International Financial Reporting Standards (IFRSs) together with their accompanying documents are issued by the International Accounting Standards Board (IASB):

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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
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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	
Jan Engström	
Patrick Finnegan	
Amaro Luiz de Oliveira Gomes	
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CONTENTS

BASIS FOR CONCLUSIONS ON IFRS 9 *FINANCIAL INSTRUMENTS*

Basis for Conclusions on IFRS 9 *Financial Instruments*

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

Introduction

BC1 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.

BC2 The Board has long acknowledged the need to improve the requirements for financial reporting of financial instruments to make it easier for users of financial statements to understand financial reporting information. To meet the heightened urgency of that need in the light of the financial crisis, the Board proposes to replace IAS 39 *Financial Instruments: Recognition and Measurement* by the end of 2010. To make progress as quickly as possible the Board has 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 BC91(b), BC93 and BC113–BC117 discuss issues relating to insurance contracts.)

BC3 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. As a result, in November 2009 the Board finalised the first part 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 any financial reporting standard, 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.

BC4 The Board sees this first phase of the project to replace IAS 39 as a stepping stone to future improvements in the financial reporting of financial instruments and is committed to completing its project on financial instruments expeditiously. The Board is also committed to the convergence of IFRSs and US GAAP requirements for financial instruments. There are many detailed differences between them, making it impossible to achieve convergence on the basis of existing requirements. The Board will consider publishing for comment any proposals that the US Financial Accounting Standards Board (FASB) may publish, to the extent that they are different from IFRSs or proposed IFRSs.

Scope

BC5 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.

BC6 The exposure draft contained proposals for all items within the scope of IAS 39. However, some respondents to the exposure draft said that the Board should restrict its proposals on classification and measurement to financial assets and retain the existing requirements for financial liabilities (including the requirements for embedded derivatives and the fair value option) until the Board has 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 that arise from its projects on own credit risk and other related projects more fully before finalising the requirements for classification and measurement of financial liabilities.

BC7 The Board noted those concerns and decided that IFRS 9 should at this stage apply only to assets within the scope of IAS 39. Thus, financial liabilities, including derivative liabilities, remain within the scope of IAS 39. Accordingly, this Basis for Conclusions discusses the responses to the exposure draft as they apply to the classification and measurement of financial assets. Taking this course will enable the Board to obtain further feedback on the accounting for financial liabilities, including how best to address accounting for changes in own credit risk.

Classification

BC8 In IFRS 9 the Board aimed to improve the ability of 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 to 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.

BC9 The Board believes that IFRS 9 both improves the ability of 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 improves the ability of users to understand the financial reporting of financial assets. IFRS 9 aligns the measurement attribute of financial assets to 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 improve the ability of users to understand the financial reporting of financial assets and to better assess the amounts, timing and uncertainty of future cash flows.

Measurement categories

BC10 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.

BC11 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.

BC12 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.

BC13 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 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.

BC14 Almost all respondents to the exposure draft 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.

BC15 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

BC16 Some respondents to the exposure draft 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.

BC17 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 *Financial Instruments: Disclosures* describes the levels in the fair value hierarchy[1]) 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.

BC18 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 7[2]. 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 classification

BC19 The exposure draft 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.

BC20 Most respondents supported classification based on 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.

BC21 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 comment letters that stated 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.

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1 IFRS 13 *Fair Value Measurement*, issued in May 2011, defines fair value and contains the 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 the valuation techniques used to measure fair value and for the related disclosures. As a consequence paragraph 27A of IFRS 7 has been deleted.

2 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 entity's business model

BC22 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 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.

BC23 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.

BC24 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 ...

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.

BC25 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.

BC26 Therefore, in response to the concerns noted in paragraph BC23, 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.

BC27 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.

BC28 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

BC29 The exposure draft 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.

BC30 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.

BC31 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.

BC32 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)

BC33 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 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.

BC34 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.

BC35 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.

BC36 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.

BC37 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.

BC38 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.

BC39 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.

BC40 The Board was persuaded that classification based solely on 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.

BC41 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.

BC42 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 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.

BC43 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

BC44 The exposure draft 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.

BC45 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.

BC46 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.

