreed that in almost all cases the effects of changes in credit risk ought not to be presented in profit or loss. However, those respondents said that if such treatment would create or enlarge an accounting mismatch in profit or loss, the entire fair value change should be presented in profit or loss. Respondents thought such cases would be rare and asked the Board to provide guidance on how to determine whether presenting the effects of changes in credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss.
- BC5.39 The Board agreed with the responses and finalised the alternative approach. Therefore entities are required to present the effects of changes in the liabilities' credit risk in other comprehensive income unless such treatment would create or enlarge an accounting mismatch in profit or loss (in which case, the entire fair value change is required to be presented in profit or loss). The Board acknowledged that that approach will introduce some additional complexity to financial reporting because not all liabilities designated under the fair value option will be treated the same. However, the Board decided that it was necessary to address circumstances in which the proposals would create or enlarge a mismatch in profit or loss. Although the Board expects those circumstances to be rare, they could be significant in some industries in some jurisdictions.
- BC5.40 The Board discussed how an entity should determine whether a mismatch would be created or enlarged. It decided that an entity has to assess whether it expects that changes in the credit risk of a liability will be offset by changes in the fair value of another financial instrument. The Board decided that such an assessment must be based on an economic relationship between the characteristics of the liability and the characteristics of the other financial instrument. Such a relationship does not arise by coincidence.
- BC5.41 The Board believes that in many cases the relationship will be contractual (as described in paragraph B5.7.10 of IFRS 9) but decided that a contractual relationship is not required. Requiring a contractual relationship would have created a very high threshold for presenting the effects of changes in a liability's credit risk in profit or loss and the Board decided that such a high threshold was too strict to accommodate all of the possible scenarios in which a mismatch would be created or enlarged by presenting those amounts in other comprehensive income.
- BC5.42 However, to increase transparency about an entity's determination about potential mismatches, the Board decided to require disclosures about an entity's methodology for making that determination. Also, an entity is required to apply its methodology consistently. The determination must be made at initial recognition of the liability and is not reassessed, which is consistent with the entity's overall election to use the fair value option.
- BC5.43 Some respondents to the exposure draft asked whether the Board intended that the proposals should apply to loan commitments and financial guarantee contracts that are designated under the fair value option. Those respondents suggested that the proposals should not apply to those items because the Board's intention seemingly had always been to address the issue of own credit risk for non-derivative liabilities. The respondents noted that loan commitments and financial guarantee contracts either meet the definition of a derivative or are very similar to a derivative from an economic perspective and therefore changes in their fair value should always be presented in profit or loss. The Board agreed with those respondents and decided that all changes in the fair value of loan commitments and financial guarantee contracts designated under the fair value option should be presented in profit or loss. In addition to the comments put forward by respondents, the Board also noted that phase II of the insurance project was discussing whether all financial guarantee contracts should be within the scope of that proposed IFRS.

Alternative approaches to address the issue of own credit risk

- BC5.44 In 2010 the Board discussed and rejected the following approaches for addressing the issue of credit risk:
- (a) *Present the effects of changes in credit risk directly in equity:* Some believe that the effects of changes in credit risk should not affect the entity's performance; therefore they believe that those amounts should be presented directly in equity. The Board rejected this approach in the exposure draft because it believes that changes in the liability's credit risk ought to affect the entity's performance if the liability is measured at fair value. If those amounts were presented directly in equity, they would never be presented in the entity's statement of comprehensive income. The Board acknowledged that IFRSs do not provide a clear objective for when an item should be presented in other comprehensive income instead of in profit or loss or whether the amounts in other comprehensive income should be reclassified to profit or loss. However, the Board believes that presenting the effects of changes in credit risk in other comprehensive income is preferable to presenting them directly in equity because the latter would

create a new problem by causing confusion or creating inconsistencies in what items are presented directly in equity. The Board noted that remeasurements of assets and liabilities should not be presented directly in equity because remeasurements are not transactions with equity holders. The Board asked respondents for feedback on presenting directly in equity the effects of changes in a liability's credit risk and almost all respondents, including users, did not support it. Accordingly the Board did not pursue this alternative.

- (b) *Present the entire change in the fair value of liabilities in other comprehensive income:* Some believe that the entire change in fair value (not just the portion attributable to changes in credit risk) should be presented in other comprehensive income. They argue that this approach would avoid the difficult question of how to measure the effects of changes in credit risk. The Board rejected this approach because it believes that at least some of the change in fair value should be presented in profit or loss. The Board's objective was to address issues related to the effects of changes in liabilities' credit risk; therefore, presenting the entire change in fair value in other comprehensive income is not appropriate. Also, this approach would result in mismatches in profit or loss because changes in the fair value of an entity's assets would be presented in profit or loss and changes in the fair value of its liabilities would be presented in other comprehensive income (see similar discussion in paragraph BC5.37). Moreover, this alternative would raise difficult questions about what (if any) amounts should be presented in profit or loss during the life of the liability (eg interest or other financing costs). The Board has discussed the topic of disaggregating finance costs from other fair value changes on numerous occasions without reaching any conclusions.

Presenting the effects of changes in credit risk in other comprehensive income via a one-step or two-step approach.

- BC5.45 The exposure draft published in 2010 proposed a 'two-step approach' for presenting a liability's credit risk in the statement of comprehensive income, with the result that those changes would not affect profit or loss. In the first step, the entity would present the entire fair value change in profit or loss. In the second step, the entity would 'back out' from profit or loss the portion of the fair value change that is attributable to changes in the liability's credit risk and present that amount in other comprehensive income.
- BC5.46 The exposure draft also set out a 'one-step approach', which would present the portion of the fair value change that is attributable to changes in the liability's credit risk directly in other comprehensive income. All other portions of the fair value change would be presented in profit or loss.
- BC5.47 The Board acknowledged that the only difference between those two approaches is how the effects of changes in the liability's credit risk are presented. The two-step approach would present those amounts first in profit or loss and then transfer them to other comprehensive income, whereas the one-step approach would present them directly in other comprehensive income.
- BC5.48 The Board proposed the two-step approach in the exposure draft because it thought that it would present more clearly all of the relevant information in the primary financial statements, but it decided to ask respondents which approach they supported.
- BC5.49 Almost all respondents, including users, supported the one-step approach. They said that the one-step approach is more efficient and less complicated than the two-step approach. They pointed out that both approaches have the same net result in profit or loss and other comprehensive income. Respondents said that there is little (if any) added benefit of the 'gross' presentation in the two-step approach and the extra line items on the face of the performance statement result in unnecessary clutter. Furthermore, respondents noted the Board's exposure draft published in May 2010 on the presentation of items in other comprehensive income. That exposure draft proposes that the profit or loss section and other comprehensive income should be displayed as separate components within an overall statement of profit or loss and other comprehensive income. Respondents questioned whether the two-step approach would have any added benefit if the Board finalised the proposals in that exposure draft.
- BC5.50 Users told the Board that the two-step approach would not be more helpful to their analysis than the one-step approach. Some users noted that the effects of changes in a liability's credit risk should not be presented in profit or loss, even if those effects were subsequently backed out.
- BC5.51 The Board was persuaded by respondents' arguments and decided to require the one-step approach. The Board noted that no information is lost by using the one-step approach because IFRS 7 and IAS 1 *Presentation of Financial Statements* require entities to disclose (either on the financial statements or in the notes) all of the information required by the two-step approach.

Reclassifying amounts to profit or loss

- BC5.52 The exposure draft published in 2010 proposed to prohibit reclassification of gains or losses to profit or loss (on derecognition of the liability or otherwise)—sometimes called 'recycling'. In the Basis for Conclusions

on that exposure draft, the Board noted that the proposal was consistent with the requirements in IFRS 9 that prohibit recycling for investments in equity instruments that are measured at fair value with changes presented in other comprehensive income.

- BC5.53 Moreover, the Board noted that if the entity repays the contractual amount, the cumulative effect over the life of the instrument of any changes in the liability's credit risk will net to zero because its fair value will equal the contractual amount. Therefore, for many liabilities, the issue of reclassification is irrelevant.
- BC5.54 Most respondents to the exposure draft disagreed with that proposal and urged the Board to require reclassification if the liability was derecognised and the effects of changes in its credit risk were realised. They acknowledged that there would not be any amount to reclassify if the entity repays the contractual amount. But they believe that if the entity repays an amount other than the contractual amount, the realised amounts in other comprehensive income should be reclassified. Those respondents view other comprehensive income as a 'temporary holding place' for unrealised gains and losses. They believe that unrealised and realised amounts are fundamentally different and thus should not be treated the same. The former are still uncertain and may never be crystallised. In contrast, the latter have crystallised and are backed by cash flows.
- BC5.55 However, the Board was not persuaded and confirmed the proposal to prohibit reclassification. The Board acknowledged that it needs to address the overall objective of other comprehensive income, including when an item should be presented in other comprehensive income instead of in profit or loss and whether amounts in other comprehensive income should be reclassified to profit or loss (and if so, when). However, in the absence of such an objective, the Board noted that its decision is consistent with the requirements in IFRS 9 that prohibit recycling for investments in equity instruments that are measured at fair value with changes presented in other comprehensive income.
- BC5.56 However, to provide users with information about how much of the accumulated other comprehensive income balance has been realised during the current reporting period (ie how much would have been reclassified if the Board had required reclassification upon derecognition), the Board decided to require entities to disclose that amount.
- BC5.57 Also, consistently with the requirements for equity investments measured at fair value with changes presented in other comprehensive income, the Board decided that an entity may transfer the cumulative gain or loss within equity.

Determining the effects of changes in the liability's credit risk

- BC5.58 IFRS 7 required an entity, when designating a financial liability under the fair value option, to disclose the amount of the change in fair value that is attributable to changes in the liability's credit risk. The application guidance in IFRS 7 provided a default method for determining that amount. If the only relevant changes in market conditions for the liability are changes in an observed (benchmark) interest rate, that method attributes all changes in fair value, other than changes in the benchmark interest rate, to changes in the credit risk of the liability. In the Basis for Conclusions on IFRS 7, the Board acknowledged that quantifying the change in a liability's credit risk might be difficult in practice. It noted that it believes that the default method provides a reasonable proxy for changes in the liability's credit risk, in particular when such changes are large, and would provide users with information with which to understand the effect on profit or loss of such a change in credit risk. However, IFRS 7 permitted entities to use a different method if it provides a more faithful representation of the changes in the liability's credit risk.
- BC5.59 During the Board's outreach programme preceding the publication of the exposure draft in 2010, preparers told the Board that the default method in IFRS 7 is appropriate in many circumstances but a more sophisticated method is sometimes needed to reflect faithfully the effects of changes in the liabilities' credit risk (eg when the volume of liabilities outstanding significantly changed during the reporting period).
- BC5.60 In the user questionnaire conducted during that outreach programme, the Board asked users whether the default method in IFRS 7 was appropriate for determining the change in a liability's credit risk. Most users said that it was an appropriate method. Many users noted the difficulty in determining that amount more precisely.
- BC5.61 Therefore, for the purposes of measuring the effects of changes in the credit risk of a liability, the exposure draft proposed to use the guidance in IFRS 7. Under the proposals, the default method would be carried forward but entities would continue to be permitted to use a different method if it provides a more faithful representation of the amount of the change in fair value that is attributable to changes in the liability's credit risk.
- BC5.62 Most respondents agreed with the proposals in the exposure draft. Those respondents agreed that the guidance in IFRS 7 for measuring the effects of changes in a liability's credit risk is appropriate and operational. They noted that determining the effects of changes in a liability's credit risk can be complex, and therefore it was necessary to allow some flexibility in how it is measured. They acknowledged that the

default method described in IFRS 7 is imprecise but said that it is a reasonable proxy in many cases. Moreover, although some respondents acknowledged that the default method does not isolate changes in a liability's credit risk from some other changes in fair value (eg general changes in the price of credit or changes in liquidity risk), those respondents said that it is often very difficult or impossible to separate those items. However, some respondents (including those who supported the Board's proposals in the exposure draft) asked for some clarification on particular aspects of the guidance in IFRS 7.

- BC5.63 Consistently with the majority of responses, the Board decided to confirm the proposals in the exposure draft to use the guidance in IFRS 7 related to determining the effects of changes in a liability's credit risk. Thus, that guidance was carried forward from IFRS 7 to IFRS 9. However, to respond to some of the questions raised in the comment letters, the Board decided to clarify the difference between the creditworthiness of the entity and the credit risk of a liability. Moreover, the Board addressed the difference between a liability's credit risk and asset-specific performance risk—and confirmed that a change in a liability's credit risk does not include changes in asset-specific performance risk. Furthermore, the Board noted that in some cases a liability might not have credit risk. Therefore, the Board included additional examples in the application guidance to clarify those points.
- BC5.64 Also, the Board clarified that the default method illustrated in IFRS 7 (and relocated to IFRS 9) is appropriate only if the only relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate. If that is not the case, an entity is required to use a more precise method. Moreover, an entity is always permitted to use a different method if that method more faithfully represents the effects of changes in a liability's credit risk.

Effective date and transition (chapter 7)

Effective date

- BC7.1 The Board recognises that many countries require time for translation and for introducing the mandatory requirements into law. In addition, entities require time to implement new standards. The Board usually sets an effective date of between six and eighteen months after issuing an IFRS. However, the Board has adopted a phased approach to publishing IFRS 9, so this is not possible.
- BC7.2 In the response to the exposure draft published in 2009, respondents urged that:
- (a) it would be helpful to preparers if the Board were to permit all phases of the project to replace IAS 39 to be adopted at the same time.
 - (b) it would be helpful to entities that issue insurance contracts if the effective date of IFRS 9 were aligned with the forthcoming IFRS on accounting for insurance contracts. Most of an insurer's assets are financial assets and most of its liabilities are insurance liabilities or financial liabilities. Thus, if an insurer applies IFRS 9 before it applies any new IFRS on insurance, it might face two rounds of major change in a short period. This would be disruptive for both users and preparers.
 - (c) because a number of countries will adopt IFRSs in the next few years, it would be helpful to entities in those countries if the Board did not require them to make two changes in a short period of time.
- BC7.3 With these factors in mind, the Board decided it should require entities to apply the requirements of IFRS 9 for annual periods beginning on or after 1 January 2013. The Board intends that this date will allow entities to adopt at the same time the guidance from all phases of the project to replace IAS 39.
- BC7.4 The Board will consider delaying the effective date of IFRS 9 if the impairment phase of the project to replace IAS 39 makes such a delay necessary, or if the new IFRS on insurance contracts has a mandatory effective date later than 2013, to avoid an insurer having to face two rounds of changes in a short period.
- BC7.5 The Board decided to permit earlier application of IFRS 9 to allow an entity to apply the new requirements on classification and measurement of financial assets. This enables entities to use IFRS 9 (as issued in November 2009) in their 2009 annual financial statements and meets one of the objectives of the phased approach, ie to have improved classification and measurement requirements for financial assets in place for 2009 year-ends.
- BC7.6 The effect of transition will be significant for some entities. As a result, there will be less comparability between entities that apply IFRS 9 and those that do not. Accordingly, IFRS 9 includes additional disclosures about the transition to IFRS 9.

Requirements added to IFRS 9 in October 2010

- BC7.7 The Board chose to complete the project to replace IAS 39 in phases to respond to requests that the accounting for financial instruments should be improved quickly. However, the Board is concerned that if an entity is permitted to adopt one phase early without also adopting early all of the preceding phases, there would be a period of significant incomparability among entities until all of the phases of the project are mandatorily effective. That is because there will be many possible combinations of which requirements are adopted early and which are not. Moreover, the period of incomparability would be significant because the phases will not be mandatorily effective before 1 January 2013.
- BC7.8 Therefore, in the exposure draft published in 2010 the Board proposed that if an entity elects to apply any finalised requirements early, the entity must also apply any preceding requirements in IFRS 9 that it does not already apply. Some respondents did not agree with this proposal and urged the Board to permit an entity to adopt the proposals in the exposure draft early without also adopting early the requirements in IFRS 9 for financial assets. As an alternative, some respondents asked the Board to finalise the proposals as an amendment to IAS 39, which could be applied immediately, rather than add the proposals to IFRS 9. Those respondents thought that the proposals in the exposure draft are unrelated to the requirements for financial assets and would be less complex to implement. However, the Board was not persuaded that the benefits of permitting an entity to adopt early only the proposals in the exposure draft exceeded the significant incomparability that would result. Moreover, the Board noted that the transition requirements in IFRS 9 for financial assets require an entity to reassess some financial liabilities designated under the fair value option. Therefore there is a linkage between the two phases and to permit entities to adopt early only the proposals in the exposure draft would be inappropriate and confusing. Moreover, the Board decided that it would be inappropriate to amend IAS 39 while it was in the process of replacing it. For those reasons, the Board decided to confirm the proposals in the exposure draft.
- BC7.9 However, if an entity chooses to adopt a phase early, the Board does not require the entity to adopt subsequent phases early. The Board decided that it would be unfair to require an entity to anticipate the outcomes of unfinished phases in order to make a decision about adopting a phase early. Moreover, the Board decided that an entity is permitted to adopt early the requirements in IFRS 9 issued in 2009 without adopting early the requirements that were added to IFRS 9 in 2010.

Mandatory Effective Date of IFRS 9—November 2011

- BC7.9A IFRS 9 (2009) and IFRS 9 (2010) were issued with a mandatory effective date of 1 January 2013. At the time, the Board noted that it would consider delaying the effective date of IFRS 9, if:
- (a) the impairment phase of the project to replace IAS 39 made such a delay necessary; or
 - (b) the new standard on insurance contracts had a mandatory effective date later than 2013, to avoid an insurer having to face two rounds of changes in a short period.
- BC7.9B In July 2011 the Board noted that in order to enable an appropriate period for implementation before the mandatory effective date of the new requirements, the impairment and hedge accounting phases of the project to replace IAS 39 would not be mandatory for periods beginning before 1 January 2013. In addition, any new requirements for the accounting for insurance contracts would not have a mandatory effective date as early as 1 January 2013.
- BC7.9C As a result of these considerations, in August 2011 the Board issued the exposure draft ED/2011/3 *Mandatory Effective Date of IFRS 9*. In the exposure draft, the Board proposed that the mandatory effective date of IFRS 9 (2009) and IFRS 9 (2010) should be deferred to annual periods beginning on or after 1 January 2015. The Board noted that it did not want to discourage entities from applying IFRS 9 and stressed that early application would still be permitted.
- BC7.9D In its redeliberations on the exposure draft in November 2011, the Board decided to confirm its proposal and change the effective date of IFRS 9 (2009) and IFRS 9 (2010) so that IFRS 9 would be required to be applied for annual periods beginning on or after 1 January 2015. In doing so, the Board noted that there are compelling reasons for all project phases to be implemented at the same time and that, based on current circumstances, it is still appropriate to pursue an approach of requiring the same effective date for all phases of this project.
- BC7.9E However, the Board noted that it is difficult to assess the amount of lead time that will be necessary to implement all phases of the project because the entire project to replace IAS 39 is not yet complete. Ultimately this may affect the Board's conclusion on the appropriateness of requiring the same mandatory effective date for all phases of this project.

Mandatory effective date of IFRS 9—November 2013

- BC7.9F In the light of the feedback it had received on the Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010)) (the ‘2012 Limited Amendments Exposure Draft’), published in November 2012, the IASB decided to defer the mandatory effective date of IFRS 9. The IASB decided that it will be able to determine the appropriate mandatory effective date only after it finalises the requirements for impairment and classification and measurement and has considered the lead time that is necessary to implement those new requirements. Consequently, the IASB decided that the mandatory effective date should not be specified in IFRS 9 until the outstanding phases are finalised. However, the IASB confirmed that in the meantime application of IFRS 9 is still permitted.

Mandatory effective date of IFRS 9—July 2014

- BC7.9G In the completed version of IFRS 9, issued in July 2014, the IASB specified that entities must adopt the completed version of IFRS 9 for annual periods beginning on or after 1 January 2018.

Transition related to IFRS 9 as issued in November 2009

- BC7.10 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that retrospective application results in the most useful information to users because the information presented for all periods is comparable. Therefore, the exposure draft published in 2009 proposed retrospective application subject to some transition relief in particular circumstances. The Board considered the difficulties and associated costs of full retrospective application of the proposals in the exposure draft.
- BC7.11 Most respondents agreed, in principle, with requiring retrospective application, but many questioned the practicability of the approach. In particular, many noted that the extensive exceptions to retrospective application that would be required to make such transition practicable significantly reduced (and possibly eliminated) any benefit that users might obtain from requiring comparative information to be restated.
- BC7.12 The Board considered whether to require prospective application, but noted that such an approach does not provide comparable information for users of financial statements. In addition, the Board noted that any transition approach (such as prospective application) that requires resetting the effective interest rate for financial assets measured at amortised cost reduces the usefulness of information about interest income.
- BC7.13 The Board decided to require retrospective application but provide transition relief to address particular difficulties that might arise from retrospective application. The Board also noted that IAS 8 sets out transition requirements that apply if retrospective application is impracticable and prohibits the use of hindsight when applying a new accounting policy to a prior period.

Transition relief

Impracticability exceptions

- BC7.14 The Board acknowledged that it may be impracticable for an entity to apply the effective interest method or impairment requirements in IAS 39 retrospectively in some situations. The process would be cumbersome, in particular for an entity with a large number of financial assets that were previously measured at fair value but are measured at amortised cost in accordance with the approach in IFRS 9. Several loss events and reversals might have occurred between the date when the asset was initially recognised and the date of initial application of the IFRS. IFRS 9 requires that if applying the impairment requirements is impracticable or requires the use of hindsight, an entity should use previously determined fair value information to determine whether a financial asset was impaired in comparative periods. IFRS 9 also requires that the fair value at the date of initial application of the new requirements should be treated as the new amortised cost carrying amount of that financial asset in that case. The Board rejected proposals that entities should be permitted, but not required, to treat the fair value at the date of initial application as amortised cost because it would impair comparability and require significant guidance about when such an option should be permitted.
- BC7.15 The Board noted that an entity would not have determined the fair value of an investment in an unquoted equity instrument²⁵ (or a derivative on such an investment) that was previously accounted for in accordance with paragraphs 46(c) and 66 of IAS 39. Moreover, an entity will not have the necessary information to determine

²⁵ IFRS 13, issued in May 2011, defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IFRS 9 refers to such equity instruments as ‘an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)’.

fair value retrospectively without using hindsight. Accordingly, IFRS 9 requires such instruments to be measured at fair value at the date of initial application.

Hybrid contracts

- BC7.16 An entity may not have previously determined the fair value of a hybrid contract in its entirety. Moreover, an entity will not have the necessary information to determine fair value retrospectively without using hindsight. However, an entity would have been required to measure both the embedded derivative and host separately at fair value to apply the disclosure requirements in IFRS 7. Therefore, in comparative periods, IFRS 9 requires the sum of the fair value of the embedded derivative and the host to be used as an approximation of the fair value of the entire hybrid contract.
- BC7.17 The proposals in the exposure draft published in 2009 would have resulted in fair value measurement for many hybrid contracts for which the embedded derivative was accounted for separately in accordance with IAS 39. Some respondents asked for such treatment under IAS 39 to be 'grandfathered'. The Board noted that many such requests had been related to the proposed treatment of hybrid contracts with financial liability hosts, which are not included in the IFRS. Therefore the Board decided not to permit an option to grandfather hybrid contracts with financial asset hosts that were bifurcated in accordance with IAS 39 as an accounting policy choice because it would impair comparability, and because some such contracts may still have a significant remaining maturity.

Assessment of the objective of the entity's business model for managing financial assets

- BC7.18 IFRS 9 requires an entity to assess whether the objective of an entity's business model is to manage financial assets to collect the contractual cash flows on the basis of circumstances at the date of initial application. The Board believes it would be difficult, and perhaps impossible, to assess that condition on the basis of circumstances when the instrument first satisfied the recognition criterion in IAS 39.

Assessment of qualifying criteria for the fair value option

- BC7.19 The Board decided that the assessment of whether a financial asset or financial liability meets the eligibility criterion for designation under the fair value option should be based on the circumstances at the date of initial application. IFRS 9 changes the classification of some financial assets, including eliminating two of the three eligibility criteria in IAS 39 for the fair value option for financial assets. Therefore, the Board believes that an entity should reconsider at transition its original assessment of whether to designate a financial asset or financial liability as at fair value through profit or loss.

Comparative information

- BC7.20 As noted above, many respondents were concerned that the inevitable exceptions to full retrospective application would result in restated information that is incomplete. They proposed an approach similar to that used on first-time adoption of IFRSs and when entities adopted IAS 39 in 2005, in which the requirement to provide comparative information was waived. Some respondents believe that such an approach would address the concerns that, although IAS 1 requires only one year of comparative information, the legal and regulatory frameworks in many jurisdictions require further comparative periods to be presented. In those situations, the restatement of comparatives would be virtually impossible for an entity wishing to adopt IFRS 9 early.
- BC7.21 In the Board's view, waiving the requirement to restate comparatives strikes a balance between the conceptually preferable method of full retrospective application (as stated in IAS 8) and the practicability of adopting the new classification model within a short time frame. Accordingly, the Board decided that it would permit, but not require, restatement of comparative periods by entities that implement IFRS 9 for reporting periods beginning before 1 January 2012. However, those considerations would be less applicable for entities that adopted outside a short time frame. Therefore, restated comparative information is required if an entity adopts IFRS 9 for reporting periods beginning after 1 January 2012.

Date of initial application

- BC7.22 The exposure draft stated that the date of initial application would be the date when an entity first applies the requirements in the IFRS. Many respondents questioned whether the date of initial application could be an arbitrary date between the date of issue of the IFRS (or even earlier) and the mandatory effective date, resulting in a loss of comparability over a long period of time. The Board agreed that a free choice would impair comparability, but noted it intended that entities should be able to apply the IFRS in 2009 or 2010 financial statements. Accordingly, the IFRS requires the date of initial application to be the beginning of a

reporting period, but provides relief from this requirement for entities applying the IFRS for reporting periods beginning on or before 1 January 2011.

Hedge accounting

- BC7.23 The Board decided not to carry forward the specific transition provisions on hedge accounting proposed in the exposure draft because they are not necessary.

Transitional disclosures

- BC7.24 The exposure draft published in July 2009 proposed disclosures for entities that apply the new IFRS 9 early. However, many noted that such disclosures would be useful for all entities applying IFRS 9 for the first time, and not only early adopters. The Board noted that the information necessary to make those disclosures would be readily available to the entity to make the necessary journal entries on transition and to account for the financial assets in the future. Accordingly, IFRS 9 requires all entities to supply additional disclosures on transition.
- BC7.25 The Board rejected a proposal in the comment letters that entities should apply disclosures similar to those based on IFRS 1 First-time Adoption of International Financial Reporting Standards explaining the transition to the new IFRS. The Board noted that the disclosures in IFRS 1 relate to first-time adoption and not to changes in accounting policies. Disclosures about changes in an accounting policy are required by IAS 8.

Transition related to the requirements added to IFRS 9 in October 2010

- BC7.26 As noted above, IAS 8 states that retrospective application results in the most useful information to users because the information presented for all periods is comparable. The Board noted that IFRS 7 already requires disclosure of the amount of the change in fair value that is attributable to changes in the credit risk of the liability. Therefore, entities are already calculating the information necessary to present the effects of changes in liabilities' credit risk in other comprehensive income. Thus, the exposure draft published in 2010 proposed retrospective application and almost all respondents agreed. The Board confirmed that proposal.
- BC7.27 The Board did not change the classification and measurement approach for financial liabilities, including the eligibility conditions for the fair value option for financial liabilities. Therefore, the proposals in the exposure draft did not permit entities to make new designations or revoke its previous designations as a result of the proposals. Some respondents believed that the Board should permit entities to reassess their designations in the light of the new requirements related to own credit risk.
- BC7.28 However, the Board was not persuaded that there is a compelling reason to permit entities to reassess their elections, especially because the underlying classification and measurement approach has not changed. As noted in paragraph BC7.19, when an entity initially applies IFRS 9 to assets, it is required to reassess particular liabilities designated under the fair value option. That was necessary because IFRS 9 (issued in 2009) introduced a new classification and measurement approach for financial assets, which would change the classification of some (and perhaps many) financial assets. Those changes require an entity to reassess liabilities designated under the fair value option to the extent that designation was originally elected to address an accounting mismatch. However, the Board believed that a similar case could not be made for the requirements added to IFRS 9 in 2010. And because IFRS 9 (issued in 2009) already requires reassessment of particular liabilities, the Board believes that a second reassessment would make transition unnecessarily complex. Therefore, the Board decided to confirm the proposal in the exposure draft.

Transition relief

- BC7.29 When the Board issued the new requirements for financial assets in November 2009, it granted some transition relief from full retrospective transition. To be consistent with the transition requirements for assets, the Board decided to grant similar transition relief for the requirements added to IFRS 9 in October 2010:
- (a) The requirements are not applied to liabilities that have been derecognised at the date of initial application. The Board concluded that applying the requirements in IFRS 9 to some derecognised items but not others would be confusing and unnecessarily complex.
 - (b) An entity is required to assess whether presenting the effects of changes in a liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss on the basis of facts and circumstances that exist at the date of initial application. This is consistent with the other transition requirements in IFRS 9 related to the fair value option. Moreover, the Board noted that the conclusion will most likely be the same regardless of whether it is made on the basis of facts and circumstances that existed at initial recognition of the liability or at the date of initial application.

- (c) Derivative liabilities that were previously accounted for at cost are measured at fair value at the date of initial application. Consistently with the requirements for financial assets, an entity will not have the necessary information to determine fair value retrospectively without using hindsight.
- (d) An entity is not required to restate prior periods if the requirements are adopted for reporting periods beginning before 1 January 2012. The Board decided that it would be inappropriate and confusing to require an entity to restate prior periods for some of the requirements in IFRS 9 but not others. However, the Board decided that if the entity elects to restate prior periods to reflect the requirements added to IFRS 9 in October 2010, it must also restate prior periods to reflect the other requirements in IFRS 9. That conclusion is consistent with the Board's decision that if an entity elects to adopt the requirements early, it must at the same time adopt early all of the requirements in IFRS 9 that it does not already apply.

Transitional insurance issues

- BC7.30 The Board noted that insurers may face particular problems if they apply IFRS 9 before they apply the phase II standard on insurance contracts (the new IFRS 4). To avoid accounting mismatches in profit or loss, many insurers classify many of their financial assets as available for sale. If those insurers apply IFRS 9 before the new IFRS 4, they might decide to classify many of their financial assets at amortised cost (assuming they meet the relevant conditions in IFRS 9). When those insurers later apply the new IFRS 4, they may wish to reclassify those assets from amortised cost to fair value through profit or loss, but that may not generally be possible in accordance with IFRS 9. Thus, those insurers might have either to classify those assets at fair value through profit or loss during the intervening period or to continue to classify them at amortised cost when they apply the new IFRS 4. Either choice might lead to an accounting mismatch.
- BC7.31 The Board considered whether it could reduce such mismatches by maintaining the available-for-sale category for insurers until they can apply the new IFRS 4. However, if the Board did so, it would have to create detailed and arbitrary descriptions of the entities and instruments to which that approach would apply. The Board concluded that permitting the continuation of that category would not provide more useful information for users.
- BC7.32 The Board will consider in developing the new IFRS 4 whether to provide an option for insurers to reclassify some or all financial assets when they first apply the new IFRS 4. This would be similar to the option in paragraph 45 of IFRS 4 *Insurance Contracts* and paragraph D4 of IFRS 1. The Board included such an option in IFRS 4 for reasons that may be equally valid for phase II.

Shadow accounting for participating contracts

- BC7.33 Some insurers expressed concerns that an accounting mismatch will arise if the assets backing participating insurance liabilities include equity investments and the insurer elects to present gains and losses on those investments in other comprehensive income. That accounting mismatch would arise because paragraph 30 of IFRS 4 does not give explicit authority to apply 'shadow accounting' in such cases.
- BC7.34 The Board acknowledges that this accounting mismatch is undesirable. However, for the following reasons, the Board did not amend paragraph 30 of IFRS 4:
- (a) This accounting mismatch will arise only if an insurer elects to present gains and losses on equity investments in other comprehensive income.
 - (b) As described in paragraph BC5.23, in creating the option to present gains and losses on equity investments in other comprehensive income, the Board's intention was to provide a presentation alternative for some equity investments in which presenting fair value gains and losses in profit or loss may not be indicative of the performance of the entity, particularly if the entity holds those equity instruments for non-contractual benefits, rather than primarily to generate increases in the value of the investment. The Board did not intend to provide an alternative for investments in any other circumstances, including if an entity intends to hold an equity investment over a long time frame. In the Board's view, if an insurer holds investments with the primary objective of realising a profit from increases in their value, for the benefit of either the insurer itself or its policyholders, the most transparent place to present those value changes is in profit or loss.

Disclosures on Transition from IAS 39 to IFRS 9—November 2011

- BC7.34A When IFRS 9 (2009) and IFRS 9 (2010) were issued, they provided limited relief from restating comparative financial statements. Entities that adopted the IFRS for reporting periods beginning before 1 January 2012 were not required to restate prior periods. At the time, the Board's view was that waiving the requirement to restate comparative financial statements struck a balance between the conceptually preferable

method of full retrospective application (as stated in IAS 8) and the practicability of adopting the new classification model within a short time frame.

BC7.34B In August 2011 the Board issued ED/2011/3 *Mandatory Effective Date of IFRS 9*. At the time, the Board noted that these practicability considerations would be less relevant for entities that adopted outside a short time frame, and therefore proposed that restated comparative financial statements would continue to be required if an entity adopts IFRS 9 for reporting periods beginning on or after 1 January 2012.

BC7.34C Some respondents to the exposure draft believed that comparative financial statements should be required to be restated for the following reasons:

- (a) The presentation of restated comparative financial statements is consistent with IAS 8.
- (b) A delay in the mandatory effective date of IFRS 9 would allow a sufficient time frame for entities to prepare restated comparative financial statements.
- (c) IAS 39 and IFRS 9 are sufficiently different from each other, so restatement will be necessary to provide meaningful information to users of financial statements.

BC7.34D In contrast, those who did not believe that comparative financial statements should be required to be restated argued that:

- (a) Comparative relief was granted for IAS 32 and IAS 39 upon first-time adoption of IFRSs for European reporting entities.
- (b) Comparability is impaired by the transition requirements, which are complex and inconsistent across various phases of the project, reducing the usefulness of the comparative information (for example, the classification and measurement phase requires retrospective application with some transition reliefs, whereas the hedge accounting phase requires prospective application).
- (c) Time pressures similar to those existing when IFRS 9 (2009) and IFRS 9 (2010) were initially issued will nonetheless exist when the last phase of the project to replace IAS 39 is issued.

BC7.34E Respondents to the exposure draft ED/2011/3 also raised specific implementation issues that increased the cost of applying the classification and measurement requirements of IFRS 9 in periods prior to their date of initial application. These reasons were the interaction between the date of initial application and:

- (a) the fact that IFRS 9 must not be applied to items that have already been derecognised as of the date of initial application;
- (b) the initial business model determination; and
- (c) the fair value option and fair value through other comprehensive income elections at the date of initial application.

BC7.34F In providing views on their preferred transition approach for the project to replace IAS 39, investors consistently emphasised a need for comparable period-to-period information—that is, information that enabled them to understand the effect of the transition from IAS 39 to IFRS 9. Investors, irrespective of their preferred approach, noted that the mix of transition requirements between phases, and the modifications to retrospective application in the classification and measurement phase, would diminish the usefulness of comparative financial statements. Many also noted that the partial restatement of comparative financial statements could create either confusion or a misleading impression of period-to-period comparability.

BC7.34G Some investor respondents, despite sharing the views in the preceding paragraph, favoured the presentation of comparative financial statements with full retrospective application of all project phases (ie including hedge accounting) as the preferred way of achieving comparability. Some of the respondents who favoured full retrospective application agreed that the modifications to retrospective application would diminish the usefulness of comparative financial statements but believed that the effect of the modifications would not be significant.

BC7.34H Due to the variation in transition requirements of the phases in the project to replace IAS 39, other investors did not favour the presentation of restated comparative financial statements. Their primary concern was having information that enabled them to understand the effect of the transition from IAS 39 to IFRS 9. They did not believe that restating comparative financial statements on the basis of the transition requirements across the phases of IFRS 9 would necessarily provide that information.

BC7.34I In addition to feedback on their preferred approach to understanding the effect of the transition to IFRS 9, investors also provided information on what they focus on when analysing financial instruments in financial statements. They noted that the statement of profit or loss and other comprehensive income (and restatement of it in comparative periods) is less important to their analysis than the statement of financial position, aside from situations where it allows for a link to the statement of financial position (for example net interest income). Similarly, where restatement means primarily the presentation of historical fair value changes, comparative information is less useful as extrapolation is not possible in the same way as it is for amortised cost information.

BC7.34J Investors also provided feedback on those disclosures that would be useful in understanding the transition from IAS 39 to IFRS 9. They cited examples that they found useful on the transition from other GAAPs to IFRSs in Europe in 2005. It was also noted that disclosures similar to those required by IFRS 7 *Financial Instruments: Disclosures* for transfers of financial assets between classification categories would be useful—ie disclosures about reclassifications are also useful when the reclassifications result from applying a new accounting standard.

BC7.34K In the light of this feedback received, the Board considered whether modified transition disclosures could provide the information necessary for investors to understand the effect of the transition from IAS 39 to IFRS 9, while reducing the burden on preparers that would result from the restatement of comparative financial statements. The Board also considered whether this approach would address concerns about the diminished usefulness and period-to-period comparability of comparative financial statements due to the different transition requirements of the phases of the project to replace IAS 39. The Board believes that modified disclosures can achieve these objectives and decided to require modified transition disclosures instead of the restatement of comparative financial statements.

BC7.34L The Board noted that much of the information requested by investors was already required by IAS 8 and IFRS 7 on transition from IAS 39 to IFRS 9. The Board also noted that it was not modifying the requirements of IAS 8. The Board, however, decided that the reclassification disclosures in IFRS 7 (as amended by IFRS 9 (2009)) should be required on transition from IAS 39 to IFRS 9, irrespective of whether they would normally be required due to a change in business model. The Board also specified that the reclassification disclosures, and other disclosures required when initially applying IFRS 9, should allow reconciliations between the measurement categories in accordance with IAS 39 and IFRS 9 and individual line items in the financial statements or classes of financial instruments. This would provide useful information that would enable users to understand the transition from IAS 39 to IFRS 9.

BC7.34M The Board also considered whether the transition disclosures should be required if the entity presents restated comparative financial statements, or only if they are not provided. The Board noted that the disclosures provide useful information to investors on transition from IAS 39 to IFRS 9, irrespective of whether comparative financial statements are restated. The Board also believed that the burden of these comparative transition disclosures for preparers would not be unreasonable because it was based largely on existing disclosure requirements and should require disclosure of information available as a result of preparing for transition. Consequently, the Board decided to require these disclosures even if restated comparative financial statements are provided. However, the Board did not want to unduly burden those who were in the process of applying IFRS 9 early by requiring disclosures that the entity was not previously required to provide. Therefore, for entities that initially apply the classification and measurement requirements from 1 January 2012 until 31 December 2012, the Board decided to permit, but not require, the presentation of the additional disclosures. If an entity elects to provide these disclosures when initially applying IFRS 9 between 1 January 2012 and 31 December 2012, it would not be required to restate comparative periods.

Transition related to the presentation of ‘own credit’ gains and losses on financial liabilities added to IFRS 9 in November 2013

BC7.34N During the redeliberations of the 2012 Limited Amendments Exposure Draft, the IASB confirmed the proposal in that Exposure Draft that the requirements in relation to gains and losses arising from changes in own credit risk should be made available for early application without applying any other requirements of IFRS 9 at the same time. However, in order to respond to the feedback that the own credit requirements should be made available as soon as possible, the IASB decided to incorporate those requirements into IFRS 9 (2010) and later versions. The IASB also confirmed its previous decision not to incorporate the own credit requirements into IAS 39 because that IFRS is being replaced by IFRS 9.

General

Summary of main changes from the exposure draft *Financial Instruments: Classification and Measurement*

BCG.1 The main changes made by IFRS 9 issued in 2009 from the exposure draft published in 2009 were:

- (a) IFRS 9 dealt with the classification and measurement of financial assets only, rather than financial assets and financial liabilities as proposed in the exposure draft.
- (b) IFRS 9 requires entities to classify financial assets on the basis of the objective of the entity’s business model for managing the financial assets and the characteristics of the contractual cash flows. It points out that the entity’s business model should be considered first, and that the contractual cash flow

characteristics should be considered only for financial assets that are eligible to be measured at amortised cost because of the business model. It states that both classification conditions are essential to ensure that amortised cost provides useful information.

- (c) Additional application guidance was added on how to apply the conditions necessary for amortised cost measurement.
- (d) IFRS 9 requires a 'look through' approach for investments in contractually linked instruments that effect concentrations of credit risk. The exposure draft had proposed that only the most senior tranche could have cash flows that represented payments of principal and interest on the principal amount outstanding.
- (e) IFRS 9 requires (unless the fair value option is elected) financial assets purchased in the secondary market to be recognised at amortised cost if the instruments are managed within a business model that has an objective of collecting contractual cash flows and the financial asset has only contractual cash flows representing principal and interest on the principal amount outstanding even if such assets were acquired at a discount that reflects incurred credit losses.
- (f) IFRS 9 requires that when an entity elects to present gains and losses on equity instruments measured at fair value in other comprehensive income, dividends are to be recognised in profit or loss. The exposure draft had proposed that those dividends would be recognised in other comprehensive income.
- (g) IFRS 9 requires reclassifications between amortised cost and fair value classifications when the entity's business model changes. The exposure draft had proposed prohibiting reclassification.
- (h) For entities that adopt IFRS 9 for reporting periods before 1 January 2012, IFRS 9 provides transition relief from restating comparative information.
- (i) IFRS 9 requires additional disclosures for all entities when they first apply the IFRS.

Summary of main changes from the exposure draft *Fair Value Option for Financial Liabilities*

BCG.2 The main changes from the exposure draft published in 2010 are:

- (a) For liabilities designated under the fair value option, IFRS 9 requires an entity to present the effects of changes in the liability's credit risk in other comprehensive income unless that treatment would create or enlarge an accounting mismatch in profit or loss. If that treatment would create or enlarge an accounting mismatch in profit or loss, the entire fair value change is presented in profit or loss. That was the alternative approach set out in the exposure draft. The proposed approach in the exposure draft had treated all liabilities designated under the fair value option in the same way and had not addressed cases in which the proposed treatment would create or enlarge an accounting mismatch in profit or loss.
- (b) IFRS 9 requires a 'one-step' approach for presenting the effects of changes in a liability's credit risk in the performance statement. That approach requires the effects of changes in a liability's credit risk to be presented directly in other comprehensive income, with the remaining amount of fair value change presented in profit or loss. The exposure draft had proposed a 'two-step' approach, which would have required the total fair value change to be presented in profit or loss. The effects of changes in a liability's credit risk would have been backed out and presented in other comprehensive income.