BC47 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 4.2, they are measured at amortised cost.

Alternative approaches to classification

BC48 In its deliberations leading to the exposure draft, 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.

BC49 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 BC48(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 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 BC48(a) and (b).

BC50 Respondents noted that the alternative approach described in paragraph BC48 and both variants described in paragraph BC49 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.

BC51 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

BC52 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 inconsistent with the classification approach. However, 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 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.

Embedded derivatives

BC53 An embedded derivative is a derivative component of a hybrid (combined) 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 requires 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.

BC54 Many respondents to the discussion paper *Reducing Complexity in Reporting Financial Instruments* commented that the requirements and guidance in IAS 39 are complex, rule-based and internally inconsistent. Respondents, and others, also noted the many application problems that arise 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.

BC55 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).

BC56 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 in IAS 39 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.

BC57 Therefore, the exposure draft 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.

BC58 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.

BC59 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 BC58(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.

Because the Board decided that the scope of IFRS 9 at this stage should be assets within the scope of IAS 39, this decision applies only to hybrid contracts with financial asset hosts.

BC60 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.

Option to designate a financial asset at fair value

BC61 IAS 39 allows 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 described in paragraph 11A of IAS 39 are met) and the entity elects to account for the hybrid (combined) contract in its entirety.

BC62 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 BC61(b) and (c) are unnecessary for financial assets.

BC63 The Board retained the eligibility condition described in paragraph BC61(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 BC61(a) as part of the future exposure draft on hedge accounting.

BC64 Almost all the respondents to the exposure draft 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.

Reclassification between fair value and amortised cost categories

BC65 The exposure draft 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.

BC66 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.

BC67 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.

BC68 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.

BC69 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.

BC70 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.

BC71 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.

BC72 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.

BC73 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.

BC74 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.

Measurement

Exception in IAS 39 from fair value measurement for some unquoted equity instruments[3] (and some derivatives linked to those instruments)

BC75 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 contains 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 are 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.

BC76 The exposure draft 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

3 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)'.

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 requires 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.

BC77 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 the exception, but suggested that disclosures would have to include information about the uncertainties surrounding measurement.

BC78 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.

BC79 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 believe that, given the lack of available reliable information, any fair value measurement would require significant management judgement or might be impossible. They also believe 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.

(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[4] 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.

BC80 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.

BC81 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 information to users of financial statements. Those disadvantages would not be offset by the benefit of reduced cost to preparers of financial statements.

Gains and losses

Investments in equity instruments

BC82 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.

BC83 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.

BC84 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.

BC85 Almost all respondents to the exposure draft 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.

BC86 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 may remain because dividends could represent a return of investment, rather than a return on

[4] 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)'.

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 accordance with IFRS 9[5]. 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.

BC87 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.

BC88 IFRS 9 amends IFRS 7 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.

BC89 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.

Effective date

BC90 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.

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5 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.

BC91 In the response to the exposure draft, 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 to 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.

BC92 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.

BC93 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.

BC94 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 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.

BC95 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.

Mandatory Effective Date of IFRS 9—November 2011

BC95A 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.

BC95B 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.

BC95C 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.

BC95D 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.

BC95E 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

BC95F 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)) 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

BC95G 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

BC96 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 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.

BC97 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.

BC98 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.

BC99 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

BC100 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.

BC101 The Board noted that an entity would not have determined the fair value of an investment in an unquoted equity instrument[6] (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 fair value retrospectively without using hindsight. Accordingly, IFRS 9 requires such instruments to be measured at fair value at the date of initial application.

6 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)’.

Hybrid contracts

BC102 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.

BC103 The proposals in the exposure draft 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 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

BC104 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 fair value option

BC105 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

BC106 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.

BC107 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 on or after 1 January 2012.

Date of initial application

BC108 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

BC109 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

BC110 The exposure draft 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.

BC111 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 for future phases

BC112 The Board does not intend to require entities that apply IFRS 9 early also to apply early any future requirements arising from the project to improve IAS 39. However, to reduce the number of versions of IFRSs that can be applied, the Board intends that any future additions to IFRS 9 can be applied only if the entity also applies requirements published before them.

Transitional insurance issues

BC113 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.

BC114 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.