Cost-benefit considerations

BCG.3 The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. To attain this objective, the Board endeavours to ensure that an IFRS will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. Although the costs to implement a new IFRS might not be borne evenly, users of financial statements benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

BCG.4 The evaluation of costs and benefits is necessarily subjective. In making its judgement, the Board considered the following:

- (a) the costs incurred by preparers of financial statements;

- (b) the costs incurred by users of financial statements when information is not available;
- (c) the comparative advantage that preparers have in developing information, compared with the costs that users would incur to develop surrogate information;
- (d) the benefit of better economic decision-making as a result of improved financial reporting; and
- (e) the costs of transition for users, preparers and others.

BCG.5 The objective of IFRS 9 is to present information that is useful to users for their assessment of the amounts, timing and uncertainty of future cash flows of financial assets. However, the Board also considered the cost of implementing IFRS 9 and applying it on a continuous basis. During the development of IFRS 9 the Board conducted an extensive outreach programme to consult users, preparers, auditors, regulators and others. Those activities helped the Board evaluate the relative costs and benefits of IFRS 9.

BCG.6 IFRS 9 should improve the ability of users to understand the financial reporting for financial assets by:

- (a) reducing the number of classification categories. All financial assets will be subsequently measured at either amortised cost or fair value. Hybrid contracts with financial asset hosts will be classified and measured in their entirety thereby eliminating the complex and rule-based requirements in IAS 39.
- (b) having a single impairment methodology that is applied to all financial assets that are not measured at fair value. Many constituents criticised the multitude of impairment methodologies in IAS 39.
- (c) providing a clear rationale for why financial assets are measured in a particular way, which aligns the measurement attribute to the way that an entity manages its financial assets and their contractual cash flow characteristics.

BCG.7 There are costs involved in the adoption and ongoing application of IFRS 9. Those costs will depend on an entity's volume and complexity of financial instruments as well as the industry and jurisdiction in which the entity operates. However, those costs should be minimised because IFRS 9 is less complex and rule-based than the equivalent requirements in IAS 39. Consequently, the Board believes that the benefits of IFRS 9 outweigh the costs.

Appendix

Amendments to the Basis for Conclusions on other IFRSs

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with IFRS 9 and the related amendments to other IFRSs.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

BCA1 The footnotes to the reference to 'IAS 39' in paragraphs BC58A, BC63A, BC65, BC66, BC74, BC89 and BC89A and to the heading 'Available-for-sale financial assets' above paragraph BC81 are deleted.

The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC17(a), and the first references to 'IAS 39' in paragraphs BC20, BC58A, BC63A, BC74, BC81, BC89 and BC89A are footnoted appropriately as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

The first references to 'IAS 39' in paragraphs BC65 and BC66 are footnoted as follows:

* In November 2009 and October 2010 the IASB amended the requirements in IAS 39 to identify and separately account for embedded derivatives and relocated them to IFRS 9 *Financial Instruments*. This Basis for Conclusions has not been updated for changes in requirements since IFRIC 9 *Reassessment of Embedded Derivatives* was issued in March 2006.

The term 'available for sale' in paragraph BC63A, the term 'available-for-sale financial assets' in paragraph BC74(b) and the heading 'Available-for-sale financial assets' above paragraph BC81 are footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009, with requirements added in October 2010, eliminated the category of available-for-sale financial assets.

IFRS 2 *Share-based Payment*

BCA2 The footnote to the reference to 'IAS 39' in the heading above paragraph BC25 is deleted.

The heading above paragraph BC25 is footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. Paragraphs BC25–BC28 refer to matters relevant when IFRS 2 was issued.

IFRS 3 *Business Combinations*

BCA3 The footnote to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC185 and the first references to 'IAS 39' in paragraphs BC244, BC256 and BC437(c) are deleted.

The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC185 and the first references to 'IAS 39' in paragraphs BC246, BC256, BC354, BC434A and BC437(c) are footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

The reference to 'IAS 39' in paragraph BC244 is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, relocated to IFRS 9 the requirements on the accounting for financial guarantees and commitments to provide loans at below-market interest rates.

The first reference to 'available-for-sale securities' in paragraph BC389 is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, eliminated the category of available-for-sale financial assets.

IFRS 4 Insurance Contracts

BCA4 The footnotes to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC11(a), the first references to 'IAS 39' in paragraphs BC22(c), BC28(b), BC40, BC41(b), BC47, BC55, BC73(d), BC82, BC161, the reference to 'available for sale' in paragraph BC145(b) and the heading above paragraph BC166 are deleted.

The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC11(a), the first references to 'IAS 39' in paragraphs BC21, BC22(c), BC28(b), BC40, BC55, BC62, BC73(d), BC82, BC117, BC146 and BC158 and the heading 'Issues related to IAS 39' above paragraph BC166 are footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

The references to 'IAS 39' in paragraphs BC47 and BC161 are footnoted as follows:

* In November 2009 and October 2010 the IASB amended the requirements in IAS 39 to identify and separately account for embedded derivatives and relocated them to IFRS 9 *Financial Instruments*. This Basis for Conclusions has not been updated for changes in requirements since IFRIC 9 *Reassessment of Embedded Derivatives* was issued in March 2006.

The term 'available for sale' in paragraph BC145(b) and the heading 'Issues related to IAS 39' above paragraph BC166 are footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, eliminated the category of available-for-sale financial assets.

BCA5 The footnotes to the headings above paragraphs DO7, DO9 and DO18 are deleted and replaced as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

BCA6 The footnote to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC8(b), the first references to 'IAS 39' in paragraphs BC13(a) and BC54(b) and the reference to 'available-for-sale assets' in paragraph BC58 are deleted.

The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC8(b) and the reference to 'IAS 39' in paragraphs BC13(a), BC54(a) and BC81 are footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. This paragraph refers to matters relevant when IFRS 5 was issued.

The term 'held-for-trading financial asset' in paragraph BC54(b) is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, eliminated the category of held-for-trading financial assets. This paragraph refers to matters relevant when IFRS 5 was issued.

The term 'available-for-sale assets' in paragraph BC58 is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, eliminated the category of available-for-sale financial assets. This paragraph refers to matters relevant when IFRS 5 was issued.

IFRS 7 *Financial Instruments: Disclosures*

BCA7 In the rubric below the title the third paragraph, added when IFRS 9 was issued in November 2009, is replaced as follows:

In November 2009 and October 2010 the requirements of IAS 39 relating to classification and measurement of items within the scope of IAS 39 were relocated to IFRS 9 Financial Instruments, and IFRS 7 was amended accordingly. The text of this Basis for Conclusions has been amended for consistency with those changes.

Paragraphs BC14–BC16 are amended to read as follows:

BC14 Paragraph 8 requires entities to disclose financial assets and financial liabilities by the measurement categories in IFRS 9 *Financial Instruments*. The Board concluded that disclosures for each measurement category would assist users in understanding the extent to which accounting policies affect the amounts at which financial assets and financial liabilities are recognised.

BC15 The Board also concluded that separate disclosure of the carrying amounts of financial assets and financial liabilities that are designated upon initial recognition as financial assets and financial liabilities at fair value through profit or loss and those mandatorily measured at fair value is useful because such designation is at the discretion of the entity.

Financial assets or financial liabilities at fair value through profit or loss (paragraphs 9–11, B4 and B5)

BC16 IFRS 9 permits entities to designate a non-derivative financial liability as at fair value through profit or loss, if specified conditions are met. If entities do so, they are required to provide the disclosures in paragraphs 10 and 11. The Board's reasons for these disclosures are set out in the Basis for Conclusions on IFRS 9, paragraphs BCZ5.29–BCZ5.34.

The heading above paragraph BC23 is amended to read as follows and paragraph BC23B is added:

Reclassification (paragraphs 12B–12D)

BC23B In November 2009 the Board issued the requirements relating to the reclassification of financial assets in IFRS 9 *Financial Instruments* and revised accordingly the disclosure requirements relating to the reclassification of financial assets.

Paragraphs BC33 and BC34 are amended to read as follows:

BC33 Paragraph 20(a) requires disclosure of income statement gains and losses by the measurement classifications in IFRS 9 (which complement the balance sheet disclosure requirement described in paragraph BC14). The Board concluded that the disclosure is needed for users to understand the financial performance of an entity's financial instruments, given the different measurement bases in IFRS 9.

BC34 Some entities include interest and dividend income in gains and losses on financial assets and financial liabilities measured at fair value through profit or loss and others do not. To assist users in comparing income arising from financial instruments across different entities, the Board decided that an entity should disclose how the income statement amounts are determined. For example, an entity should disclose whether net gains and losses on financial assets or financial liabilities measured at fair value through profit or loss include interest and dividend income (see Appendix B, paragraph B5(e)).

Paragraphs BC39 and BC39B–BC39E are amended to read as follows:

BC39 Paragraph 28 requires disclosure about the difference that arises if the transaction price differs from the fair value of a financial instrument that is determined in accordance with paragraph B5.4.8 of IFRS 9. Those disclosures relate to matters addressed in the December 2004 amendment to IAS 39 *Transition and Initial Recognition of Financial Assets and Financial Liabilities*. That amendment does not specify how entities should account for those initial differences in subsequent periods. The disclosures required by paragraph 28 inform users about the amount of gain or loss that will be recognised in profit or loss in future periods. The Board noted that the information required to provide these disclosures would be readily available to the entities affected.

BC39B Because its own fair value measurement project was not yet completed, the Board decided not to propose a fair value hierarchy for measurement, but only for disclosures. The fair value hierarchy for disclosures is the same as that in SFAS 157 but uses IFRS language pending completion of the fair value measurement project. Although the implicit fair value hierarchy for measurement in IFRS 9 is

different from the fair value hierarchy in SFAS 157, the Board recognised the importance of using a three-level hierarchy for disclosures that is the same as that in SFAS 157.

BC39C The Board noted the following three-level measurement hierarchy implicit in IFRS 9:

...

BC39D For example, the Board acknowledged that some financial instruments that for measurement purposes are considered to have an active market in accordance with paragraphs B5.4.3–B5.4.5 of IFRS 9 might be in Level 2 for disclosure purposes. Also, the application of paragraph B5.4.9 of IFRS 9 might result in no gain or loss being recognised on the initial recognition of a financial instrument that is in Level 2 for disclosure purposes.²⁶

BC39E The introduction of the fair value disclosure hierarchy does not affect any measurement or recognition requirements of other standards. In particular, the Board noted that the recognition of gains or losses at inception of a financial instrument (as required by paragraph B5.4.8 of IFRS 9) would not change as a result of the fair value disclosure hierarchy.

Paragraph BC73(b) is amended to read as follows:

BC73 The main changes to the proposals in ED 7 are:

- (a) ...
- (b) a requirement has been added for disclosures about the difference between the transaction price at initial recognition (used as fair value in accordance with paragraph B5.4.8 of IFRS 9) and the results of a valuation technique that will be used for subsequent measurement.
- (c) ...

BCA8 The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC17 and the reference to 'IAS 39' in paragraph BC23A are footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. This paragraph refers to matters relevant when IFRS 7 was issued.

The reference to IAS 39 in paragraph BC65A is footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

IAS 1 *Presentation of Financial Statements*

BCA9 The footnotes to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC38A, to the reference to 'IAS 39' in paragraph BC38B and to the references to 'available-for-sale' in paragraphs BC49 and BC69 are deleted.

The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC38A and the reference to 'IAS 39' in paragraph BC38B are footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. This paragraph refers to matters relevant when IAS 1 was issued.

The term 'available-for-sale financial assets' in paragraphs BC49 and BC69 is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, eliminated the category of available-for-sale financial assets. This paragraph refers to matters relevant when IAS 1 was issued.

The term 'held-to-maturity investments' in paragraph BC77 is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, eliminated the category of held-to-maturity financial assets. This paragraph refers to matters relevant when IAS 1 was issued.

²⁶ IFRS 13, issued in May 2011, contains the requirements for measuring fair value. As a consequence paragraphs B5.4.3–B5.4.5 of IFRS 9 have been deleted and paragraph B5.4.9 of IFRS 9 has been relocated to paragraphs B5.1.2A and B5.2.2A.

IAS 17 Leases

BCA10 The footnote to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC21 is deleted.

The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC21 is footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. This paragraph refers to matters relevant when IAS 17 was issued.

BCA11 [Deleted]

BCA12 [Deleted]

IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

BCA13 The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC2 and the first reference to 'IAS 39' in paragraph BC3 are footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. This paragraph refers to matters relevant when IAS 20 was amended in 2008.

IAS 27 Consolidated and Separate Financial Statements

BCA14 The footnotes to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC22 and to the references to 'IAS 39' in paragraphs BC65–BC66C are deleted.

The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC22 and the second reference to 'IAS 39' in paragraph BC65 are footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

The first references to the term 'available-for-sale' in paragraphs BC54, BC56 and BC65 are footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009, and amended in October 2010 eliminated the category of available-for-sale financial assets.

BCA15 In the dissenting opinions on the amendments to IFRS 1 and IAS 27 issued in May 2008 the footnote to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph DO3 is deleted and replaced by the following footnote:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

IAS 28 Investments in Associates

BCA16 The footnotes to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC7 and the references to 'IAS 39' in paragraphs BC9, BC22 and BC26 are deleted.

The reference to 'IAS 39' in the heading above paragraph BC7 and the first references to 'IAS 39' in paragraphs BC22 and BC26 are footnoted as follows:

* In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

The first reference to 'IAS 39' in paragraph BC9 is footnoted as follows:

† In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of

IAS 39. IFRS 9 eliminated the category of available-for-sale financial assets and permits entities to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument that is not held for trading.

The term ‘available-for-sale equity instrument’ in paragraph BC26 is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, eliminated the category of available-for-sale financial assets.

IAS 31 Investments in Joint Ventures

BCA17 The footnotes to the reference to ‘IAS 39 *Financial Instruments: Recognition and Measurement*’ in paragraph BC7 and to the references to ‘IAS 39’ in paragraphs BC9 and BC17 are deleted.

The heading above paragraph BC7 and the first reference to ‘IAS 39’ in paragraph BC17 are footnoted as follows:

* In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

The first reference to ‘IAS 39’ in paragraphs BC9 is footnoted as follows:

* In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. IFRS 9 eliminated the category of available-for-sale financial assets and permits entities to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument that is not held for trading.

IAS 32 Financial Instruments: Presentation

BCA18 The footnotes to the reference to ‘IAS 39 *Financial Instruments: Recognition and Measurement*’ in paragraph BC2 and to the references to ‘IAS 39’ in paragraphs BC25, BC26 and BC53(a) are deleted.

The reference to ‘IAS 39 *Financial Instruments: Recognition and Measurement*’ in paragraph BC2 and the first references to ‘IAS 39’ in paragraphs BC26 and BC53(a) are footnoted as follows:

* In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

The first reference to ‘IAS 39’ in paragraph BC25 is footnoted as follows:

* In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. The requirements of paragraph 43 of IAS 39 relating to the initial measurement of financial assets were relocated to paragraph 5.1.1 of IFRS 9.

BCA19 In the dissenting opinion on the issue of IAS 32 in December 2003, the reference to ‘IAS 39’ in paragraph DO2 is footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

IAS 36 Impairment of Assets

BCA20 The footnote to the reference to ‘IAS 39’ in paragraph BCZ15(d) is deleted.

The reference to ‘IAS 39’ in paragraph BCZ15(d) is footnoted as follows:

* The IASB’s project to revise IAS 32 and IAS 39 in 2003 resulted in the relocation of the requirements on fair value measurement from IAS 32 to IAS 39. In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. In 2011 the IASB’s project on fair value measurement resulted in the relocation of the requirements for measuring fair value to IFRS 13 *Fair Value Measurement*.

IAS 39 *Financial Instruments: Recognition and Measurement*

BCA21 The following paragraphs are added to the rubric:

In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of financial assets within the scope of IAS 39 and relocated them to IFRS 9 Financial Instruments. Accordingly, the following were deleted: paragraphs BC13 and BC14, the heading above paragraph BC25 and paragraphs BC25–BC29, paragraph BC70, the heading above paragraph BC104A and paragraphs BC104A–BC104E, the headings above paragraphs BC125, BC127 and BC129 and paragraphs BC125–BC130, the heading above paragraph BC221 and that paragraph and the heading above paragraph BC222 and that paragraph.

In October 2010 the Board relocated to IFRS 9 the requirements of IAS 39 relating to classification and measurement of financial liabilities and derecognition of financial assets and financial liabilities. The Board did not reconsider most of those requirements. Accordingly the following were relocated to IFRS 9: paragraphs BC11C, BC37–BC79A and BC85–BC104.

Paragraphs BC11C, BC11E, BC11F, BC13 and BC14, BC25–BC29, BC37–BC104E, BC105–BC107, BC125–BC130, BC221 and BC222 and the headings above BC25, BC37, BC104A, BC105 ('Impairment of investments in equity instruments (paragraph 61)' only), BC221 and BC222 are deleted.

Paragraph BC20A is amended to read as follows:

BC20A As discussed in paragraphs BC21–BC23E, the Board amended IAS 39 in 2005 to address financial guarantee contracts. In making those amendments, the Board moved the material on loan commitments from the scope section of the Standard to the section on subsequent measurement. The purpose of this change was to rationalise the presentation of this material without making substantive changes.

The headings above paragraphs BC15, BC21 and BC24 are amended to read as follows:

Loan commitments

Financial guarantee contracts

Contracts to buy or sell a non-financial item

BCA22 The footnotes to the references to 'IAS 39' in paragraphs BC185(d), BC186, BC189(a), BC201(f) and BC203 are deleted. The following footnotes are amended to read as follows and added:

To the reference to 'IAS 39' in paragraph BC12	In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 <i>Financial Instruments</i> . In October 2010 the Board amended IFRS 9 to add the requirements for classifying and measuring financial liabilities and derecognising financial assets and financial liabilities. Those requirements were relocated from IAS 39. In 2011 the Board's project on fair value measurement resulted in the relocation of the requirements for measuring fair value to IFRS 13.
To the heading above paragraph BC15	In October 2010 the Board amended IFRS 9 to add the requirements for classifying and measuring financial liabilities and derecognising financial assets and financial liabilities. Those requirements were relocated from IAS 39.
At the end of paragraph C16	IFRS 9 <i>Financial Instruments</i> , issued in November 2009, eliminated the category of loans and receivables.

To the heading above paragraphs BC21 and BC24	In October 2010 the Board amended IFRS 9 to add the requirements for classifying and measuring financial liabilities and derecognising financial assets and financial liabilities. Those requirements were relocated from IAS 39.
To the reference to 'loans and receivables' in paragraph BC111	IFRS 9 <i>Financial Instruments</i> , issued in November 2009, eliminated the category of loans and receivables.
At the end of paragraph BC185(d) and to the references to 'required to be paid' in paragraphs BC186 and BC189(a)	In October 2010 the Board amended IFRS 9 to add the requirements for classifying and measuring financial liabilities and derecognising financial assets and financial liabilities. Those requirements were relocated from IAS 39.
To the reference to 'held-to-maturity' in paragraph BC201(f)	IFRS 9 <i>Financial Instruments</i> , issued in November 2009, eliminated the category of held-to-maturity.
At the end of paragraph BC203(b)	In October 2010 the Board amended IFRS 9 to add the requirements for classifying and measuring financial liabilities and derecognising financial assets and financial liabilities. Those requirements were relocated from IAS 39.

BCA23 The dissenting opinions from the issue of IAS 39 in December 2003, *The Fair Value Option* in June 2005 and *Reclassification of Financial Assets* in October 2008 are deleted.

IAS 40 *Investment Property*

BCA24 The footnotes to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC8 and BC9, to the references to 'IAS 39' in paragraphs B35 and B67(a)(i) and to the reference to 'available-for-sale investments' in paragraph B63(a) are deleted.

The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC8 is footnoted as follows:

* In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. Paragraph BC8 refers to matters relevant when IAS 40 was issued.

BCA25 The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph B2 and the references to 'IAS 39' in paragraphs B46(b), B54 and B63(d) are footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39. This paragraph refers to matters relevant when IAS 40 was issued.

The reference to 'IAS 39' in paragraph B35 is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, eliminated the held-to-maturity category. This paragraph discusses matters relevant when IAS 40 was issued.

The reference to 'available-for-sale' in paragraph B63(a) is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, eliminated the category of available-for-sale financial assets.

In paragraph B67(a)(i) the footnote to 'IAS 39' is amended to read as follows:

* Paragraph 69 was replaced by paragraph 46 when the IASB revised IAS 39 in 2003. In 2009 paragraph 46 of IAS 39 was deleted by IFRS 9 *Financial Instruments*.

IAS 41 *Agriculture*

BCA26 The footnotes to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph B48 and to the reference to 'IAS 39' in paragraph B54 are deleted.

The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph B48 and the first reference to 'IAS 39' in paragraph B54 are footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*

BCA27 In paragraph BC18 the reference to 'IAS 39' is footnoted as follows:

* In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. Paragraph 49 of IAS 39 was relocated to paragraph 5.4.3 of IFRS 9. Paragraph BC18 refers to matters relevant when IFRIC 2 was issued.

IFRIC 4 *Determining whether an Arrangement contains a Lease*

BCA28 The footnote to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC14 is deleted.

The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC14 is footnoted as follows:

* In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*

BCA29 The footnotes to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC6, to the references to 'IAS 39' in paragraphs BC11(a), BC12, BC20 and BC24 and to 'receivable' in paragraph BC11(a) are deleted.

The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC6, the first references to 'IAS 39' in paragraphs BC8(c), BC20, BC24 and BC27 and the heading above paragraph BC11 are footnoted as follows:

* In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

The term 'available-for-sale financial asset' in paragraph BC11 is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 eliminated the categories of financial assets used in IAS 39. This paragraph discusses the matters relevant when IFRIC 5 was issued.

IFRIC 10 *Interim Financial Reporting and Impairment*

BCA30 The footnotes to the references to 'IAS 39' in paragraphs BC2 and BC9 are deleted.

The first references to 'IAS 39' in paragraphs BC2 and BC9 are footnoted as follows:

* In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

IFRIC 12 Service Concession Arrangements

BCA31 The footnotes to the reference to 'IAS 39' in paragraph BC59 and to the heading above paragraph BC60 are deleted.

The references to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC43(a) and to 'IAS 39' in paragraph BC59 and the heading above paragraph BC60 are footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

IFRIC 17 Distributions of Non-cash Assets to Owners

BCA32 The footnotes to the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC22, to the last sentence of paragraph BC28(a), to the reference to 'AG81' in paragraph BC29, to the reference to 'IAS 39' in paragraph BC32 and to the reference to 'available-for-sale' in paragraph BC47(e) are deleted.

The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC22 and the references to 'IAS 39' in paragraphs BC37 and BC50 are footnoted as follows:

* In November 2009 and October 2010 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

The reference to 'IAS 39' in paragraph BC28(a) is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, requires all investments in equity instruments to be measured at fair value.

The reference to 'AG81' in paragraph BC29 is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009, amended paragraphs AG80 and AG81 of IAS 39 so that they apply only to derivatives on unquoted equity instruments. IFRS 9, issued in October 2010, deleted paragraphs AG80 and AG81 of IAS 39. IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains requirements for measuring fair value. IFRS 13 defines a Level 1 input as a quoted price in an active market for an identical asset or liability. Level 2 inputs include quoted prices for identical assets or liabilities in markets that are not active. As a result IAS 39 and IFRS 9 refer to such equity instruments as 'an equity instrument that does not have a quoted price in an active market for an identical instrument (ie a Level 1 input)'.

The reference to 'IAS 39' in paragraph BC32 is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, eliminated the requirement in IAS 39 for some assets to be measured using a historical cost basis.

The term 'available-for-sale investment' in paragraph BC47(e) is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009 and amended in October 2010, eliminated the category of available-for-sale financial assets.

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments

BCA33 The reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC2 and the references to 'IAS 39' in paragraphs BC10, BC20, BC24, BC31 and BC34(c) are footnoted as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

SIC Interpretation 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease

BCA34 The rubric '[The original text ... struck through]' is deleted and replaced with the following rubric:

[In November 2009 and October 2010 the requirements of IAS 39 relating to classification and measurement of items within the scope of IAS 39 were relocated to IFRS 9 Financial Instruments. To

avoid confusion with earlier amendments marked up on the original text to reflect the revision of IAS 39 in 2003 and the subsequent issue of IFRS 4, paragraphs 14 and 15 have been amended for consistency with IFRS 9 as issued in 2010.]

Paragraph 14 is amended to read as follows:

- 14 When an Entity ... A financial asset and a financial liability, or a portion of either, are derecognised only when the requirements of paragraphs 3.2.1–3.2.23, 3.3.1–3.3.4, B3.2.1–B3.2.17 and B3.3.1–B3.3.7 of IFRS 9 are met.
- 15 IFRS 4 provides guidance for recognising and measuring financial guarantees and similar instruments that provide for payments to be made if the debtor fails to make payments when due, if that contract transfers significant insurance risk to the issuer. Financial guarantee contracts that provide for payments to be made in response to changes in relation to a variable (sometimes referred to as an ‘underlying’) are subject to IAS 39.*

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

Dissenting opinions

Dissent of James J Leisenring from IFRS 9 *Financial Instruments* (issued 2009)

- DO1 Mr Leisenring supports efforts to reduce the complexity of accounting for financial instruments. In that regard, he supports requiring all financial instruments to be measured at fair value, with that measurement being recognised in profit or loss. He finds no compelling reason related to improving financial reporting to reject that approach. It is an approach that maximises comparability and minimises complexity.
- DO2 It maximises comparability because all financial instruments would be measured at one attribute within an entity and across entities. No measurement or presentation would change to reflect either arbitrary distinctions or management behaviour or intentions. IFRS 9 emphasises management intentions and behaviour, which substantially undermines comparability.
- DO3 Complexity of accounting would be drastically reduced if all financial instruments were measured at fair value. The approach favoured by Mr Leisenring provides at least the following simplifications:
- (a) no impairment model is necessary.
 - (b) criteria for when a given instrument must or can be measured with a given attribute are unnecessary.
 - (c) there is no need to bifurcate embedded derivatives or to identify financial derivatives.
 - (d) it eliminates the need for fair value hedge accounting for financial instruments.
 - (e) it eliminates the disparity in the measurement of derivatives within and outside the scope of IAS 39.
 - (f) it minimises the incentives for structuring transactions to achieve a particular accounting outcome.
 - (g) no fair value option would be needed to eliminate accounting mismatches.
 - (h) it provides a superior foundation for developing a comprehensive standard for the derecognition of financial instruments that is not present in a mixed attribute model.
- DO4 Mr Leisenring accepts that measuring more instruments at fair value increases measurement complexity, but this increase is minimal compared with the reductions in complexity that would be otherwise achieved. There is no disagreement that derivatives must be measured at fair value. Those instruments raise the most difficult measurement issues, as cash instruments have many fewer problems. Indeed, some suggestions for an impairment model would measure at fair value the credit loss component of cash instruments. If that were to be the conclusion on impairment (an expected loss approach), it would minimise the incremental fair value measurement complexity of recording at fair value instruments now at amortised cost.
- DO5 Mr Leisenring recognises that measuring all instruments at fair value through profit or loss raises presentation issues about disaggregation of fair value changes. However, he does not believe that these issues are insurmountable.
- DO6 Investors have often told both the IASB and the FASB that fair value of financial instruments recognised in profit or loss provides the most useful information for their purposes. There is a worldwide demand for an improved and common solution to the accounting for financial instruments. Investors are disappointed that the Board will not take this opportunity to make, with other standard-setters, truly substantive changes rather than these minimal changes that perpetuate all the legitimate concerns that have been expressed about the mixed attribute model.
- DO7 IFRS 9 does to some extent reduce complexity but that reduction is minimal. Certain measurement classifications are eliminated but others have been added. Mr Leisenring does not think that, on balance, this is an improvement over IAS 39.
- DO8 Fundamental to IFRS 9 is the distinction between financial instruments measured at amortised cost and those at fair value. Mr Leisenring is concerned that neither of the two conditions necessary for that determination is operational. Paragraph BC4.86 criticises IAS 39 because the embedded derivative requirement of that Standard is based on a list of examples. However, the basic classification model of IFRS 9 is based on lists of examples in paragraphs B4.1.4, B4.1.13 and B4.1.14. The examples are helpful but are far from exhaustive of the issues that will be problematic in applying the two criteria for classification at amortised cost.
- DO9 Mr Leisenring also thinks that the two criteria are inconsistently applied. When the objective of the entity's business model is to hold the assets to collect the contracted cash flows of an instrument there is no requirement that the entity must actually do so. The cash flow characteristics of the instrument are also ignored when the guidance is applied to investments in contractually linked instruments (tranches). In those circumstances the contractual cash flows of the instrument are ignored and one is required to look through to the composition of assets and liabilities of the issuing entity. This 'look through' requirement is also potentially complex and in

Mr Leisenring's opinion is likely to be not very operational. Mr Leisenring also objects to eliminating the requirement to bifurcate derivatives embedded in cash instruments. This objection is primarily because of concern that the two criteria to qualify for amortised cost will not be operational. The pressure on those two conditions will be enormous because there will be an incentive to embed derivatives in a cash instrument in anticipation that the instrument might qualify for amortised cost. Derivatives should be at fair value whether embedded or standing alone and a bifurcation requirement would achieve that accounting. If Mr Leisenring were confident that the criteria for amortised cost could be applied as intended he would not be as concerned because instruments with embedded derivatives would be at fair value in their entirety.

- DO10 Mr Leisenring is concerned that, in the current crisis, instruments that have provided some of the most significant losses when measured at fair value would be eligible for amortised cost. That conclusion is not responsive to the present environment. The approach also allows actively traded debt instruments, including treasury securities, to be at amortised cost. These results are unacceptable and reduce the usefulness of reported information for investors.
- DO11 The Board is required by its *Framework*²⁷ to be neutral in its decision-making and to strive to produce neutral information to maximise the usefulness of financial information. IFRS 9 fails in that regard because it produces information based on free choice, management intention and management behaviour. Reporting that will result from this approach will not produce neutral information and diminishes the usefulness of financial reporting.
- DO12 The Board is insistent in paragraph BC4.20 that accounting based on a business model is not free choice but never explains why selection of a business model is not a management choice. The existence of a trading account, a fair value option and the objective of a business model are all free choices.
- DO13 The classification of selected equity instruments at fair value with the result of the remeasurement reported outside profit or loss is also a free choice. The Board concludes that reporting fair value changes in profit or loss may not reflect the operating performance of an entity. Mr Leisenring could accept accounting for changes in fair value of some instruments outside profit or loss in other comprehensive income. That accounting, however, should not be a free choice and why that presentation is superior in defined circumstances should be developed. In addition, when these securities are sold any realised gains and losses are not 'recycled' to profit or loss. That conclusion is inconsistent with the Board's conclusion that dividends received on these instruments should be reported in profit or loss. Such dividends would represent a return on investment or a form of 'recycling' of changes in the value of the instruments.
- DO14 Mr Leisenring believes that a business model is rarely relevant in writing accounting standards. Identical transactions, rights and obligations should be accounted for in the same way if comparability of financial information is to be achieved. The result of applying IFRS 9 ignores any concern for comparability of financial information.
- DO15 The credit crisis has provided confirmation that a drastic change in accounting for financial instruments is desirable. However, many have said that while they agree that the approach suggested by Mr Leisenring would be superior, and a significant improvement, the world is not ready to embrace such change. It is unclear to Mr Leisenring what factors need to be present for the optimal solution to be acceptable. He has concluded that it is hard to envisage circumstances that would make the case any more compelling for fundamental change and improvement than the present circumstances. Therefore, IFRS 9 will inevitably preserve a mixed attribute model and the resulting complexity for a significant period of time.
- DO16 An objective of replacing IAS 39 was to provide a basis for convergence with accounting standards issued by the FASB. Mr Leisenring is concerned that IFRS 9 does not provide such a basis. As a consequence, allowing early adoption of the IFRS is undesirable. For convergence to be achieved significant changes in the IFRS are inevitable. Early adoption of the IFRS will therefore necessitate another costly accounting change when convergence is achieved. Permitting early adoption of this IFRS is also undesirable as it permits a lack of comparability in accounting for many years due to the deferred required effective date.
- DO17 Mr Leisenring would accept that if, for reasons other than the desire to provide useful information to investors, his approach is politically unattainable, an alternative could be developed that would be operational. That approach would require all financial assets and financial liabilities to be recorded at fair value through profit or loss except originated loans retained by the originator, trade receivables and accounts payable. If certain derivatives were embedded in an instrument to be accounted for at amortised cost the derivative would be either bifurcated and accounted for at fair value or the entire instrument would be measured at fair value. Either approach would be acceptable.

²⁷ The reference to the *Framework* is to the IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

Dissent of Patricia McConnell from IFRS 9 *Financial Instruments* (2009)

- DO18 Ms McConnell believes that fair value is the most relevant and useful measurement attribute for financial assets. However, she acknowledges that many investors prefer not to measure all financial assets at fair value. Those investors believe that both amortised cost and fair value can provide useful information for particular kinds of financial assets in particular circumstances. Therefore, in order to meet the objective of developing high quality, global accounting standards that serve the interests of all investors, Ms McConnell believes that no single measurement attribute should have primacy over another. Thus any new IFRS setting classification and measurement principles for financial assets should require disclosure of sufficient information in the primary financial statements to permit determination of profit or loss and financial position using both amortised cost and fair value. For example, when a measurement attribute other than fair value is used for financial assets, information about fair value should be displayed prominently in the statement of financial position. The Board did not adopt such disclosure in IFRS 9, as discussed in paragraphs BC4.9–BC4.11 of the Board’s Basis for Conclusions.
- DO19 As stated in paragraph BC4.1, an objective of the Board in developing IFRS 9 was to reduce the number of classification categories for financial instruments. However, Ms McConnell believes that IFRS 9 has not accomplished that objective. IFRS 9 would permit or require the following categories: (1) amortised cost, (2) a fair value option through profit or loss for financial assets that qualify for amortised cost but for which amortised cost would create an accounting mismatch, (3) fair value through profit or loss for debt instruments that fail to qualify for amortised cost, (4) fair value through profit or loss for trading securities, (5) fair value through profit or loss for equity securities not held for trading and (6) fair value through other comprehensive income for equity investments not held for trading. Ms McConnell does not view those six categories as a significant improvement over the six categories in IAS 39; like the categories in IAS 39, they will hinder investors’ understanding of an already complex area of financial reporting.
- DO20 IFRS 9 sets out two criteria for measuring financial assets at amortised cost: (1) the way the entity manages its financial assets (‘business model’) and (2) the contractual cash flow characteristics of its financial assets. On the surface, this appears to be an improvement over IAS 39’s criterion that was based on management’s intention to trade, hold available for sale, hold to maturity, or hold for the foreseeable future. However, Ms McConnell finds it difficult to see how IFRS 9’s criterion based on the objective of the entity’s business model differs significantly from management’s intention. In her opinion selection of a business model is a management choice, as is the decision to have a trading account, use the fair value option for debt instruments or the fair value option for equity instruments with gains and losses reported in other comprehensive income. In paragraphs BC4.20 and BC4.21 the Board argues that selection of a measurement method based on an entity’s business model is not a free choice. Ms McConnell does not find the arguments persuasive.
- DO21 IFRS 9 permits an entity to make an irrevocable election to present in other comprehensive income changes in the value of any investment in equity instruments that is not held for trading. Ms McConnell could accept accounting for changes in fair value of some instruments outside profit or loss in other comprehensive income. However, that treatment should not be a free choice; criteria for that presentation should be developed. In addition, the Board decided that when those securities are sold any realised gains and losses are not ‘reclassified’ to profit or loss. That conclusion is inconsistent with the Board’s decision to report dividends received on these investments in profit or loss. Such dividends represent a return on investment or a form of ‘reclassifying’ changes in the value of the instruments.
- DO22 In addition, Ms McConnell believes the ‘look through’ guidance for contractually linked investments (tranches) is an exception to one of the criteria necessary for applying amortised cost, namely the contractual cash flow characteristics of the instrument. In those circumstances the contractual cash flows of the instrument are ignored. Instead an entity is required to ‘look through’ to the underlying pool of instruments and assess their cash flow characteristics and credit risk relative to a direct investment in the underlying instruments. Ms McConnell believes that this provision adds complexity to the IFRS and reduces the usefulness of the reporting for financial assets. Moreover, since an entity is required to ‘look through’ only upon initial recognition of the financial asset, subsequent changes in the relative exposure to credit risk over the life of a structured investment vehicle would be ignored. Consequently, Ms McConnell believes it is possible that highly volatile investments, such as those owning sub-prime residential mortgage loans, would be reported at amortised cost.

Dissent of Patricia McConnell from *Mandatory Effective Date of IFRS 9 and Transition Disclosures* (Amendments to IFRS 9 (2009), IFRS 9 (2010) and IFRS 7)

- DO23 Ms McConnell concurs with the Board's decision to defer the mandatory effective date of IFRS 9 (2009) and IFRS 9 (2010), but not with its decision to set a mandatory effective date of 1 January 2015. She agrees with the Board that there are compelling reasons for all project phases to be implemented at the same time and, therefore, that the mandatory application of all phases of the project to replace IAS 39 should occur concurrently. However, Ms McConnell does not believe that a mandatory effective date for IFRS 9 (2009) and IFRS 9 (2010) should be established until there is more clarity on the requirements and completion dates of the remaining phases of the project to replace IAS 39, including possible improvements to existing IFRS 9.
- DO24 Ms McConnell commends the Board for requiring modified transition disclosures and acknowledges that the modified disclosures will provide useful information that will enable users of financial statements to better understand the transition from IAS 39 to IFRS 9, just as they would provide useful information when financial assets are reclassified in accordance with IFRS 9.
- DO25 Although Ms McConnell believes that the modified disclosures are useful, she does not believe that they are an adequate substitute for restated comparative financial statements. Ms McConnell believes that comparative statements are vitally important to users of financial statements. To the extent that the accounting policies applied in comparative financial statements are comparable period-to-period, comparative financial statements enable users to more fully understand the effect of the accounting change on a company's statements of comprehensive income, financial position and cash flows.
- DO26 Ms McConnell agrees with the Board that the date of initial application should be defined as a fixed date. In the absence of a fixed date, entities would have to go back to the initial recognition of each individual instrument for classification and measurement. This would be very burdensome, if not impossible. Moreover, particularly because reclassifications in accordance with IFRS 9 only occur (and are required) upon a change in business model for the related group of instruments, reclassifications should be very rare. Consequently, the expected benefit of not naming a fixed date of initial application would not exceed the costs.
- DO27 However, Ms McConnell disagrees with defining the date of initial application as the date that an entity first applies this IFRS. She believes that the date of initial application should be defined as the beginning of the earliest period presented in accordance with IFRS 9. This date of initial application would enable entities to compile information in accordance with IFRS 9 while still preparing their external financial reports in accordance with IAS 39. Ms McConnell does not consider that there is a significant risk that entities would use hindsight when applying IFRS 9 to comparative periods prior to those financial statements being reported publicly in accordance with IFRS 9. She also notes that, although it would be costly for entities to prepare financial reporting information in accordance with an extra set of requirements during the comparative period (or periods), this would address concerns on the part of preparers that it is overly burdensome for them to compile information in accordance with IFRS 9 before the date of initial application has passed.
- DO28 Ms McConnell acknowledges that defining the date of initial application as the beginning of the earliest date presented would delay the release of financial statements prepared in accordance with IFRS 9 for at least one year, or longer, if the date of initial application were set as she believes it should be. Delays would also result if the mandatory effective date of IFRS 9 was set so that entities could prepare more than one comparative period under IFRS 9 on the basis of requirements in many jurisdictions. Ms McConnell has also considered that it is costly for entities to prepare financial reporting information in accordance with an extra set of requirements during the comparative period (or periods). However, Ms McConnell believes that the benefits to users of financial statements of restated comparative financial statements justify the costs.

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IFRS 9 *Financial Instruments*

Illustrative example

This example accompanies, but is not part of, IFRS 9

Financial liabilities at fair value through profit or loss

- IE1 The following example illustrates the calculation that an entity might perform in accordance with paragraph B5.7.18 of IFRS 9.
- IE2 On 1 January 20X1 an entity issues a 10-year bond with a par value of CU150,000²⁸ and an annual fixed coupon rate of 8 per cent, which is consistent with market rates for bonds with similar characteristics.
- IE3 The entity uses LIBOR as its observable (benchmark) interest rate. At the date of inception of the bond, LIBOR is 5 per cent. At the end of the first year:
- (a) LIBOR has decreased to 4.75 per cent.
 - (b) the fair value for the bond is CU153,811, consistent with an interest rate of 7.6 per cent.²⁹
- IE4 The entity assumes a flat yield curve, all changes in interest rates result from a parallel shift in the yield curve, and the changes in LIBOR are the only relevant changes in market conditions.

²⁸ In this guidance monetary amounts are denominated in 'currency units (CU)'.

²⁹ This reflects a shift in LIBOR from 5 per cent to 4.75 per cent and a movement of 0.15 per cent which, in the absence of other relevant changes in market conditions, is assumed to reflect changes in credit risk of the instrument.

IE5 The entity estimates the amount of change in the fair value of the bond that is not attributable to changes in market conditions that give rise to market risk as follows:

<p>[paragraph B5.7.18(a)]</p> <p>First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.</p>	<p>At the start of the period of a 10-year bond with a coupon of 8 per cent, the bond's internal rate of return is 8 per cent.</p> <p>Because the observed (benchmark) interest rate (LIBOR) is 5 per cent, the instrument-specific component of the internal rate of return is 3 per cent.</p>
<p>[paragraph B5.7.18(b)]</p> <p>Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in accordance with paragraph B5.7.18(a).</p>	<p>The contractual cash flows of the instrument at the end of the period are:</p> <ul style="list-style-type: none"> • interest: CU12,000^a per year for each of years 2–10. • principal: CU150,000 in year 10. <p>The discount rate to be used to calculate the present value of the bond is thus 7.75 per cent, which is 4.75 per cent end of period LIBOR rate, plus the 3 per cent instrument-specific component.</p> <p>This gives a present value of CU152,367.^b</p>
<p>[paragraph B5.7.18(c)]</p> <p>The difference between the observed market price of the liability at the end of the period and the amount determined in accordance with paragraph B5.7.18(b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be presented in other comprehensive income in accordance with paragraph 5.7.7(a).</p>	<p>The market price of the liability at the end of the period is CU153,811.^c</p> <p>Thus, the entity presents CU1,444 in other comprehensive income, which is CU153,811 – CU152,367, as the increase in fair value of the bond that is not attributable to changes in market conditions that give rise to market risk.</p>
<p>(a) $\text{CU}150,000 \times 8\% = \text{CU}12,000$</p> <p>(b) $\text{PV} = [\text{CU}12,000 \times (1 - (1 + 0.0775)^{-9})/0.0775] + \text{CU}150,000 \times (1 + 0.0775)^{-9}$</p> <p>(c) $\text{market price} = [\text{CU}12,000 \times (1 - (1 + 0.076)^{-9})/0.076] + \text{CU}150,000 \times (1 + 0.076)^{-9}$</p>	

Disclosures on Transition from IAS 39 to IFRS 9

IE6 The following illustration is an example of one possible way to meet the quantitative disclosure requirements in paragraphs 44S–44W of IFRS 7 at the date of initial application of IFRS 9. However, this illustration does not address all possible ways of applying the disclosure requirements of this IFRS.