BC115 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

BC116 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.

BC117 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 BC84, 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

BC117A 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.

BC117B 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.

BC117C 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.

BC117D 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.

BC117E 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.

BC117F 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.

BC117G 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.

BC117H 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.

BC117I 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.

BC117J 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.

BC117K 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.

BC117L 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.

BC117M 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.

Summary of main changes from the exposure draft

BC118 The main changes from the exposure draft are:

(a) At this stage, IFRS 9 deals 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 has been 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 are 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.

Cost-benefit considerations

BC119 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.

BC120 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 result of improved financial reporting; and

(e) the costs of transition for users, preparers and others.

BC121 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.

BC122 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.

BC123 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 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. Amended paragraphs *are shown with new text underlined and deleted text struck through.*

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

IFRS 1 (as revised in November 2008)

BCA1 The Basis for Conclusions on IFRS 1 is amended as described below.

In paragraph BC58A a footnote is added to the reference to 'IAS 39' as follows:

> * In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.
>
> In paragraphs BC63A, BC89 and BC89A the first reference to 'IAS 39' is footnoted as follows:
>
> * In November 2009 the IASB 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 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. This paragraph refers to matters relevant when IFRS 1 was issued.

In paragraph BC65 the reference to IAS 39 and in paragraph BC66 the first reference to 'IAS 39' are footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, amended the requirements in IAS 39 to identify and separately account for derivatives embedded in a financial host within the scope of IFRS 9. The requirements in IAS 39 continue to apply for derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9. This Basis for Conclusions has not been updated for changes in requirements since IFRIC 9 *Reassessment of Embedded Derivatives* was issued in March 2006.

In paragraph BC74 the reference to 'IAS 39' is footnoted as follows:

> * In November 2009 the IASB 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 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. Paragraphs BC74(b) and (c) and BC81–BC83A discuss matters relevant when IFRS 1 was issued.

The heading 'Available-for-sale financial assets' above paragraph BC81 is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets. Paragraphs BC81–BC83A discuss matters relevant when IFRS 1 was issued.

IFRS 2 *Share-based Payment*

BCA2 In the Basis for Conclusions on IFRS 2 the heading above paragraph BC25 is footnoted as follows:

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

IFRS 3 *Business Combinations*

BCA3 The Basis for Conclusions on IFRS 3 is amended as described below.

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

> * In November 2009 the IASB 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 *Financial*

Instruments. IFRS 9 applies to all assets within the scope of IAS 39. This paragraph discusses matters relevant when IFRS 3 was issued.

In paragraph BC244 the reference to 'IAS 39' is footnoted as follows:

* In November 2009 the IASB relocated to IFRS 9 *Financial Instruments* the requirements on the accounting for financial guarantees and commitments to provide loans at below-market interest rates.

IFRS 4 *Insurance Contracts*

BCA4 The Basis for Conclusions on IFRS 4 is amended as described below.

In paragraph BC11 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*', in paragraphs BC22(c) and BC146 the first reference to 'IAS 39' and in paragraphs BC28(b), BC40, BC41(b), BC55, BC73(d) and BC82 the references to 'IAS 39' are footnoted as follows:

* In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. This paragraph discusses matters relevant when IFRS 4 was issued.

In paragraphs BC47 and BC161 the reference to 'IAS 39' is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009, amended the requirements in IAS 39 to identify and separately account for derivatives embedded in a financial host within the scope of IFRS 9. The requirements in IAS 39 continue to apply for derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9. This Basis for Conclusions has not been updated for changes in requirements since IFRIC 9 *Reassessment of Embedded Derivatives* was issued in March 2006.

In paragraph BC145(b) 'available for sale' is footnoted as follows:

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

The heading 'Issues related to IAS 39' above paragraph BC166 is footnoted as follows:

* In November 2009 the IASB 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 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. Paragraphs BC166–BC194 discuss matters relevant when IFRS 4 was issued.

BCA5 In the dissenting opinions on IFRS 4 the headings above paragraphs DO7, DO9 and DO18 are footnoted as follows:

* In November 2009 the IASB 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 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

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

BCA6 The Basis for Conclusions on IFRS 5 is amended as described below.

In paragraph BC8(b) the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

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

In paragraph BC13 the footnote to 'IAS 39' is deleted and replaced by the following footnote:

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

In paragraph BC54(b) the reference to 'IAS 39' is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of held-for-trading financial assets. Paragraph BC54 discusses matters relevant when IFRS 5 was issued.

In paragraph BC58 the reference to 'available-for-sale' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets. Paragraph BC58 discusses matters relevant when IFRS 5 was issued.

IFRS 7 *Financial Instruments: Disclosures*

BCA7 The Basis for Conclusions on IFRS 7 is amended as described below.

In the rubric below the title a paragraph is added as follows:

In November 2009 the requirements of IAS 39 *relating to classification and measurement of assets within the scope of* IAS 39 *were relocated to IFRS 9* Financial Instruments. *The text of this Basis for Conclusions has been marked up to reflect those changes: new text is underlined and deleted text is struck through.*

Paragraph BC14 is amended to read as follows:

BC14 Paragraph 8 requires entities to disclose financial assets <u>by the measurement categories in IFRS 9 *Financial Instruments*</u> and financial liabilities by the measurement categories in IAS 39 *Financial Instruments: Recognition and Measurement*. 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.

Paragraph BC15 is amended to read as follows:

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

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

Reclassification (paragraphs 12B ~~and 12A~~<u>–12D</u>)

BC23B In November 2009 the Board revised the requirements relating to reclassification of financial assets in IFRS 9 *Financial Instruments*. Accordingly, the Board revised the disclosure requirements relating to 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 categories in IAS 39 <u>and measurement classifications in IFRS 9</u> (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 IAS 39 <u>and IFRS 9</u>.

BC34 Some entities include interest and dividend income in gains and losses on financial assets and financial liabilities ~~held for trading~~ <u>measured at fair value through profit or loss</u> 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 ~~held for trading~~ <u>measured at fair value through profit or loss</u> include interest and dividend income (see Appendix B, paragraph B5(e)).

IAS 1 *Presentation of Financial Statements*

BCA8 The Basis for Conclusions on IAS 1 is amended as described below.

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

> * In November 2009 the IASB 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 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. Paragraphs BC38A–BC38D discuss matters relevant when IAS 1 was issued.

In paragraphs BC49 and BC69 the references to 'available-for-sale' are footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets. This paragraph discusses matters relevant when IAS 1 was issued.

In paragraphs BC77 the reference to 'held-to-maturity investments' is footnoted as follows:

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

IAS 17 *Leases*

BCA9 In the Basis for Conclusions on IAS 17 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC21 is footnoted as follows:

> * In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.

BCA10 [Deleted by IASB]

IAS 27 *Consolidated and Separate Financial Statements*

BCA11 The Basis for Conclusions on IAS 27 is amended as described below.

In paragraph BC22 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

> * In November 2009 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.

In paragraphs BC65–BC66C the references to IAS 39 are footnoted as follows:

BC65 Paragraph 29 of IAS 27 (as revised in 2000) permitted investments in subsidiaries to be measured in any one of three ways in a parent's separate financial statements. These were cost, the equity method or as available-for-sale financial assets in accordance with IAS 39*. Paragraph 12 of IAS 28 (as revised in 2000) permitted the same choices for investments in associates in separate financial statements, and paragraph 38 of IAS 31 (as revised in 2000) mentioned that IAS 31 did not indicate a preference for any particular treatment for accounting for interests in jointly controlled entities in a venturer's separate financial statements. The Board decided to require use of cost or IAS 39[‡] for all investments included in separate financial statements.

BC66 Although the equity method would provide users with some profit and loss information similar to that obtained from consolidation, the Board noted that such information is reflected in the investor's economic entity financial statements and does not need to be provided to the users of its separate financial statements. For separate statements, the focus is upon the performance of the assets as investments. The Board concluded that separate financial statements prepared using either the fair value method in accordance with IAS 39[‡] or the cost method would be relevant. Using the fair value method in accordance with IAS 39[‡] would provide a measure of the economic value of the investments. Using the cost method can result in relevant information, depending on the purpose of preparing the separate financial statements. For example, they may be needed only by particular parties to determine the dividend income from subsidiaries.