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 at 1 January 2015

Financial assets	(i)	(ii)	(iii)	(iv) = (i) + (ii) + (iii)	(v) = (iii)
	IAS 39 carrying amount 31 December 2014 (1)	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2015	Retained earnings effect on 1 January 2015 (2)
<u>Measurement category:</u>					
Fair value through profit or loss					
<i>Additions:</i>					
From available for sale (IAS 39)		(a)			(c)
From amortised cost (IAS 39) – required reclassification		(b)			
From amortised cost (IAS 39) – fair value option elected at 1 January 2015					
<i>Subtractions:</i>					
To amortised cost (IFRS 9)					
Total change to fair value through profit or loss					
Fair value through other comprehensive income					
<i>Additions:</i>					
From fair value through profit or loss (fair value option under IAS 39) – fair value through other comprehensive income elected at 1 January 2015					
From cost (IAS 39)					
<i>Subtractions:</i>					
Available for sale (IAS 39) to fair value through profit or loss (IFRS 9)					(d)
Available for sale (IAS 39) to amortised cost (IFRS 9)					(e)
Total change to fair value through other comprehensive income					

continued...

*continued...***Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 at 1 January 2015**

Financial assets	(i)	(ii)	(iii)	(iv) = (i) + (ii) + (iii)	(v) = (iii)
	IAS 39 carrying amount 31 December 2014 (1)	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2015	Retained earnings effect on 1 January 2015 (2)
Amortised cost					
<i>Additions:</i>					
From available for sale (IAS 39)					(f)
From fair value through profit or loss (IAS 39) – required reclassification					
From fair value through profit or loss (IAS 39) – fair value option revoked at 1 January 2015					
<i>Subtractions:</i>					
To fair value through profit or loss (IFRS 9) – required reclassification					
To fair value through profit or loss (IFRS 9) – fair value option elected at 1 January 2015					
Total change to amortised cost					
Total financial asset balances, reclassifications and remeasurements at 1 January 2015	(i)	Total (ii) = 0	(iii)	(iv) = (i) + (ii) + (iii)	

- (1) Includes the effect of reclassifying hybrid instruments that were bifurcated under IAS 39 with host contract components of (a), which had associated embedded derivatives with a fair value of X at 31 December 2014, and (b), which had associated embedded derivatives with a fair value of Y at 31 December 2014.
- (2) Includes (c), (d), (e) and (f), which are amounts reclassified from other comprehensive income to retained earnings at the date of initial application.

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 at 1 January 2015

Financial assets	(i)	(ii)	(iii)	(iv) = (i) + (ii) + (iii)	(v) = (iii)
	IAS 39 carrying amount 31 December 2014 (1)	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2015	Retained earnings effect on 1 January 2015 (2)
Fair value through profit or loss					
<i>Additions:</i>					
From amortised cost (IAS 39) – fair value option elected at 1 January 2015					
<i>Subtractions:</i>					
To amortised cost (IFRS 9) – fair value option revoked at 1 January 2015					
Total change to fair value through profit or loss					
Amortised cost					
<i>Additions:</i>					
From fair value through profit or loss (IAS 39) – required reclassification					
From fair value through profit or loss (IAS 39) – fair value option revoked at 1 January 2015					
<i>Subtractions:</i>					
To fair value through profit or loss (IFRS 9) – fair value option elected at 1 January 2015					
Total change to amortised cost					
Total financial liability balances, reclassifications and remeasurements at 1 January 2015					
	(i)	Total (ii) = 0	(iii)	(iv) = (i) + (ii) + (iii)	
Total change to retained earnings at 1 January 2015					(v) = (iii)

Note: This illustration assumes that the entity's date of initial application for IFRS 9 (2009) and IFRS 9 (2010) is 1 January 2015.

QUESTIONS AND ANSWERS ON IMPLEMENTING IFRS 9 *FINANCIAL INSTRUMENTS*

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Guidance on implementing IFRS 9 Financial Instruments

This guidance accompanies, but is not part of, IFRS 9. The numbers used for the questions are carried forward from the implementation guidance accompanying IAS 39 Financial Instruments: Recognition and Measurement.

Section B Definitions

B.1 Definition of a financial instrument: gold bullion

Is gold bullion a financial instrument (like cash) or is it a commodity?

It is a commodity. Although bullion is highly liquid, there is no contractual right to receive cash or another financial asset inherent in bullion.

B.2 Definition of a derivative: examples of derivatives and underlyings

What are examples of common derivative contracts and the identified underlying?

IFRS 9 defines a derivative as follows:

A derivative is a financial instrument or other contract within the scope of this IFRS with all three of the following characteristics:

- (a) **Its value changes in response to the change in 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 nonfinancial variable that the variable is not specific to a party to the contract (sometimes called the ‘underlying’);**
- (b) **It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and**
- (c) **It is settled at a future date.**

Type of contract	Main pricing-settlement variable (underlying variable)
Interest rate swap	Interest rates
Currency swap (foreign exchange swap)	Currency rates
Commodity swap	Commodity prices
Equity swap	Equity prices (equity of another entity)
Credit swap	Credit rating, credit index or credit price
Total return swap	Total fair value of the reference asset and interest rates
Purchased or written treasury bond option (call or put)	Interest rates
Purchased or written currency option (call or put)	Currency rates
Purchased or written commodity option (call or put)	Commodity prices
Purchased or written stock option (call or put)	Equity prices (equity of another entity)

Type of contract	Main pricing-settlement variable (underlying variable)
Interest rate futures linked to government debt (treasury futures)	Interest rates
Currency futures	Currency rates
Commodity futures	Commodity prices
Interest rate forward linked to government debt (treasury forward)	Interest rates
Currency forward	Currency rates
Commodity forward	Commodity prices
Equity forward	Equity prices (equity of another entity)

The above list provides examples of contracts that normally qualify as derivatives under IFRS 9. The list is not exhaustive. Any contract that has an underlying may be a derivative. Moreover, even if an instrument meets the definition of a derivative contract, special provisions may apply, for example, if it is a weather derivative (see IAS 39.AG1), a contract to buy or sell a non-financial item such as commodity (see IAS 39.5 and IFRS 9.BA.2) or a contract settled in an entity's own shares (see IAS 32.21–IAS 32.24). Therefore, an entity must evaluate the contract to determine whether the other characteristics of a derivative are present and whether special provisions apply.

B.3 Definition of a derivative: settlement at a future date, interest rate swap with net or gross settlement

For the purpose of determining whether an interest rate swap is a derivative financial instrument under IFRS 9, does it make a difference whether the parties pay the interest payments to each other (gross settlement) or settle on a net basis?

No. The definition of a derivative does not depend on gross or net settlement.

To illustrate: Entity ABC enters into an interest rate swap with a counterparty (XYZ) that requires ABC to pay a fixed rate of 8 per cent and receive a variable amount based on three-month LIBOR, reset on a quarterly basis. The fixed and variable amounts are determined on the basis of a CU100 million notional amount. ABC and XYZ do not exchange the notional amount. ABC pays or receives a net cash amount each quarter based on the difference between 8 per cent and three-month LIBOR. Alternatively, settlement may be on a gross basis.

The contract meets the definition of a derivative regardless of whether there is net or gross settlement because its value changes in response to changes in an underlying variable (LIBOR), there is no initial net investment, and settlements occur at future dates.

B.4 Definition of a derivative: prepaid interest rate swap (fixed rate payment obligation prepaid at inception or subsequently)

If a party prepays its obligation under a pay-fixed, receive-variable interest rate swap at inception, is the swap a derivative financial instrument?

Yes.

To illustrate: Entity S enters into a CU100 million notional amount five-year pay-fixed, receive-variable interest rate swap with Counterparty C. The interest rate of the variable part of the swap is reset on a quarterly basis to three-month LIBOR. The interest rate of the fixed part of the swap is 10 per cent per year. Entity S prepays its fixed obligation under the swap of CU50 million ($\text{CU100 million} \times 10 \text{ per cent} \times 5 \text{ years}$) at inception, discounted using market interest rates, while retaining the right to receive interest payments on the CU100 million reset quarterly based on three-month LIBOR over the life of the swap.

The initial net investment in the interest rate swap is significantly less than the notional amount on which the variable payments under the variable leg will be calculated. The contract requires an initial net investment that is smaller than

would be required for other types of contracts that would be expected to have a similar response to changes in market factors, such as a variable rate bond. Therefore, the contract fulfils the ‘no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors’ provision of IFRS 9. Even though Entity S has no future performance obligation, the ultimate settlement of the contract is at a future date and the value of the contract changes in response to changes in the LIBOR index. Accordingly, the contract is regarded as a derivative contract.

Would the answer change if the fixed rate payment obligation is prepaid subsequent to initial recognition?

If the fixed leg is prepaid during the term, that would be regarded as a termination of the old swap and an origination of a new instrument that is evaluated under IFRS 9.

B.5 Definition of a derivative: prepaid pay-variable, receive-fixed interest rate swap

If a party prepays its obligation under a pay-variable, receive-fixed interest rate swap at inception of the contract or subsequently, is the swap a derivative financial instrument?

No. A prepaid pay-variable, receive-fixed interest rate swap is not a derivative if it is prepaid at inception and it is no longer a derivative if it is prepaid after inception because it provides a return on the prepaid (invested) amount comparable to the return on a debt instrument with fixed cash flows. The prepaid amount fails the ‘no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors’ criterion of a derivative.

To illustrate: Entity S enters into a CU100 million notional amount five-year pay-variable, receive-fixed interest rate swap with Counterparty C. The variable leg of the swap is reset on a quarterly basis to three-month LIBOR. The fixed interest payments under the swap are calculated as 10 per cent times the swap’s notional amount, ie CU10 million per year. Entity S prepays its obligation under the variable leg of the swap at inception at current market rates, while retaining the right to receive fixed interest payments of 10 per cent on CU100 million per year.

The cash inflows under the contract are equivalent to those of a financial instrument with a fixed annuity stream since Entity S knows it will receive CU10 million per year over the life of the swap. Therefore, all else being equal, the initial investment in the contract should equal that of other financial instruments that consist of fixed annuities. Thus, the initial net investment in the pay-variable, receive-fixed interest rate swap is equal to the investment required in a non-derivative contract that has a similar response to changes in market conditions. For this reason, the instrument fails the ‘no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors’ criterion of IFRS 9. Therefore, the contract is not accounted for as a derivative under IFRS 9. By discharging the obligation to pay variable interest rate payments, Entity S in effect provides a loan to Counterparty C.

B.6 Definition of a derivative: offsetting loans

Entity A makes a five-year fixed rate loan to Entity B, while B at the same time makes a five-year variable rate loan for the same amount to A. There are no transfers of principal at inception of the two loans, since A and B have a netting agreement. Is this a derivative under IFRS 9?

Yes. This meets the definition of a derivative (that is to say, there is an underlying variable, no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and future settlement). The contractual effect of the loans is the equivalent of an interest rate swap arrangement with no initial net investment. Non-derivative transactions are aggregated and treated as a derivative when the transactions result, in substance, in a derivative. Indicators of this would include:

- they are entered into at the same time and in contemplation of one another
- they have the same counterparty
- they relate to the same risk
- there is no apparent economic need or substantive business purpose for structuring the transactions separately that could not also have been accomplished in a single transaction.

The same answer would apply if Entity A and Entity B did not have a netting agreement, because the definition of a derivative instrument in IFRS 9 does not require net settlement.

B.7 Definition of a derivative: option not expected to be exercised

The definition of a derivative in IFRS 9 requires that the instrument ‘is settled at a future date’. Is this criterion met even if an option is expected not to be exercised, for example, because it is out of the money?

Yes. An option is settled upon exercise or at its maturity. Expiry at maturity is a form of settlement even though there is no additional exchange of consideration.

B.8 Definition of a derivative: foreign currency contract based on sales volume

Entity XYZ, whose functional currency is the US dollar, sells products in France denominated in euro. XYZ enters into a contract with an investment bank to convert euro to US dollars at a fixed exchange rate. The contract requires XYZ to remit euro based on its sales volume in France in exchange for US dollars at a fixed exchange rate of 6.00. Is that contract a derivative?

Yes. The contract has two underlying variables (the foreign exchange rate and the volume of sales), no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and a payment provision. IFRS 9 does not exclude from its scope derivatives that are based on sales volume.

B.9 Definition of a derivative: prepaid forward

An entity enters into a forward contract to purchase shares of stock in one year at the forward price. It prepays at inception based on the current price of the shares. Is the forward contract a derivative?

No. The forward contract fails the ‘no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors’ test for a derivative.

To illustrate: Entity XYZ enters into a forward contract to purchase one million T ordinary shares in one year. The current market price of T is CU50 per share; the one-year forward price of T is CU55 per share. XYZ is required to prepay the forward contract at inception with a CU50 million payment. The initial investment in the forward contract of CU50 million is less than the notional amount applied to the underlying, one million shares at the forward price of CU55 per share, ie CU55 million. However, the initial net investment approximates the investment that would be required for other types of contracts that would be expected to have a similar response to changes in market factors because T’s shares could be purchased at inception for the same price of CU50. Accordingly, the prepaid forward contract does not meet the initial net investment criterion of a derivative instrument.

B.10 Definition of a derivative: initial net investment

Many derivative instruments, such as futures contracts and exchange traded written options, require margin accounts. Is the margin account part of the initial net investment?

No. The margin account is not part of the initial net investment in a derivative instrument. Margin accounts are a form of collateral for the counterparty or clearing house and may take the form of cash, securities or other specified assets, typically liquid assets. Margin accounts are separate assets that are accounted for separately.

B.11 Definition of held for trading: portfolio with a recent actual pattern of short-term profit-taking

The definition of a financial asset or financial liability held for trading states that ‘a financial asset or financial liability is classified as held for trading if it is ... part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking’. What is a ‘portfolio’ for the purposes of applying this definition?

Although the term ‘portfolio’ is not explicitly defined in IFRS 9, the context in which it is used suggests that a portfolio is a group of financial assets or financial liabilities that are managed as part of that group (Appendix A of IFRS 9). If there is evidence of a recent actual pattern of short-term profit-taking on financial instruments included in such a portfolio, those financial instruments qualify as held for trading even though an individual financial instrument may in fact be held for a longer period of time.

B.28 Regular way contracts: no established market

Can a contract to purchase a financial asset be a regular way contract if there is no established market for trading such a contract?

Yes. IFRS 9 refers to terms that require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned. Marketplace, as that term is used in Appendix A of IFRS 9, is not limited to a formal stock exchange or organised over-the-counter market. Rather, it means the environment in which the financial asset is customarily exchanged. An acceptable time frame would be the period reasonably and customarily required for the parties to complete the transaction and prepare and execute closing documents.

For example, a market for private issue financial instruments can be a marketplace.

B.29 Regular way contracts: forward contract

Entity ABC enters into a forward contract to purchase one million of M's ordinary shares in two months for CU10 per share. The contract is with an individual and is not an exchange-traded contract. The contract requires ABC to take physical delivery of the shares and pay the counterparty CU10 million in cash. M's shares trade in an active public market at an average of 100,000 shares a day. Regular way delivery is three days. Is the forward contract regarded as a regular way contract?

No. The contract must be accounted for as a derivative because it is not settled in the way established by regulation or convention in the marketplace concerned.

B.30 Regular way contracts: which customary settlement provisions apply?

If an entity's financial instruments trade in more than one active market, and the settlement provisions differ in the various active markets, which provisions apply in assessing whether a contract to purchase those financial instruments is a regular way contract?

The provisions that apply are those in the market in which the purchase actually takes place.

To illustrate: Entity XYZ purchases one million shares of Entity ABC on a US stock exchange, for example, through a broker. The settlement date of the contract is six business days later. Trades for equity shares on US exchanges customarily settle in three business days. Because the trade settles in six business days, it does not meet the exemption as a regular way trade.

However, if XYZ did the same transaction on a foreign exchange that has a customary settlement period of six business days, the contract would meet the exemption for a regular way trade.

B.31 Regular way contracts: share purchase by call option

Entity A purchases a call option in a public market permitting it to purchase 100 shares of Entity XYZ at any time over the next three months at a price of CU100 per share. If Entity A exercises its option, it has 14 days to settle the transaction according to regulation or convention in the options market. XYZ shares are traded in an active public market that requires three-day settlement. Is the purchase of shares by exercising the option a regular way purchase of shares?

Yes. The settlement of an option is governed by regulation or convention in the marketplace for options and, therefore, upon exercise of the option it is no longer accounted for as a derivative because settlement by delivery of the shares within 14 days is a regular way transaction.

B.32 Recognition and derecognition of financial liabilities using trade date or settlement date accounting

IFRS 9 has special rules about recognition and derecognition of financial assets using trade date or settlement date accounting. Do these rules apply to transactions in financial instruments that are classified as financial liabilities, such as transactions in deposit liabilities and trading liabilities?

No. IFRS 9 does not contain any specific requirements about trade date accounting and settlement date accounting in the case of transactions in financial instruments that are classified as financial liabilities. Therefore, the general recognition and derecognition requirements in paragraphs 3.1.1 and 3.3.1 of IFRS 9 apply. Paragraph 3.1.1 of IFRS 9 states that financial liabilities are recognised on the date the entity 'becomes a party to the contractual provisions of the instrument'. Such contracts generally are not recognised unless one of the parties has performed or the contract is a derivative contract not exempted from the scope of IFRS 9. Paragraph 3.3.1 of IFRS 9 specifies that financial

liabilities are derecognised only when they are extinguished, ie when the obligation specified in the contract is discharged or cancelled or expires.

Section C Embedded derivatives

C.1 Embedded derivatives: separation of host debt instrument

If an embedded non-option derivative is required to be separated from a host debt instrument, how are the terms of the host debt instrument and the embedded derivative identified? For example, would the host debt instrument be a fixed rate instrument, a variable rate instrument or a zero coupon instrument?

The terms of the host debt instrument reflect the stated or implied substantive terms of the hybrid contract. In the absence of implied or stated terms, the entity makes its own judgement of the terms. However, an entity may not identify a component that is not specified or may not establish terms of the host debt instrument in a manner that would result in the separation of an embedded derivative that is not already clearly present in the hybrid contract, that is to say, it cannot create a cash flow that does not exist. For example, if a five-year debt instrument has fixed interest payments of CU40,000 annually and a principal payment at maturity of CU1,000,000 multiplied by the change in an equity price index, it would be inappropriate to identify a floating rate host contract and an embedded equity swap that has an offsetting floating rate leg in lieu of identifying a fixed rate host. In that example, the host contract is a fixed rate debt instrument that pays CU40,000 annually because there are no floating interest rate cash flows in the hybrid contract.

In addition, the terms of an embedded non-option derivative, such as a forward or swap, must be determined so as to result in the embedded derivative having a fair value of zero at the inception of the hybrid contract. If it were permitted to separate embedded non-option derivatives on other terms, a single hybrid contract could be decomposed into an infinite variety of combinations of host debt instruments and embedded derivatives, for example, by separating embedded derivatives with terms that create leverage, asymmetry or some other risk exposure not already present in the hybrid contract. Therefore, it is inappropriate to separate an embedded non-option derivative on terms that result in a fair value other than zero at the inception of the hybrid contract. The determination of the terms of the embedded derivative is based on the conditions existing when the financial instrument was issued.

C.2 Embedded derivatives: separation of embedded option

The response to Question C.1 states that the terms of an embedded non-option derivative should be determined so as to result in the embedded derivative having a fair value of zero at the initial recognition of the hybrid contract. When an embedded option-based derivative is separated, must the terms of the embedded option be determined so as to result in the embedded derivative having either a fair value of zero or an intrinsic value of zero (that is to say, be at the money) at the inception of the hybrid contract?

No. The economic behaviour of a hybrid contract with an option-based embedded derivative depends critically on the strike price (or strike rate) specified for the option feature in the hybrid contract, as discussed below. Therefore, the separation of an option-based embedded derivative (including any embedded put, call, cap, floor, capton, floortion or swaption feature in a hybrid contract) should be based on the stated terms of the option feature documented in the hybrid contract. As a result, the embedded derivative would not necessarily have a fair value or intrinsic value equal to zero at the initial recognition of the hybrid contract.