BC66A As part of its annual improvements project begun in 2007, the Board identified an apparent inconsistency with IFRS 5. The inconsistency relates to the accounting by a parent in its separate financial statements when investments it accounts for in accordance with IAS 39[‡] are classified as held for sale in accordance with IFRS 5. Paragraph 38 requires an entity that prepares separate financial statements to account for such investments that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5. However, financial assets that an entity accounts for in accordance with IAS 39[‡] are excluded from IFRS 5's measurement requirements.

BC66B Paragraph BC13 of the Basis for Conclusions on IFRS 5 explains that the Board decided that non-current assets should be excluded from the measurement scope of IFRS 5 only 'if (i) they are already carried at fair value with changes in fair value recognised in profit or loss or (ii) there would be difficulties in determining their fair value less costs to sell.' The Board acknowledged in the Basis for Conclusions on IFRS 5 that not all financial assets within the scope of IAS 39[‡] are recognised at fair value with changes in fair value recognised in profit or loss, but it did not want to make any further changes to the accounting for financial assets at that time.

BC66C Therefore, the Board amended paragraph 38 by *Improvements to IFRSs* issued in May 2008 to align the accounting in separate financial statements for those investments that are accounted for in accordance with IAS 39[‡] with the measurement exclusion that IFRS 5 provides for other assets that are accounted for in accordance with IAS 39 before classification as held for sale. Thus, an entity should continue to account for such investments in accordance with IAS 39 when they meet the held for sale criteria in IFRS 5.

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

[†] 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 *Financial Instruments*.

BCA12 In the dissenting opinions on the amendments issued in May 2008, the references to IAS 39 are footnoted as follows:

DO3 These Board members acknowledge that a new parent could choose to apply paragraph 38(b) of IAS 27 and account for its investment in the original parent in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.[‡] However, the new parent then would be required to account for the investment in accordance with IAS 39[‡] in subsequent periods and to account for all other investments in the same category in accordance with IAS 39[‡].

[†]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 *Financial Instruments*.

IAS 28 *Investments in Associates*

BCA13 The Basis for Conclusions on IAS 28 is amended as described below.

In paragraph BC7 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

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

In paragraph BC9 the first reference to 'IAS 39' is footnoted as follows:

* 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 *Financial Instruments*. IFRS 9 eliminated the available-for-sale category 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.

In paragraph BC22 the first reference to 'IAS 39' is footnoted as follows:

* 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 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

In paragraph BC26 the reference to 'IAS 39' is footnoted as follows:

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

IAS 31 *Investments in Joint Ventures*

BCA14 The Basis for Conclusions on IAS 31 is amended as described below.

In paragraph BC7 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

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

In paragraph BC9 the first reference to IAS 39 is footnoted as follows:

* 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 *Financial*

Instruments. IFRS 9 eliminated the available-for-sale category 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.

In paragraph BC17 the first reference to 'IAS 39' is footnoted as follows:

* In November 2009 the IASB 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 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

IAS 32 *Financial Instruments: Presentation*

BCA15 The Basis for Conclusions on IAS 32 *Financial Instruments: Presentation* is amended as described below.

In paragraph BC2 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

* In November 2009 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.

In paragraph BC25 the reference to 'IAS 39, paragraph 43' is footnoted as follows:

* In November 2009 the requirements of IAS 39, paragraph 43 relating to the initial measurement of financial assets were relocated to paragraph 5.1.1 of IFRS 9 *Financial Instruments*.

In paragraphs BC26, BC29 and BC53(a), the references to 'IAS 39' are footnoted as follows:

* In November 2009 the requirements on measurement of assets within the scope of IAS 39 were moved from IAS 39 to IFRS 9 *Financial Instruments*.

IAS 39 *Financial Instruments: Recognition and Measurement*

BCA16 The Basis for Conclusions on IAS 39 *Financial Instruments: Recognition and Measurement* is amended as described below.

The following paragraph is added to the rubric:

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* 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.*

The following are 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.