If an entity were required to identify the terms of an embedded option-based derivative so as to achieve a fair value of the embedded derivative of zero, the strike price (or strike rate) generally would have to be determined so as to result in the option being infinitely out of the money. This would imply a zero probability of the option feature being exercised. However, since the probability of the option feature in a hybrid contract being exercised generally is not zero, it would be inconsistent with the likely economic behaviour of the hybrid contract to assume an initial fair value of zero. Similarly, if an entity were required to identify the terms of an embedded option-based derivative so as to achieve an intrinsic value of zero for the embedded derivative, the strike price (or strike rate) would have to be assumed to equal the price (or rate) of the underlying variable at the initial recognition of the hybrid contract. In this case, the fair value of the option would consist only of time value. However, such an assumption would not be consistent with the likely economic behaviour of the hybrid contract, including the probability of the option feature being exercised, unless the agreed strike price was indeed equal to the price (or rate) of the underlying variable at the initial recognition of the hybrid contract.

The economic nature of an option-based embedded derivative is fundamentally different from a forward-based embedded derivative (including forwards and swaps), because the terms of a forward are such that a payment based on the difference between the price of the underlying and the forward price will occur at a specified date, while the terms of an option are such that a payment based on the difference between the price of the underlying and the strike price of the option may or may not occur depending on the relationship between the agreed strike price and the price of the underlying at a specified date or dates in the future. Adjusting the strike price of an option-based embedded derivative, therefore, alters the nature of the hybrid contract. On the other hand, if the terms of a non-option embedded derivative in a host debt instrument were determined so as to result in a fair value of any amount other than zero at the inception of the hybrid contract, that amount would essentially represent a borrowing or lending. Accordingly, as discussed in the answer to Question C.1, it is not

appropriate to separate a non-option embedded derivative in a host debt instrument on terms that result in a fair value other than zero at the initial recognition of the hybrid contract.

C.4 Embedded derivatives: equity kicker

In some instances, venture capital entities providing subordinated loans agree that if and when the borrower lists its shares on a stock exchange, the venture capital entity is entitled to receive shares of the borrowing entity free of charge or at a very low price (an ‘equity kicker’) in addition to interest and repayment of principal. As a result of the equity kicker feature, the interest on the subordinated loan is lower than it would otherwise be. Assuming that the subordinated loan is not measured at fair value with changes in fair value recognised in profit or loss (paragraph 4.3.3(c) of IFRS 9), does the equity kicker feature meet the definition of an embedded derivative even though it is contingent upon the future listing of the borrower?

Yes. The economic characteristics and risks of an equity return are not closely related to the economic characteristics and risks of a host debt instrument (paragraph 4.3.3(a) of IFRS 9). The equity kicker meets the definition of a derivative because it has a value that changes in response to the change in the price of the shares of the borrower, it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and it is settled at a future date (paragraph 4.3.3(b) and Appendix A of IFRS 9). The equity kicker feature meets the definition of a derivative even though the right to receive shares is contingent upon the future listing of the borrower. Paragraph BA.1 of IFRS 9 states that a derivative could require a payment as a result of some future event that is unrelated to a notional amount. An equity kicker feature is similar to such a derivative except that it does not give a right to a fixed payment, but an option right, if the future event occurs.

C.6 Embedded derivatives: synthetic instruments

Entity A issues a five-year floating rate debt instrument. At the same time, it enters into a five-year pay-fixed, receive-variable interest rate swap with Entity B. Entity A regards the combination of the debt instrument and swap as a synthetic fixed rate instrument. Entity A contends that separate accounting for the swap is inappropriate since paragraph B4.3.8(a) of IFRS 9 requires an embedded derivative to be classified together with its host instrument if the derivative is linked to an interest rate that can change the amount of interest that would otherwise be paid or received on the host debt contract. Is the entity’s analysis correct?

No. Embedded derivative instruments are terms and conditions that are included in non-derivative host contracts. It is generally inappropriate to treat two or more separate financial instruments as a single combined instrument (‘synthetic instrument’ accounting) for the purpose of applying IFRS 9. Each of the financial instruments has its own terms and conditions and each may be transferred or settled separately. Therefore, the debt instrument and the swap are classified separately. The transactions described here differ from the transactions discussed in Question B.6, which had no substance apart from the resulting interest rate swap.

C.7 Embedded derivatives: purchases and sales contracts in foreign currency instruments

A supply contract provides for payment in a currency other than (a) the functional currency of either party to the contract, (b) the currency in which the product is routinely denominated in commercial transactions around the world and (c) the currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place. Is there an embedded derivative that should be separated under IFRS 9?

Yes. To illustrate: a Norwegian entity agrees to sell oil to an entity in France. The oil contract is denominated in Swiss francs, although oil contracts are routinely denominated in US dollars in commercial transactions around the world, and Norwegian krone are commonly used in contracts to purchase or sell non-financial items in Norway. Neither entity carries out any significant activities in Swiss francs. In this case, the Norwegian entity regards the supply contract as a host contract with an embedded foreign currency forward to purchase Swiss francs. The French entity regards the supply contract as a host contract with an embedded foreign currency forward to sell Swiss francs. Each entity includes fair value changes on the currency forward in profit or loss unless the reporting entity designates it as a cash flow hedging instrument, if appropriate.

C.8 Embedded foreign currency derivatives: unrelated foreign currency provision

Entity A, which measures items in its financial statements on the basis of the euro (its functional currency), enters into a contract with Entity B, which has the Norwegian krone as its functional currency, to purchase oil in six months for 1,000 US dollars. The host oil contract is not within the scope of IFRS 9 because it was

entered into and continues to be for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements (paragraph 5 of IAS 39 and paragraph BA.2 of IFRS 9). The oil contract includes a leveraged foreign exchange provision that states that the parties, in addition to the provision of, and payment for, oil will exchange an amount equal to the fluctuation in the exchange rate of the US dollar and Norwegian krone applied to a notional amount of 100,000 US dollars. Under paragraph 4.3.3 of IFRS 9, is that embedded derivative (the leveraged foreign exchange provision) regarded as closely related to the host oil contract?

No, that leveraged foreign exchange provision is separated from the host oil contract because it is not closely related to the host oil contract (paragraph B4.3.8(d) of IFRS 9).

The payment provision under the host oil contract of 1,000 US dollars can be viewed as a foreign currency derivative because the US dollar is neither Entity A's nor Entity B's functional currency. This foreign currency derivative would not be separated because it follows from paragraph B4.3.8(d) of IFRS 9 that a crude oil contract that requires payment in US dollars is not regarded as a host contract with a foreign currency derivative.

The leveraged foreign exchange provision that states that the parties will exchange an amount equal to the fluctuation in the exchange rate of the US dollar and Norwegian krone applied to a notional amount of 100,000 US dollars is in addition to the required payment for the oil transaction. It is unrelated to the host oil contract and therefore separated from the host oil contract and accounted for as an embedded derivative under paragraph 4.3.3 of IFRS 9.

C.9 Embedded foreign currency derivatives: currency of international commerce

Paragraph B4.3.8(d) of IFRS 9 refers to the currency in which the price of the related goods or services is routinely denominated in commercial transactions around the world. Could it be a currency that is used for a certain product or service in commercial transactions within the local area of one of the substantial parties to the contract?

No. The currency in which the price of the related goods or services is routinely denominated in commercial transactions around the world is only a currency that is used for similar transactions all around the world, not just in one local area. For example, if cross-border transactions in natural gas in North America are routinely denominated in US dollars and such transactions are routinely denominated in euro in Europe, neither the US dollar nor the euro is a currency in which the goods or services are routinely denominated in commercial transactions around the world.

C.10 Embedded derivatives: holder permitted, but not required, to settle without recovering substantially all of its recognised investment

If the terms of a combined contract permit, but do not require, the holder to settle the combined contract in a manner that causes it not to recover substantially all of its recognised investment and the issuer does not have such a right (for example, a puttable debt instrument), does the contract satisfy the condition in paragraph B4.3.8(a) of IFRS 9 that the holder would not recover substantially all of its recognised investment?

No. The condition that 'the holder would not recover substantially all of its recognised investment' is not satisfied if the terms of the combined contract permit, but do not require, the investor to settle the combined contract in a manner that causes it not to recover substantially all of its recognised investment and the issuer has no such right. Accordingly, an interest-bearing host contract with an embedded interest rate derivative with such terms is regarded as closely related to the host contract. The condition that 'the holder would not recover substantially all of its recognised investment' applies to situations in which the holder can be forced to accept settlement at an amount that causes the holder not to recover substantially all of its recognised investment.

Section D Recognition and derecognition

D.1 Initial recognition

D.1.1 Recognition: cash collateral

Entity B transfers cash to Entity A as collateral for another transaction with Entity A (for example, a securities borrowing transaction). The cash is not legally segregated from Entity A's assets. Should Entity A recognise the cash collateral it has received as an asset?

Yes. The ultimate realisation of a financial asset is its conversion into cash and, therefore, no further transformation is required before the economic benefits of the cash transferred by Entity B can be realised by Entity A. Therefore, Entity A recognises the cash as an asset and a payable to Entity B while Entity B derecognises the cash and recognises a receivable from Entity A.

D.2 Regular way purchase or sale of a financial asset

D.2.1 Trade date vs settlement date: amounts to be recorded for a purchase

How are the trade date and settlement date accounting principles in IFRS 9 applied to a purchase of a financial asset?

The following example illustrates the application of the trade date and settlement date accounting principles in IFRS 9 for a purchase of a financial asset. On 29 December 20X1, an entity commits itself to purchase a financial asset for CU1,000, which is its fair value on commitment (trade) date. Transaction costs are immaterial. On 31 December 20X1 (financial year-end) and on 4 January 20X2 (settlement date) the fair value of the asset is CU1,002 and CU1,003, respectively. The amounts to be recorded for the asset will depend on how it is classified and whether trade date or settlement date accounting is used, as shown in the two tables below.

Settlement date accounting			
Balances	Financial assets measured at amortised cost	Financial assets measured at fair value with changes presented in other comprehensive income	Financial assets measured at fair value through profit or loss
29 December 20X1			
Financial asset	–	–	–
Financial liability	–	–	–
31 December 20X1			
Receivable	–	2	2
Financial asset	–	–	–
Financial liability	–	–	–
Other comprehensive income (fair value adjustment)	–	(2)	–
Retained earnings (through profit or loss)	–	–	(2)
4 January 20X2			
Receivable	–	–	–
Financial asset	1,000	1,003	1,003
Financial liability	–	–	–
Other comprehensive income (fair value adjustment)	–	(3)	–
Retained earnings (through profit or loss)	–	–	(3)

Trade date accounting			
Balances	Financial assets measured at amortised cost	Financial assets measured at fair value with changes presented in other comprehensive income	Financial assets measured at fair value through profit or loss
29 December 20X1			
Financial asset	1,000	1,000	1,000
Financial liability	(1,000)	(1,000)	(1,000)
31 December 20X1			
Receivable	–	–	–
Financial asset	1,000	1,002	1,002
Financial liability	(1,000)	(1,000)	(1,000)
Other comprehensive income (fair value adjustment)	–	(2)	–
Retained earnings (through profit or loss)	–	–	(2)
4 January 20X2			
Receivable	–	–	–
Financial asset	1,000	1,003	1,003
Financial liability	–	–	–
Other comprehensive income (fair value adjustment)	–	(3)	–
Retained earnings (through profit or loss)	–	–	(3)

D.2.2 Trade date vs settlement date: amounts to be recorded for a sale

How are the trade date and settlement date accounting principles in IFRS 9 applied to a sale of a financial asset?

The following example illustrates the application of the trade date and settlement date accounting principles in IFRS 9 for a sale of a financial asset. On 29 December 20X2 (trade date) an entity enters into a contract to sell a financial asset for its current fair value of CU1,010. The asset was acquired one year earlier for CU1,000 and its amortised cost is CU1,000. On 31 December 20X2 (financial year-end), the fair value of the asset is CU1,012. On 4 January 20X3 (settlement date), the fair value is CU1,013. The amounts to be recorded will depend on how the asset is classified and whether trade date or settlement date accounting is used as shown in the two tables below (any interest that might have accrued on the asset is disregarded).

A change in the fair value of a financial asset that is sold on a regular way basis is not recorded in the financial statements between trade date and settlement date even if the entity applies settlement date accounting because the seller's right to changes in the fair value ceases on the trade date.

Settlement date accounting		
Balances	Financial assets measured at amortised cost	Financial assets measured at fair value through profit or loss
29 December 20X2		
Receivable	–	–
Financial asset	1,000	1,010
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	–	10
31 December 20X2		
Receivable	–	–
Financial asset	1,000	1,010
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	–	10
4 January 20X3		
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10

Trade date accounting		
Balances	Financial assets measured at amortised cost	Financial assets measured at fair value through profit or loss
29 December 20X2		
Receivable	1,010	1,010
Financial asset	–	–
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10
31 December 20X2		
Receivable	1,010	1,010
Financial asset	–	–
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10
4 January 20X3		
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10

D.2.3 Settlement date accounting: exchange of non-cash financial assets

If an entity recognises sales of financial assets using settlement date accounting, would a change in the fair value of a financial asset to be received in exchange for the non-cash financial asset that is sold be recognised in accordance with paragraph 5.7.4 of IFRS 9?

It depends. Any change in the fair value of the financial asset to be received would be accounted for under paragraph 5.7.4 of IFRS 9 if the entity applies settlement date accounting for that category of financial assets. However, if the entity classifies the financial asset to be received in a category for which it applies trade date accounting, the asset to be received is recognised on the trade date as described in paragraph B3.1.5 of IFRS 9. In that case, the entity recognises a liability of an amount equal to the carrying amount of the financial asset to be delivered on settlement date.

To illustrate: on 29 December 20X2 (trade date) Entity A enters into a contract to sell Note Receivable A, which is measured at amortised cost, in exchange for Bond B, which meets the definition of held for trading and is measured at fair value. Both assets have a fair value of CU1,010 on 29 December, while the amortised cost of Note Receivable A is CU1,000. Entity A uses settlement date accounting for financial assets measured at amortised cost and trade date accounting for assets that meet the definition of held for trading. On 31 December 20X2 (financial year-end), the fair value of Note Receivable A is CU1,012 and the fair value of Bond B is CU1,009. On 4 January 20X3, the fair value of Note Receivable A is CU1,013 and the fair value of Bond B is CU1,007. The following entries are made:

29 December 20X2

Dr	Bond B	CU1,010	
	Cr	Payable	CU1,010

31 December 20X2

Dr	Trading loss	CU1	
	Cr Bond B		CU1

4 January 20X3

Dr	Payable	CU1,010	
Dr	Trading loss	CU2	
	Cr Note Receivable A		CU1,000
	Cr Bond B		CU2
	Cr Realisation gain		CU10

Section E Measurement

E.1 Initial measurement of financial assets and financial liabilities

E.1.1 Initial measurement: transaction costs

Transaction costs should be included in the initial measurement of financial assets and financial liabilities other than those at fair value through profit or loss. How should this requirement be applied in practice?

For financial assets not measured at fair value through profit or loss, transaction costs are added to the fair value at initial recognition. For financial liabilities, transaction costs are deducted from the fair value at initial recognition.

For financial instruments that are measured at amortised cost, transaction costs are subsequently included in the calculation of amortised cost using the effective interest method and, in effect, amortised through profit or loss over the life of the instrument.

Transaction costs expected to be incurred on transfer or disposal of a financial instrument are not included in the measurement of the financial instrument.

E.3 Gains and losses

E.3.3 IFRS 9 and IAS 21 Exchange differences arising on translation of foreign entities: other comprehensive income or profit or loss?

IAS 21.32 and IAS 21.48 state that all exchange differences resulting from translating the financial statements of a foreign operation should be recognised in other comprehensive income until disposal of the net investment. This would include exchange differences arising from financial instruments carried at fair value, which would include financial assets measured at fair value through profit or loss in accordance with IFRS 9.

If the foreign operation is a subsidiary whose financial statements are consolidated with those of its parent, in the consolidated financial statements how are IFRS 9 and IAS 21.39 applied?

IFRS 9 applies in the accounting for financial instruments in the financial statements of a foreign operation and IAS 21 applies in translating the financial statements of a foreign operation for incorporation in the financial statements of the reporting entity.

To illustrate: Entity A is domiciled in Country X and its functional currency and presentation currency are the local currency of Country X (LCX). A has a foreign subsidiary (Entity B) in Country Y whose functional currency is the local currency of Country Y (LCY). B is the owner of a debt instrument, which meets the definition of held for trading and is therefore measured at fair value.

In B's financial statements for year 20X0, the fair value and carrying amount of the debt instrument is LCY100 in the local currency of Country Y. In A's consolidated financial statements, the asset is translated into the local currency of Country X at the spot exchange rate applicable at the end of the reporting period (2.00). Thus, the carrying amount is LCX200 (= LCY100 × 2.00) in the consolidated financial statements.

At the end of year 20X1, the fair value of the debt instrument has increased to LCY110 in the local currency of Country Y. B recognises the trading asset at LCY110 in its statement of financial position and recognises a fair value gain of LCY10 in its profit or loss. During the year, the spot exchange rate has increased from 2.00 to 3.00 resulting in an increase in the fair value of the instrument from LCX200 to LCX330 (= LCY110 × 3.00) in the currency of Country X. Therefore, Entity A recognises the trading asset at LCX330 in its consolidated financial statements.

Entity A translates the statement of comprehensive income of B 'at the exchange rates at the dates of the transactions' (IAS 21.39(b)). Since the fair value gain has accrued through the year, A uses the average rate as a practical approximation ($[3.00 + 2.00] / 2 = 2.50$, in accordance with IAS 21.22). Therefore, while the fair value of the trading asset has increased by LCX130 (= LCX330 – LCX200), Entity A recognises only LCX25 (= LCY10 × 2.5) of this increase in consolidated profit or loss to comply with IAS 21.39(b). The resulting exchange difference, ie the remaining increase in the fair value of the debt instrument (LCX130 – LCX25 = LCX105), is accumulated in equity until the disposal of the net investment in the foreign operation in accordance with IAS 21.48.

E.3.4 IFRS 9 and IAS 21 Interaction between IFRS 9 and IAS 21

IFRS 9 includes requirements about the measurement of financial assets and financial liabilities and the recognition of gains and losses on remeasurement in profit or loss. IAS 21 includes rules about the reporting of foreign currency items and the recognition of exchange differences in profit or loss. In what order are IAS 21 and IFRS 9 applied?

Statement of financial position

Generally, the measurement of a financial asset or financial liability at fair value or amortised cost is first determined in the foreign currency in which the item is denominated in accordance with IFRS 9. Then, the foreign currency amount is translated into the functional currency using the closing rate or a historical rate in accordance with IAS 21 (paragraph B5.7.2 of IFRS 9). For example, if a monetary financial asset (such as a debt instrument) is measured at amortised cost in accordance with IFRS 9, amortised cost is calculated in the currency of denomination of that financial asset. Then, the foreign currency amount is recognised using the closing rate in the entity's financial statements (IAS 21.23). That applies regardless of whether a monetary item is measured at amortised cost or fair value in the foreign currency (IAS 21.24). A non-monetary financial asset (such as an investment in an equity instrument) is translated using the closing rate if it is measured at fair value in the foreign currency (IAS 21.23(c)).

As an exception, if the financial asset or financial liability is designated as a hedged item in a fair value hedge of the exposure to changes in foreign currency rates under IAS 39, the hedged item is remeasured for changes in foreign currency rates even if it would otherwise have been recognised using a historical rate under IAS 21 (IAS 39.89), ie the foreign currency amount is recognised using the closing rate. This exception applies to non-monetary items that are carried in terms of historical cost in the foreign currency and are hedged against exposure to foreign currency rates (IAS 21.23(b)).

Profit or loss

The recognition of a change in the carrying amount of a financial asset or financial liability in profit or loss depends on a number of factors, including whether it is an exchange difference or other change in carrying amount, whether it arises on a monetary item (for example, most debt instruments) or non-monetary item (such as most equity investments), whether the associated asset or liability is designated as a cash flow hedge of an exposure to changes in foreign currency rates, and whether it results from translating the financial statements of a foreign operation. The issue of recognising changes in the carrying amount of a financial asset or financial liability held by a foreign operation is addressed in a separate question (see Question E.3.3).

Any exchange difference arising on recognising a *monetary item* at a rate different from that at which it was initially recognised during the period, or recognised in previous financial statements, is recognised in profit or loss in accordance with IAS 21 (paragraph B5.7.2 of IFRS 9, IAS 21.28 and IAS 21.32), unless the monetary item is designated as a cash flow hedge of a highly probable forecast transaction in foreign currency, in which case the requirements for recognition of gains and losses on cash flow hedges in IAS 39 apply (IAS 39.95). Differences arising from recognising a monetary item at a foreign currency amount different from that at which it was previously recognised are accounted for in a similar manner, since all changes in the carrying amount relating to foreign currency movements should be treated consistently. All other changes in the statement of financial position measurement of a monetary item are recognised in profit or loss in accordance with IFRS 9.

Any changes in the carrying amount of a *non-monetary item* are recognised in profit or loss or in other comprehensive income in accordance with IFRS 9. If the non-monetary item is designated as a cash flow hedge of an unrecognised firm commitment or a highly probable forecast transaction in foreign currency, the requirements for recognition of gains and losses on cash flow hedges in IAS 39 apply (IAS 39.95).

When some portion of the change in carrying amount is recognised in other comprehensive income and some portion is recognised in profit or loss, an entity cannot offset those two components for the purposes of determining gains or losses that should be recognised in profit or loss or in other comprehensive income.

Appendix

Amendments to guidance on other IFRSs

The following amendments to guidance on IFRSs are necessary in order to ensure consistency with IFRS 9 Financial Instruments and the related amendments to other IFRSs.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

IGA1 The heading above paragraph IG52 and paragraphs IG52–IG58A and IG59 are amended to read as follows:

IAS 39 *Financial Instruments: Recognition and Measurement and IFRS 9 Financial Instruments*

IG52 An entity recognises and measures all financial assets and financial liabilities in its opening IFRS statement of financial position in accordance with IFRS 9, except as specified in paragraphs B2–B6 of the IFRS, which address derecognition and hedge accounting.