The following footnotes are added:

At the end of paragraph BC11E	Superseded by IFRS 9 *Financial Instruments*
At the end of paragraph BC11F	IFRS 9 *Financial Instruments* applies to combined instruments in which a derivative is embedded in a host that is within the scope of IFRS 9. However, the requirements of IAS 39 continue to apply to derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9.
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 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.
At the end of paragraph BC16	IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of loans and receivables.

To the heading above paragraph BC37	IFRS 9 *Financial Instruments* applies to combined instruments in which a derivative is embedded in a host that is within the scope of IFRS 9. However, the requirements of IAS 39 continue to apply to derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9.
To the heading above paragraph BC40A	IFRS 9 *Financial Instruments* applies to combined instruments in which a derivative is embedded in a host that is within the scope of IFRS 9. However, the requirements of IAS 39 continue to apply to derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9.
The second sentence in paragraph BC40B	IFRS 9 *Financial Instruments* eliminated the requirement to separate embedded derivatives from financial hosts within the scope of IFRS 9. However, this amendment is still relevant to derivatives embedded in host insurance contracts and other host contracts outside the scope of IFRS 9.
To the heading 'Recognition and derecognition' above paragraph BC41	In November 2009 the requirements for the recognition of assets within the scope of IAS 39 were relocated in IFRS 9 *Financial Instruments*.
To the heading 'Measurement' above paragraph BC70A	The relevant paragraphs relating to measurement of assets within the scope of IAS 39 have been relocated in the Basis for Conclusions on IFRS 9 *Financial Instruments*. The remaining paragraphs still apply to financial liabilities within the scope of IAS 39 and have not been amended.
To the reference to 'IAS 39' in paragraph BC72	IFRS 9 *Financial Instruments* eliminated the loans and receivables and available-for-sale categories from IAS 39.
The reference to 'held-to'maturity' in paragraph BC80A	IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of held-to-maturity financial assets.
To the heading 'Impairment of investments in equity instruments' above paragraph BC105	IFRS 9 *Financial Instruments*, issued in November 2009, amended the measurement requirements for investments in equity instruments. However, the section on impairment remains relevant for assets that are measured at amortised cost in accordance with IFRS 9.
To the reference to 'loans and receivables' in paragraph BC111	IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of loans and receivables.
The reference to 'held-to-maturity' in paragraph BC201(f)	IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the held-to-maturity category.

IAS 40 *Investment Property*

BCA17 The Basis for Conclusions on IAS 40 *Investment Property* is amended as described below.

In paragraph BC8 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' and in paragraph BC9 the reference to 'IAS 39' are footnoted as follows:

> * 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 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

BCA18 The Basis for Conclusions on IAS 40 (2000) *Investment Property* is amended as described below:

In paragraph B35 the reference to 'IAS 39' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the held-to-maturity category.

In paragraph B63(a) the reference to 'IAS 39' is footnoted as follows:

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

The footnote to paragraph B67(a)(i) is amended as follows (new text underlined):

> † Paragraph 69 was replaced by paragraph 46 when the IASB revised IAS 39 in 2003. <u>In 2009 paragraph 46 of IAS 39 was replaced by paragraph 5.2.1 of IFRS 9 *Financial Instruments*.</u>

IAS 41 *Agriculture*

BCA19 The Basis for IASC's Conclusions on IAS 41 is amended as described below.

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

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

IFRIC 4 *Determining whether an Arrangement contains a Lease*

BCA20 The Basis for Conclusions on IFRIC 4 is amended as described below.

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

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

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

BCA21 The Basis for Conclusions on IFRIC 5 is amended as described below.

In paragraph BC6 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' and in paragraphs BC12, BC20 and BC24 the first reference in each to 'IAS 39' are footnoted as follows:

> * 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 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

In paragraph BC11 a footnote is added to the reference to 'IAS 39' as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the categories of available-for-sale and held-to-maturity financial assets.

IFRIC 9 *Reassessment of Embedded Derivatives*

BCA22 The Basis for Conclusions on IFRIC 9 is amended as described below.

In paragraph BC2 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, amended the requirements in IAS 39 to identify and separately account for derivatives embedded in a financial host within the scope of IFRS 9. The requirements in IAS 39 continue to apply for derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9.

IFRIC 10 *Interim Financial Reporting and Impairment*

BCA23 The Basis for Conclusions on IFRIC 10 is amended as described below.