Recognition

IG53 An entity recognises all financial assets and financial liabilities (including all derivatives) that qualify for recognition in accordance with IFRS 9 and have not yet qualified for derecognition in accordance with IFRS 9, except non-derivative financial assets and non-derivative financial liabilities derecognised in accordance with previous GAAP before 1 January 2004, to which the entity does not choose to apply paragraph B3 (see paragraphs B2 and B3 of the IFRS). For example, an entity that does not apply paragraph B3 does not recognise assets transferred in a securitisation, transfer or other derecognition transaction that occurred before 1 January 2004 if those transactions qualified for derecognition in accordance with previous GAAP. However, if the entity uses the same securitisation arrangement or other derecognition arrangement for further transfers after 1 January 2004, those further transfers qualify for derecognition only if they meet the derecognition criteria of IFRS 9.

IG54 An entity does not recognise financial assets and financial liabilities that do not qualify for recognition in accordance with IFRS 9, or have already qualified for derecognition in accordance with IFRS 9.

Embedded derivatives

IG55 When IFRS 9 requires an entity to separate an embedded derivative from a host contract, the initial carrying amounts of the components at the date when the instrument first satisfies the recognition criteria in IFRS 9 reflect circumstances at that date (IFRS 9 paragraph 4.3.3). If the entity cannot determine the initial carrying amounts of the embedded derivative and host contract reliably, it measures the entire combined contract as at fair value through profit or loss (IFRS 9 paragraph 4.3.6).

Measurement

IG56 In preparing its opening IFRS statement of financial position, an entity applies the criteria in IFRS 9 to identify on the basis of the facts and circumstances that exist at the date of transition to IFRSs those financial assets and financial liabilities that are measured at fair value and those that are measured at amortised cost. The resulting classifications are applied retrospectively.

IG57 ... first satisfied the recognition criteria in IFRS 9. However, ...

IG58 An entity's estimates of impairments of financial assets measured at amortised cost at the date of transition to IFRSs are consistent with estimates made for the same date ...

Transition adjustments

IG58A An entity shall treat an adjustment to the carrying amount of a financial asset or financial liability as a transition adjustment to be recognised in the opening balance of retained earnings at the date of transition to IFRSs only to the extent that it results from adopting IAS 39 and IFRS 9. Because all derivatives, other than those that are financial guarantee contracts or are designated and effective hedging instruments, are measured at fair value through profit or loss, the differences between the previous carrying amount (which may have been zero) and the fair value of the derivatives are recognised as an adjustment of the balance of retained earnings at the beginning of the financial year in which IAS 39 and IFRS 9 are initially applied (other than for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

IG59 An entity may, in accordance with its previous GAAP, have measured investments at fair value and recognised the revaluation gain outside profit or loss. If an investment is classified as at fair value through profit or loss, the pre-IFRS 9 revaluation gain that had been recognised outside profit or loss is reclassified into retained earnings on initial application of IFRS 9. If, on initial application of IFRS 9, an investment in an equity instrument is classified as at fair value through other comprehensive income, then the pre-IFRS 9 revaluation gain is recognised in a separate component of equity. Subsequently, the entity recognises gains and losses on the financial asset in other comprehensive income (except dividends, which are recognised in profit or loss) and accumulates the cumulative gains and losses in that separate component of equity. On subsequent derecognition, the entity may transfer that separate component of equity within equity.

IGA2 IG Example 11, paragraph IG63 is amended to read as follows:

The table ‘Reconciliation of equity at 1 January 20X4 (date of transition to IFRSs)’ is amended to read as follows:

Reconciliation of equity at 1 January 20X4 (date of transition to IFRSs)				
Note		Previous GAAP CU	Effect on transition to IFRSs CU	IFRSs CU
1	Property, plant and equipment	8,299	100	8,399
2	Goodwill	1,220	150	1,370
2	Intangible assets	208	(150)	58
3	Financial assets	3,471	420	3,891
	Total non-current assets	13,198	520	13,718
	Trade and other receivables	3,710	0	3,710
4	Inventories	2,962	400	3,362
5	Other receivables	333	431	764
	Cash and cash equivalents	748	0	748
	Total current assets	7,753	831	8,584
	Total assets	20,951	1,351	22,302
				continued...

*continued...***Reconciliation of equity at 1 January 20X4 (date of transition to IFRSs)**

Note		<i>Previous GAAP CU</i>	<i>Effect of transition to IFRSs CU</i>	<i>IFRSs CU</i>
	Interest-bearing loans	9,396	0	9,396
	Trade and other payables	4,124	0	4,124
6	Employee benefits	0	66	66
7	Restructuring provision	250	(250)	0
	Current tax liability	42	0	42
8	Deferred tax liability	579	460	1,039
	Total liabilities	14,391	276	14,667
	Total assets less total liabilities	6,560	1,075	7,635
	Issued capital	1,500	0	1,500
5	Hedging reserve	0	302	302
9	Retained earnings	5,060	773	5,833
	Total equity	6,560	1,075	7,635

Note 3 to the reconciliation of equity at 1 January 20X4 is amended to read as follows:

- 3 Financial assets are all classified as at fair value through profit or loss in accordance with IFRSs and are carried at their fair value of CU3,891. They were carried at cost of CU3,471 in accordance with previous GAAP. The resulting gains of CU294 (CU420, less related deferred tax of CU126) are included in retained earnings.

Note 8 to the reconciliation of equity at 1 January 20X4 is amended to read as follows:

8	The above changes increased the deferred tax liability as follows:	
		CU
	Hedging reserve (note 5)	129
	Retained earnings	331
		<hr/>
	Increase in deferred tax liability	460
		<hr/>
	Because the tax base at 1 January 20X4 of the items reclassified from intangible assets to goodwill (note 2) equalled their carrying amount at that date, the reclassification did not affect deferred tax liabilities.	

Note 9 to the reconciliation of equity at 1 January 20X4 is amended to read as follows:

9	The adjustments to retained earnings are as follows:	
		CU
	Depreciation (note 1)	100
	Financial assets (note 3)	420
	Production overhead (note 4)	400
	Pension liability (note 6)	(66)
	Restructuring provision (note 7)	250
	Tax effect of the above	(331)
	Total adjustment to retained earnings	<u>773</u>

The reconciliation of total comprehensive income for 20X4 is amended to read as follows:

Reconciliation of total comprehensive income for 20X4				
Note		Previous GAAP CU	Effect of transition to IFRSs CU	IFRSs CU
	Revenue	20,910	0	20,910
1, 2, 3	Cost of sales	(15,283)	(97)	(15,380)
	Gross profit	5,627	(97)	5,530
6	Other income	0	180	180
1	Distribution costs	(1,907)	(30)	(1,937)
1, 4	Administrative expenses	(2,842)	(300)	(3,142)
	Finance income	1,446	0	1,446
	Finance costs	(1,902)	0	(1,902)
	Profit before tax	422	(247)	175
5	Tax expense	(158)	74	(84)
	Profit (loss) for the year	264	(173)	91
7	Cash flow hedges	0	(40)	(40)
8	Tax relating to other comprehensive income	0	(29)	(29)
	Other comprehensive income	0	(69)	(69)
	Total comprehensive income	264	(242)	22

Note 6 to the reconciliation of total comprehensive income for 20X4 is amended to read as follows:

- 6 Financial assets at fair value through profit or loss increased in value by CU180 during 20X4. They were carried at cost in accordance with previous GAAP. Fair value changes have been included in 'Other income'.

IFRS 3 Business Combinations

IGA2A In the table of comparison of IFRS 3 and SFAS 141(R), in the guidance section on 'Contingent consideration' the first reference to IAS 39 is footnoted as follows:

- In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all items within the scope of IAS 39.

IFRS 4 Insurance Contracts

IGA3 In the table in IG Example 1, the 'Treatment in Phase I' column of contract types 1.7–1.12, 1.15, 1.18, 1.19 and 1.20(a) are amended to read as follows:

1.7	Not an insurance contract at inception, if the insurer can reprice the mortality risk without constraints. Within the scope of IFRS 9 <i>Financial Instruments</i> unless the contract contains a discretionary participation feature. Will become an insurance contract when the annuity rate is fixed (unless the contingent amount is insignificant in all scenarios that have commercial substance).
1.8	Within the scope of IFRS 9.
1.9	Paragraph 35 of the IFRS sets out requirements for these contracts, which are excluded from the scope of IFRS 9.
1.10	Within the scope of IFRS 9. Payments denominated in unit values representing the fair value of the specified assets are measured at current unit value (see paragraph B4.3.8(g) of IFRS 9).
1.11	Insurance contract, but within the scope of IFRS 9, not IFRS 4. However, if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either IFRS 9 and IAS 32 ^{b)} or IFRS 4 to such financial guarantee contracts. The legal form of the contract does not affect its recognition and measurement. Accounting by the holder of such a contract is excluded from the scope of IFRS 9 and IFRS 4 (unless the contract is a reinsurance contract). Therefore, paragraphs 10–12 of IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> apply. Those paragraphs specify criteria to use in developing an accounting policy if no IFRS applies specifically to an item.
1.12	Not an insurance contract. A derivative within the scope of IFRS 9.
1.15	Insurance contract within the scope of the IFRS (unless changes in the condition of the asset have an insignificant effect). The risk of changes in the fair value of the non-financial asset is not a financial risk because the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific asset held (a non-financial variable). However, if the contract compensates the beneficiary only for changes in market prices and not for changes in the condition of the beneficiary's asset, the contract is a derivative and within the scope of IFRS 9. Residual value guarantees given by a lessee under a finance lease are within the scope of IAS 17 <i>Leases</i> .

1.18	Insurance risk is insignificant. Therefore, the contract is a financial asset within the scope of IFRS 9. Servicing fees are within the scope of IAS 18 (recognise as services are provided, subject to various conditions).
1.19	Financial instrument with embedded derivative within the scope of IFRS 9.
1.20	<p>The contract is an insurance contract, and contains an insurance component (with the issuer as policyholder and the holder as the insurer) and a deposit component.</p> <p>(a) If specified conditions are met, paragraph 10 of the IFRS requires the holder to unbundle the deposit component and apply IFRS 9 to it.</p> <p>(b) ...</p>

IGA4 Paragraph IG3 is amended to read as follows:

IG3 IFRS 9 requires an entity to separate embedded derivatives that meet specified conditions from the host instrument that contains them, measure the embedded derivatives at fair value and recognise changes in their fair value in profit or loss. However, an insurer need not separate an embedded derivative that itself meets the definition of an insurance contract (paragraph 7 of the IFRS). Nevertheless, separation and fair value measurement of such an embedded derivative are not prohibited if the insurer's existing accounting policies require such separation, or if an insurer changes its accounting policies and that change meets the criteria in paragraph 22 of the IFRS.

IGA5 In the table in IG Example 2, the 'Treatment if embedded in a host insurance contract' and 'Treatment if embedded in a host investment contract' columns of embedded derivative types 2.4, 2.5, 2.6(b), 2.12 and 2.14–2.17 are amended to read as follows:

Type	<i>Treatment if embedded in a host insurance contract</i>	<i>Treatment if embedded in a host investment contract</i>
2.4	<p>The embedded guarantee is not an insurance contract (unless significant payments are life-contingent^a). However, it is closely related to the host contract (paragraph B4.3.8(b) of IFRS 9). Fair value measurement is not required (but not prohibited).</p> <p>If significant payments are life-contingent, the contract is an insurance contract and contains a deposit component (the guaranteed minimum). However, an insurer is not required to unbundle the contract if it recognises all obligations arising from the deposit component (paragraph 10 of the IFRS).</p> <p>If cancelling the deposit component requires the policyholder to cancel the insurance component, the two cancellation options may be interdependent; if the option to cancel the deposit component cannot be measured separately (ie without considering the other option), both options are regarded as part of the insurance component (paragraph B4.3.8(h) of IFRS 9).</p>	Fair value measurement is not permitted (paragraph B4.3.8(b) of IFRS 9).
2.5	The embedded guarantee is not an insurance contract (unless the embedded guarantee is life-contingent to a significant extent). Fair value measurement is required (paragraph B4.3.8(b) of IFRS 9).	Fair value measurement is required (paragraph B4.3.8(b) of IFRS 9).

Type	<i>Treatment if embedded in a host insurance contract</i>	<i>Treatment if embedded in a host investment contract</i>
2.6(b)	The embedded derivative is not an insurance contract. Fair value measurement is required (unless the guarantee is regarded as closely related to the host contract because the guarantee is an unleveraged interest floor that is at or out of the money at inception, see paragraph B4.3.8(b) of IFRS 9).	Fair value measurement is required (unless the guarantee is regarded as closely related to the host contract because the guarantee is an unleveraged interest floor that is at or out of the money at inception, see paragraph B4.3.8(b) of IFRS 9).
2.12	Fair value measurement is not required (but not prohibited: paragraph 8 of the IFRS). The surrender value may be viewed as a deposit component, but the IFRS does not require an insurer to unbundle a contract if it recognises all its obligations arising under the deposit component (paragraph 10).	The surrender option is closely related to the host contract if the surrender value is approximately equal to the amortised cost at each exercise date (paragraph B4.3.5(e) of IFRS 9). Otherwise, the surrender option is measured at fair value.
2.14	The option is not closely related to the host contract (unless the option is life-contingent to a significant extent). Fair value measurement is required (paragraphs 8 of the IFRS and B4.3.5(c) and (d) of IFRS 9).	Fair value measurement is required (paragraph B4.3.5 (c) and (d) of IFRS 9).
2.15	If the insurer measures that portion of its obligation at account value, no further adjustment is needed for the option (unless the surrender value differs significantly from account value) (see paragraph B4.3.8(g) of IFRS 9). Otherwise, fair value measurement is required.	If the insurer regards the account value as the amortised cost or fair value of that portion of its obligation, no further adjustment is needed for the option (unless the surrender value differs significantly from account value). Otherwise, fair value measurement is required.
2.16	The embedded derivative is not an insurance contract and is not closely related to the contract (paragraph B4.3.5(f) of IFRS 9). Fair value measurement is required.	Fair value measurement is required.
2.17	The embedded derivative (option to receive the persistency bonus) is not an insurance contract (unless the persistency bonus is life-contingent to a significant extent). Insurance risk does not include lapse or persistency risk (paragraph B15 of the IFRS). Fair value measurement is required.	An option or automatic provision to extend the remaining term to maturity of a debt instrument is not closely related to the host debt instrument unless there is a concurrent adjustment to the approximate current market rate of interest at the time of the extension (paragraph B4.3.5(b) of IFRS 9). If the option or provision is not closely related to the host instrument, fair value measurement is required.

IGA6 IG Example 3 is amended to read as follows:

IG Example 3: Unbundling a deposit component of a reinsurance contract
<p><i>Application of requirements: case 1—no claims</i></p> <p>...</p> <p>If the reinsurer is required, or elects, to unbundle the contract, it does so as follows. Each payment by the cedant has two components: a loan advance (deposit component) and a payment for insurance cover (insurance component). Applying IFRS 9 to the deposit component, the reinsurer is required to measure it initially at fair value. Fair value could be determined by discounting the future cash flows from the deposit component. Assume that an appropriate discount rate is 10 per cent and that the insurance cover is equal in each year, so that the payment for insurance cover is the same in every year. Each payment of CU10 by the cedant is then made up of a loan advance of CU6.7 and an insurance premium of CU3.3.</p> <p>...</p>
<p><i>Incremental cash flows because of the claim in year 1</i></p> <p>...</p> <p>The incremental cash flows have a present value, in year 1, of CU35 (assuming a discount rate of 10 per cent is appropriate). Applying paragraphs 10–12 of the IFRS, the cedant unbundles the contract and applies IFRS 9 to this deposit component (unless the cedant already recognises its contractual obligation to repay the deposit component to the reinsurer). If this were not done, the cedant might recognise the CU150 received in year 1 as income, and the incremental payments in years 2–5 as expenses. However, in substance, the reinsurer has paid a claim of CU35 and made a loan of CU115 (CU150 less CU35) that will be repaid in instalments.</p> <p>...</p>

IGA7 IG Example 4 is amended to read as follows:

IG Example 4: Shadow Accounting
<p><i>Background</i></p> <p>...</p> <p>At the inception of a contract, insurer A has DAC of CU20 relating to that contract and the present value, at inception, of EGP is CU100. In other words, DAC is 20 per cent of EGP at inception. Thus, for each CU1 of realised gross profits, insurer A amortises DAC by CU0.20. For example, if insurer A sells assets and recognises a gain of CU10, insurer A amortises DAC by CU2 (20 per cent of CU10).</p> <p>Before adopting IFRSs for the first time in 20X5, insurer A measured financial assets on a cost basis. (Therefore, EGP under those national requirements considers only realised gains and losses.) However, under IFRSs, it classifies its financial assets as measured at fair value through profit or loss. In 20X5, insurer A recognises unrealised gains of CU10 on the assets backing the contract and in 20X6 it sells the assets for an amount equal to their fair value at the end of 20X5.</p> <p><i>Application of paragraph 30 of the IFRS</i></p> <p>Paragraph 30 of the IFRS permits, but does not require, insurer A to adopt shadow accounting. If insurer A adopts shadow accounting, it amortises DAC in 20X5 by an additional CU2 (20 per cent of CU10) as a result of the change in the fair value of the assets. Insurer A recognises the additional amortisation of CU2 in profit or loss.</p> <p>When insurer A sells the assets in 20X6, it makes no further adjustment to DAC.</p> <p>In summary, shadow accounting treats an unrealised gain in the same way as a realised gain. If insurer A does not adopt shadow accounting, unrealised gains on assets do not affect the amortisation of DAC.</p>

IGA8 Paragraph IG65A is amended to read as follows:

IG65A The issuer of a financial guarantee contract provides disclosures complying with IFRS 7 if it applies IFRS 9 in recognising and measuring the contract. If the issuer elects, when permitted by paragraph 4(d) of IFRS 4, to apply IFRS 4 in recognising and measuring the contract, it provides disclosures complying with IFRS 4. The main implications are as follows:

- (a) IFRS 4 requires disclosure about actual claims compared with previous estimates (claims development), but does not require disclosure of the fair value of the contract.
- (b) IFRS 7 requires disclosure of the fair value of the contract, but does not require disclosure of claims development.

IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

IGA9 The tables in Example 10 are amended to read as follows:

	Carrying amount at the end of the reporting period before classification as held for sale	Carrying amount as remeasured immediately before classification as held for sale
	CU*	CU
Goodwill	1,500	1,500
Property, plant and equipment (carried at revalued amounts)	4,600	4,000
Property, plant and equipment (carried at cost)	5,700	5,700
Inventory	2,400	2,200
Investments in equity instruments	1,800	1,500
Total	16,000	14,900

* In this guidance, monetary amounts are denominated in 'currency units (CU)'.

...

The impairment loss is allocated to non-current assets to which the measurement requirements of the IFRS are applicable. Therefore, no impairment loss is allocated to inventory and investments in equity instruments. The loss is allocated to the other assets in the order of allocation set out in paragraphs 104 and 122 of IAS 36 (as revised in 2004).

...

	Carrying amount as remeasured immediately before classification as held for sale	Allocated impairment loss	Carrying amount after allocation of impairment loss
	CU	CU	CU
Goodwill	1,500	(1,500)	0
Property, plant and equipment (carried at revalued amounts)	4,000	(165)	3,835
Property, plant and equipment (carried at cost)	5,700	(235)	5,465
Inventory	2,200	–	2,200
Investments in equity instruments	1,500	–	1,500
Total	14,900	(1,900)	13,000

IGA10 The table in Example 12 is amended to read as follows:

	Carrying amount after classification as held for sale	
	Disposal group I: CU	Disposal group II: CU
Property, plant and equipment	4,900	1,700
Investments in equity instruments	1,400 ^a	–
Liabilities	(2,400)	(900)
Net carrying amount of disposal group	3,900	800
(a) An amount of CU400 relating to these assets has been recognised in other comprehensive income and accumulated in equity.		

IFRS 7 Financial Instruments: Disclosures

IGA11 The heading above paragraph IG7 and paragraphs IG7–IG11 are deleted.

IGA12 The table in paragraph IG13A is amended to read as follows:

Assets measured at fair value				
Description	Fair value measurement at end of the reporting period using:			
	Level 1		Level 2	Level 3
	31 Dec 20X2	CU million	CU million	CU million
Financial assets at fair value through profit or loss				
Trading securities	100	40	55	5
Trading derivatives	39	17	20	2
Financial assets at fair value through other comprehensive income				
Equity investments	75	30	40	5
Total	214	87	115	12

(Note: For liabilities, a similar table might be presented.)

IGA13 The table in paragraph IG13B is amended to read as follows:

Assets measured at fair value based on Level 3				
	Fair value measurement at the end of the reporting period			
	Financial assets at fair value			Total
	Trading securities	Trading derivatives	Equity investments	
	CU million	CU million	CU million	CU million
Opening balance	6	5	3	14
Total gains or losses				
in profit or loss	(2)	(2)	–	(4)
in other comprehensive income	–	–	1	1
Purchases	1	2	1	4
Issues	–	–	–	–
Settlements	–	(1)	–	(1)
Transfers out of Level 3	–	(2)	–	(2)
Closing balance	5	2	5	12
Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period	(1)	(1)	–	(2)

Fair value measurement at the end of the reporting period				
Financial assets at fair value			Total	
Trading securities	Trading derivatives	Equity investments		
CU million	CU million	CU million	CU million	
Gains or losses included in profit or loss for the period (above) are presented in trading income and in other income as follows:				
			Trading Income	
Total gains or losses included in profit or loss for the period			(4)	
Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period			(2)	
(Note: For liabilities, a similar table might be presented.)				