In paragraphs BC2 and BC9 the references to 'IAS 39' are footnoted as follows:

> * In November 2009 the IASB 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 *Financial Instruments*. Consequently, no financial assets are carried at cost.

IFRIC 12 *Service Concession Arrangements*

BCA24 The Basis for Conclusions on IFRIC 12 is amended as described below.

In paragraph BC59 the reference to 'IAS 39' is footnoted as follows:

> * In November 2009 the IASB 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 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

The heading above paragraph BC60 is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, amended the requirements in IAS 39 for the classification of assets within the scope of IAS 39. This Basis for Conclusions has not been updated for changes in requirements since IFRIC 12 was issued.

IFRIC 17 *Distributions of Non-cash Assets to Owners*

BCA25 The Basis for Conclusions on IFRIC 17 is amended as described below.

In paragraph BC22 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

> * In November 2009 the IASB 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 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

Paragraph BC28(a) is footnoted as follows:

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

In paragraph BC29 the reference to paragraph AG81 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 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 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)'.

In paragraph BC32 the reference to 'IAS 39' is footnoted as follows:

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

In paragraph BC47(e) the reference to 'available-for-sale' is footnoted as follows:

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

Dissenting opinions

Dissenting opinion of James J Leisenring

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 BC56 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 B4.4, B4.13 and B4.14. 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* 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 BC27 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.

Dissenting opinion of Patricia McConnell

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 BC16–BC18 of the Board's Basis for Conclusions.

DO19 As stated in paragraph BC8, 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 though 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 BC27 and BC28 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.

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. In the amended paragraphs, new text is underlined and deleted text is struck through.*

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

IGA1 In the guidance on implementing IFRS 1 (both June 2003 and November 2008 versions), the heading above paragraph IG52 and paragraphs IG52-IG55, IG56, IG57, IG58, IG58A and IG59 are amended 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 and IAS 39 respectively, except as specified in paragraphs B2–B6 of the IFRS, which address derecognition and hedge accounting.

IG53 An entity recognises all financial assets and financial liabilities (including all derivatives) that qualify for recognition in accordance with IAS 39 and IFRS 9 and have not yet qualified for derecognition in accordance with IAS 39, 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 IAS 39.

IG54 An entity does not recognise financial assets and financial liabilities that do not qualify for recognition in accordance with IAS 39 or IFRS 9, or have already qualified for derecognition in accordance with IAS 39.

IG55 When IAS 39 requires an entity to separate an embedded derivative from a host contract outside the scope of IFRS 9, the initial carrying amounts of the components at the date when the instrument first satisfies the recognition criteria in IAS 39 reflect circumstances at that date (IAS 39 paragraph 11). If the entity cannot determine the initial carrying amounts of the embedded derivative and host contract reliably, it treats designates the entire combined contract as a financial instrument held for trading at fair value through profit or loss (IAS 39 paragraph 12). This results in fair value measurement (except when the entity cannot determine a reliable fair value, see IAS 39 paragraph 46(c)), with changes in fair value recognised in profit or loss.

IG56 In preparing its opening IFRS statement of financial position, an entity applies the criteria in IAS 39 and 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. In particular:

~~(a)~~ ~~to comply with ...~~

...

~~(e)~~ ~~... any of the previous categories.~~

IG57 For those financial assets and financial liabilities measured at amortised cost in the opening IFRS statement of financial position, an entity determines their cost on the basis of circumstances existing when the assets and liabilities first satisfied the recognition criteria in IAS 39 or IFRS 9. However,…..

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

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 ~~classified as held for trading~~ 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 ~~is~~ 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-~~IAS 39~~ IFRS 9 revaluation gain that had been recognised outside profit or loss is reclassified into retained earnings on initial application of ~~IAS 39~~ IFRS 9. If, on initial application of ~~IAS 39~~ IFRS 9, an investment in an equity instrument is classified as ~~available for sale~~ at fair value through other comprehensive income, then the pre-~~IAS 39~~ IFRS 9 revaluation gain is recognised in a separate component of equity. Subsequently, the entity recognises gains and losses on the ~~available-for-sale~~ 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. ~~until the investment is impaired, sold, collected or otherwise disposed of.~~ On subsequent derecognition ~~or impairment of the available-for-sale financial asset~~, the entity ~~reclassifies to profit or loss the cumulative gain or loss remaining in equity (IAS 39 paragraph 55(b)).~~ may transfer that separate component of equity within equity.