IGA14 Paragraph IG14 and the illustrative disclosure following paragraph IG14 are amended to read as follows:

IG14 At initial recognition an entity measures the fair value of financial instruments that are not traded in active markets. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique. In these circumstances, the difference will be recognised in profit or loss in subsequent periods in accordance with IFRS 9 and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would take into account when pricing the asset or liability (see paragraph B5.1.2A(b) of IFRS 9). Paragraph 28 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 28:

...

Accounting policies

The entity uses the following valuation technique to determine the fair value of financial instruments that are not traded in an active market: [description of technique, not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with IFRS 9, is generally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

In the notes to the financial statements

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with IFRS 9, the fair value of an instrument at inception is generally the transaction price. If the transaction price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy].

IGA15 Paragraph IG36 is amended to read as follows:

IG36 The following example illustrates the application of the disclosure requirement in paragraph 40(a):

Interest rate risk

At 31 December 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, post-tax profit for the year would have been CU1.7 million (20X1—CU2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings. If interest rates had been 10 basis points higher, with all other variables held constant, post-tax profit would have been CU1.5 million (20X1—CU2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings. Profit is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X). [footnote omitted] ...

IAS 1 *Presentation of Financial Statements*

IGA16 The heading above paragraph IG7 and paragraphs IG7–IG9 are deleted. Paragraph IG2 is amended to read as follows:

IG2 The guidance is in two sections. Paragraphs IG3–IG6 provide examples of the presentation of financial statements. Paragraphs IG7–IG9 have been deleted. Paragraphs IG10 and IG11 provide examples of capital disclosures.

IGA17 In the illustrative financial statements, references to 'Available-for-sale financial assets' are replaced by 'Investments in equity instruments'. In the single statement of comprehensive income the reference to footnote (b) against the deleted line item 'Available-for-sale financial assets' is deleted. The heading and table 'Disclosure of components of other comprehensive income' are amended to read as follows:

Part 1: Illustrative presentation of financial statements

Disclosure of components of other comprehensive income [footnote omitted]

Notes

Year ended 31 December 20X7

(in thousands of currency units)

	20X7	20X6
Other comprehensive income:		
Exchange differences on translating foreign operations [footnote omitted]	5,334	10,667
Investments in equity instruments	(24,000)	26,667
Cash flow hedges:		
Gains (losses) arising during the year	(4,667)	(4,000)
Less: Reclassification adjustments for gains (losses) included in profit or loss	3,333	—
Less: Adjustments for amounts transferred to initial carrying amount of hedged items	667	—
Gains on property revaluation	933	3,367
Actuarial gains (losses) on defined benefit pension plans	(667)	1,333
Share of other comprehensive income of associates	400	(700)
Other comprehensive income	(18,667)	37,334
Income tax relating to components of other comprehensive income ⁽ⁱ⁾	4,667	(9,334)
Other comprehensive income for the year	(14,000)	28,000

IGA18 The second paragraph in footnote (k) to the illustrative financial statements is amended to read as follows:

- (k) The amount included in the translation, investments in equity instruments and cash flow hedge reserves represents other comprehensive income for each component, net of tax and non-controlling interests, eg other comprehensive income related to investments in equity instruments for 20X6 of 16,000 is 26,667, less tax 6,667, less non-controlling interests 4,000.

IGA19 The second paragraph in footnote (l) to the illustrative financial statements is amended to read as follows:

- (l) The amount included in the translation, investments in equity instruments and cash flow hedge reserves represents other comprehensive income for each component, net of tax and non-controlling interests, eg other comprehensive income related to the translation of foreign operations for 20X7 of 3,200 is 5,334, less tax 1,334, less non-controlling interests 800.

IAS 18 Revenue

IGA20 In the illustrative examples, paragraphs 5 and 14 are amended to read as follows:

5 ...

For a sale and repurchase agreement on an asset other than a financial asset, the terms of the agreement need to be analysed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer and hence revenue is recognised. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue. For a sale and repurchase agreement on a financial asset, IFRS 9 *Financial Instruments* applies.

14 *Financial service fees*

...

- (a) *Fees that are an integral part of the effective interest rate of a financial instrument.*

...

- (i) *Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under IFRS 9 is measured at fair value through profit or loss.*

Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related transaction costs [footnote omitted] (as defined in IAS 39), are deferred and recognised as an adjustment to the effective interest rate.

- (ii) *Commitment fees received by the entity to originate a loan when the loan commitment is outside the scope of IFRS 9.*

If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of IFRS 9, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related transaction costs (as defined in IAS 39), is deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry. Loan commitments that are within the scope of IFRS 9 are accounted for as derivatives and measured at fair value.

- (iii) *Origination fees received on issuing financial liabilities measured at amortised cost.*

These fees are an integral part of generating an involvement with a financial liability. When a financial liability is not classified as at fair value through profit or loss, the origination fees received are included, with the related transaction costs (as defined in IAS 39) incurred, in the initial carrying amount of the financial liability and recognised as an adjustment to the effective interest rate. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

- (b) *Fees earned as services are provided.*

(i) ...

- (ii) *Commitment fees to originate a loan when the loan commitment is outside the scope of IFRS 9.*

If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of IFRS 9, the commitment fee is recognised as revenue on a time proportion basis over the commitment period. Loan commitments that are within the scope of IFRS 9 are accounted for as derivatives and measured at fair value.

(iii) ...

IAS 27 Consolidated and Separate Financial Statements

IGA21 Paragraph IG7 is amended to read as follows:

IG7 IFRS 9 *Financial Instruments* does not apply to interests in subsidiaries, associates and jointly controlled entities that are consolidated, accounted for using the equity method or proportionately consolidated in accordance with IAS 27, IAS 28 and IAS 31 respectively. When instruments containing potential voting rights in substance currently give access to the economic benefits associated with an ownership interest, and the investment is accounted for in one of the above ways, the instruments are not subject to the requirements of IFRS 9. In all other cases, instruments containing potential voting rights are accounted for in accordance with IFRS 9.

IGA22 A footnote is added to 'IAS 39' after the Table of Concordance as follows:

* In November 2009 and October 2010 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all financial items within the scope of IAS 39. This section refers to matters relevant when IAS 27 was issued.

IAS 32 Financial Instruments: Presentation

IGA23 Paragraph IE1 is amended to read as follows:

IE1 The following examples [footnote omitted] illustrate the application of paragraphs 15–27 and IFRS 9 to the accounting for contracts on an entity's own equity instruments (other than the financial instruments specified in paragraphs 16A and 16B or paragraphs 16C and 16D).

IGA24 In the example in paragraph IE5, the caption below the first journal entry is amended to read as follows:

To record the obligation to deliver CU104,000 in one year at its present value of CU100,000 discounted using an appropriate interest rate (see IFRS 9, paragraph B5.1.1).

IAS 37 Provisions, Contingent Liabilities and Contingent Assets

IGA25 Example 9 is amended to read as follows:

On 31 December 20X0, Entity A gives a guarantee of certain borrowings of Entity B, whose financial condition at that time is sound. During 20X1, the financial condition of Entity B deteriorates and at 30 June 20X1 Entity B files for protection from its creditors.

This contract meets the definition of an insurance contract in IFRS 4 *Insurance Contracts*, but is within the scope of IFRS 9 *Financial Instruments*, because it also meets the definition of a financial guarantee contract in IFRS 9. If an issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either IFRS 4 or IFRS 9 to such financial guarantee contracts. IFRS 4 permits the issuer to continue its existing accounting policies for insurance contracts if specified minimum requirements are satisfied. IFRS 4 also permits changes in accounting policies that meet specified criteria. The following is an example of an accounting policy that IFRS 4 permits and that also complies with the requirements in IFRS 9 for financial guarantee contracts within the scope of IFRS 9.

IAS 39 Financial Instruments: *Recognition and Measurement*

IGA26 Section C and Section D are deleted.

IGA27 The following Questions and Answers (Q&A) are deleted:

- Section B Definitions: B.1–B.23, B.28–B.32
- Section E Measurement: E.1, E.3, E.4.9, E.4.10
- Section F Hedged items: F.1.1, F.1.10, F.2.9–F.2.11, F.2.19, F.2.20

IGA28 In the answer to Question A.1, ‘IAS 39’ is amended to ‘IFRS 9’.

IGA29 In the answer to Question A.2, ‘exemption from IAS 39’ is amended to ‘exemption from paragraph 5 of IAS 39’.

IGA30 Question B.26 is amended to read as follows:

How is amortised cost calculated for financial assets measured at amortised cost in accordance with IFRS 9?

IGA31 In Question E.2.1 and the answer, ‘IAS 39.AG72’ is amended to ‘paragraph B5.4.4 of IFRS 9’.

IGA32 In the answer to Question E.2.2, ‘IAS 39.AG71’ is amended to ‘paragraph B5.4.3 of IFRS 9’.

IGA33 The answer to Question E.4.2 is amended to read as follows:

No. Paragraph 5.1.1 of IFRS 9 requires a financial asset to be initially measured at fair value. For a loan asset, the fair value is the amount of cash lent adjusted for any fees and costs (unless a portion of the amount lent is compensation for other stated or implied rights or privileges). In addition, paragraph 5.2.2 of IFRS 9 requires an entity to apply the impairment requirements in IAS 39. IAS 39.58 requires that an impairment loss is recognised only if there is objective evidence of impairment as a result of a past event that occurred after initial recognition. Accordingly, it is inconsistent with paragraph 5.1.1 of IFRS 9 and IAS 39.58 to reduce the carrying amount of a loan asset on initial recognition through the recognition of an immediate impairment loss.

IGA34 Question E.4.5 is amended to read as follows:

A financial institution calculates impairment in the unsecured portion of financial assets measured at amortised cost on the basis of a provision matrix that specifies fixed provision rates for the number of days a financial asset has been classified as non-performing (zero per cent if less than 90 days, 20 per cent if 90–180 days, 50 per cent if 181–365 days and 100 per cent if more than 365 days). Can the results be considered to be appropriate for the purpose of calculating the impairment loss on the financial assets measured at amortised cost under IAS 39.63?

IGA35 The last sentence of the answer to Question F.1.2 is amended to read as follows:

However, if the foreign currency component of the sales commitment is required to be separated as an embedded derivative under paragraphs 4.3.3 and B4.3.8(d) of IFRS 9, it could be designated as a hedging instrument in a hedge of the exposure to changes in the fair value of the maturity amount of the debt attributable to foreign currency risk.

IGA36 The last sentence of the answer to Question F.1.4 is deleted.

IGA37 The answer to Question F.2.1 is amended to read as follows:

No. Derivative instruments always meet the definition of held for trading and are measured at fair value with gains and losses recognised in profit or loss unless they are designated and effective hedging instruments (IAS 39.9 and IFRS 9 paragraphs 4.1.1–4.1.5, 5.7.1 and 5.7.3). As an exception, IAS 39.AG94 permits the designation of a purchased option as the hedged item in a fair value hedge.

IGA38 The answer to Question F.2.5 is amended to read as follows:

Yes. A derivative instrument that will be settled gross can be designated as the hedging instrument in a cash flow hedge of the variability of the consideration to be paid or received in the future transaction that will occur on gross settlement of the derivative contract itself because there would be an exposure to variability in the purchase or sale price without the derivative. This applies to all fixed price contracts that are accounted for as derivatives under IAS 39 and IFRS 9.

For example, if an entity enters into a fixed price contract to sell a commodity and that contract is accounted for as a derivative under IAS 39 and IFRS 9 (for example, because the entity has a practice of settling such contracts net in cash or of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer’s margin), the entity may designate the fixed price contract as a cash flow hedge of the variability of the consideration to be received

on the sale of the asset (a future transaction) even though the fixed price contract is the contract under which the asset will be sold. Also, ...

IGA39 Q&A F.2.13 is amended to read as follows:

Is fair value hedge accounting permitted for exposure to interest rate risk in fixed rate loans that are measured at amortised cost?

Yes. Under IFRS 9, some fixed rate loans are measured at amortised cost. Banking institutions in many countries hold the bulk of their fixed rate loans to collect their contractual cash flows. Thus, changes in the fair value of such fixed rate loans that are due to changes in market interest rates will not affect profit or loss. IAS 39.86 specifies that a fair value hedge is a hedge of the exposure to changes in fair value that is attributable to a particular risk and that can affect profit or loss. Therefore, IAS 39.86 may appear to preclude fair value hedge accounting for fixed rate loans. However, the entity could sell them and the change in fair values would affect profit or loss. Thus, fair value hedge accounting is permitted for fixed rate loans.

IGA40 The last paragraph of the answer to Question F.2.17 is amended to read as follows:

To illustrate: Entity A acquires a 10 per cent fixed rate government bond with a remaining term to maturity of ten years. Entity A classifies the bond as measured at amortised cost. To hedge itself against fair value exposure on the bond associated with the present value of the interest rate payments until year 5, Entity A acquires a five-year pay-fixed, receive-floating swap. ...

IGA41 In the answer to Question F.5.6, references to 'IAS 39.43' are replaced with 'paragraph 5.1.1 of IFRS 9' and 'IAS 39.55' are replaced with 'paragraph 5.7.1 of IFRS 9'.

IGA42 In the answer to Question F.6.4, 'IAS 39' in the second sentence is amended to 'IAS 39 or IFRS 9'.

IGA43 Q&A G.1 is amended to read as follows:

IFRS 9 requires remeasurement of financial assets and financial liabilities measured at fair value. Unless a financial asset or a financial liability is designated as a cash flow hedging instrument, fair value changes for financial assets and financial liabilities at fair value through profit or loss are recognised in profit or loss, and fair value changes for financial assets designated as at fair value through other comprehensive income are recognised in other comprehensive income. What disclosures are required regarding the amounts of the fair value changes during a reporting period?

IFRS 7.20 requires items of income, expense and gains and losses to be disclosed. This disclosure requirement encompasses items of income, expense and gains and losses that arise on remeasurement to fair value. Therefore, an entity provides disclosures of fair value changes, distinguishing between changes that are recognised in profit or loss and changes that are recognised in other comprehensive income. Further breakdown is provided of changes that relate to:

- (a) financial assets or financial liabilities measured at fair value through profit or loss, showing separately those on financial assets or financial liabilities designated as such upon initial recognition, and those on financial assets or financial liabilities that are mandatorily measured at fair value in accordance with IFRS 9. For financial liabilities designated as at fair value through profit or loss, an entity shall show separately the amount of gain or loss recognised in other comprehensive income and the amount recognised in profit or loss;
- (b) financial assets measured at fair value through other comprehensive income; and
- (c) hedging instruments.

In addition, IFRS 7.11A and IFRS 7.11B require an entity to disclose the amount of gain or loss recognised in other comprehensive income for financial assets measured at fair value through other comprehensive income, including any amount transferred within equity.

IFRS 7 neither requires nor prohibits disclosure of components of the change in fair value by the way items are classified for internal purposes. For example, an entity may choose to disclose separately the change in fair value of those derivatives that meet the definition of held for trading in IFRS 9, but the entity classifies as part of risk management activities outside the trading portfolio.

In addition, IFRS 7.8 requires disclosure of the carrying amounts of financial assets or financial liabilities at fair value through profit or loss, showing separately: (i) those designated as such upon initial recognition; (ii) financial assets mandatorily classified as such in accordance with IFRS 9; (iii) financial liabilities that meet the definition of held for trading in IFRS 9; and (iv) disclosures of financial assets measured at fair value through other comprehensive income.

IFRIC 12 Service Concession Arrangements

IGA44 Paragraphs IE7 and IE28 are amended to read as follows:

IE7 IFRS 9 *Financial Instruments* may require the entity to measure the amounts due from the grantor at amortised cost, unless the entity designates those amounts as measured at fair value through profit or loss. If the receivable is measured at amortised cost in accordance with IFRS 9, it is measured initially at fair value and subsequently at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount calculated using the effective interest method minus repayments.

IE28 IFRS 9 *Financial Instruments* may require the entity to measure the amount due from or at the direction of the grantor in exchange for the construction services at amortised cost. If the receivable is measured at amortised cost in accordance with IFRS 9, it is measured initially at fair value and subsequently at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount minus repayments.

Tables of Concordance

This table shows how the contents of IAS 39 and IFRS 9 correspond. In transferring the material from IAS 39 to IFRS 9 some minor editorial changes have been necessary.

Paragraph in IAS 39 (as amended by IFRS 9 in 2009)	Paragraphs in IFRS 9 (October 2010)
1—deleted	
2–8—not moved	
9—the following definitions are moved to IFRS 9: <ul style="list-style-type: none"> • derecognition • derivative • fair value • financial guarantee contract • financial liability at fair value through profit or loss • held for trading • regular way purchase or sale 	The definitions noted were added to Appendix A
10	4.3.1
11–13	4.3.3–4.3.7
14	3.1.1
15–37	3.2.1–3.2.23
38	3.1.2
39–42	3.3.1–3.3.4
43, 44	5.1.1, 5.1.2
47	4.2.1
48–49	5.4.1–5.4.3
50, 50A	4.4.2, 4.4.3
53 and 54—deleted	
55	5.7.1
56	5.7.2, 5.7.3
57	5.7.4
AG94–AG95—not moved	
AG96—deleted	AG96—deleted

Paragraph in IAS 39 (as amended by IFRS 9 in 2009)	Paragraphs in IFRS 9 (October 2010)
58–65—not moved	
71–102—not moved	
103–103G—not moved	
103H–103J—deleted	
103M	7.2.9
105–107A—deleted	
108–108C—not moved	
109–110—not moved	
AG1–AG4A—not moved	
AG4B–AG4K	B4.1.27–B4.1.36
AG5–AG8—not moved	
AG9–AG12A	BA.1–BA.5
AG13—not moved	
AG14–AG15	BA.6–BA.8
AG27–AG33B	B4.3.1–B4.3.10
AG34, AG35	B3.1.1, B3.1.2
AG36–AG52	B3.2.1–B3.2.17
AG53–AG56	B3.1.3–B3.1.6
AG57–AG63	B3.3.1–B3.3.7
AG64	B5.1.1
AG69–AG79	B5.4.1–B5.4.12
AG80, AG81—deleted	
AG82	B5.4.13
AG83	B5.7.2, B5.7.4
AG84–AG93—not moved	
AG97–AG133—not moved	AG97–AG133—not moved

This table shows how the contents of IFRS 9 (issued in November 2009) and IFRS 9 (issued in October 2010) correspond.

Paragraph in IFRS 9 (November 2009)	Paragraphs in IFRS 9 (October 2010)
1.1	1.1
2.1	2.1
3.1.1	3.1.1
3.1.2	Replaced by amended 3.1.2
4.1	4.1.1
4.2	4.1.2
4.3	4.1.3
4.4	4.1.4
4.5	4.1.5
4.6	4.3.1
4.7	4.3.2
4.8	Replaced by 4.3.3–4.3.7
4.9	4.4.1
5.1.1	5.1.1
5.2.1	5.2.1
5.2.2	5.2.2
5.2.3	5.2.3
5.3.1	5.6.1
5.3.2	5.6.2
5.3.3	5.6.3
5.4.1	Replaced by 5.7.1
5.4.2	5.7.2
5.4.3	Replaced by 5.7.3
5.4.4	5.7.5
5.4.5	5.7.6
8.1.1	Replaced by 7.1.1
8.2.1	7.2.1
8.2.2	7.2.2
8.2.3	7.2.3
8.2.4	7.2.4
8.2.5	7.2.5
8.2.6	7.2.6
8.2.7	7.2.7
8.2.8	7.2.8

Paragraph in IFRS 9 (November 2009)	Paragraphs in IFRS 9 (October 2010)
8.2.9	Replaced by 7.2.9
8.2.10	7.2.10
8.2.11	7.2.11
8.2.12	7.2.14
8.2.13	7.2.15
B4.1	B4.1.1
B4.2	B4.1.2
B4.3	B4.1.3
B4.4	B4.1.4
B4.5	B4.1.5
B4.6	B4.1.6
B4.7	B4.1.7
B4.8	B4.1.8
B4.9	B4.1.9
B4.10	B4.1.10
B4.11	B4.1.11
B4.12	B4.1.12
B4.13	B4.1.13
B4.14	B4.1.14
B4.15	B4.1.15
B4.16	B4.1.16
B4.17	B4.1.17
B4.18	B4.1.18
B4.19	B4.1.19
B4.20	B4.1.20
B4.21	B4.1.21
B4.22	B4.1.22
B4.23	B4.1.23
B4.24	B4.1.24
B4.25	B4.1.25
B4.26	B4.1.26
B5.1	B5.1.1
B5.2	B5.1.2
B5.3	B5.2.1
B5.4	B5.2.2
B5.5	B5.4.14

Paragraph in IFRS 9 (November 2009)	Paragraphs in IFRS 9 (October 2010)
B5.6	B5.4.15
B5.7	B5.4.16
B5.8	B5.4.17
B5.9	B4.4.1
B5.10	B4.4.2
B5.11	B4.4.3

Paragraph in IFRS 9 (November 2009)	Paragraphs in IFRS 9 (October 2010)
B5.12	B5.7.1
B5.13	B5.7.2
B5.14	B5.7.3
B5.15	B5.7.4
B8.1	B7.2.1