IGA2 IG Example 11 in paragraph IG63 is amended 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*	*Effect of transition to IFRSs*	*IFRSs*
		CU	CU	CU
1	Property, plant and equipment	8,299	100	8399
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

	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 as follows:

3 Financial assets are all classified as ~~available for sale~~ <u>at fair value through profit or loss</u> 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 ~~the revaluation surplus~~ <u>retained earnings</u>.

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
Increase in deferred tax liability	460

Because the tax base at 1 January 20X4 of the items reclassified from intangible assets to goodwill (note 2) equaled 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	773

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

Reconciliation of total comprehensive income for 20X4

Note		*Previous GAAP*	*Effect of transition to IFRSs*	*IFRSs*
		CU	CU	CU
	Revenue	20,910	0	20,910
1, 2, 3	Cost of sales	(15,283)	(97)	(15,380)
	Gross profit	5,627	(97)	5,520
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 as follows:

6	~~Available-for-sale f~~ Financial assets at fair value through profit or loss ~~carried at fair value in accordance with IFRSs~~ 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'. ~~The entity sold available-for-sale financial assets during the year, recognising a gain of CU40 in profit or loss. Of that realised gain CU30 had been included in the revaluation surplus as at 1 January 20X4 and is reclassified from revaluation surplus to profit or loss (as a reclassification adjustment).~~

IFRS 4 *Insurance Contracts*

IGA3 The guidance on implementing IFRS 4 is amended as described below.

In the table in IG Example 1, the 'Treatment in Phase I' column of contract type 1.18 is amended as follows:

> Insurance risk is insignificant. Therefore, the contract is a financial ~~instrument~~ asset within the scope of ~~IAS 39~~ IFRS 9. Servicing fees are within the scope of IAS 18 (recognise as services are provided, subject to various conditions).

IG Example 4 in paragraph IG10 is amended as follows:

IG Example 4: Shadow accounting

Background

...

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).

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. a~~vailable for sale. Thus insurer A measures the assets at fair value and recognises changes in their fair value in other comprehensive income.~~

In 20X5, insurer A recognises unrealised gains of CU10 on the assets backing the contract~~.~~ and ~~I~~in 20X6~~, insurer A~~ it sells the assets for an amount equal to their fair value at the end of 20X5 ~~and, to comply with IAS 39, reclassifies the now realised gain of CU10 from equity to profit or loss as a reclassification adjustment~~.

Application of paragraph 30 of the IFRS

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. ~~Because insurer A recognized the change in the fair value in other comprehensive income, it~~ Insurer A recognises the additional amortisation of CU2 in ~~other comprehensive income~~ profit or loss.

When insurer A sells the assets in 20X6, it makes no further adjustment to DAC.~~, but reclassifies DAC amortization of CU2, relating to the now realised gain, from equity to profit or loss as a reclassification adjustment.~~

In summary, shadow accounting treats an unrealised gain in the same way as a realised gain.~~, except that the unrealised gain and resulting DAC amortisiation are (a) recognised in other comprehensive income rather than in profit or loss and (b) reclassified from equity to profit or loss when the gain on the asset becomes realised.~~ If insurer A does not adopt shadow accounting, unrealized gains on assets do not affect the amortisation of DAC.

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

IGA3A In the guidance on implementing IFRS 5 in the tables in Example 10, both references to 'AFS financial assets' are replaced by 'Investments in equity instruments' and in the accompanying text the reference to 'AFS financial assets' is replaced by 'investments in equity instruments'. In the first table in Example 12 the reference to 'AFS financial asset' is replaced by 'Investments in equity instruments'.

IFRS 7 *Financial Instruments: Disclosures*

IGA4 In the guidance on implementing IFRS 7, the table in paragraph IG13A is amended to read as follows:

Assets measured at fair value

		Fair value measurement at end of the reporting period using:		
		Level 1	**Level 2**	**Level 3**
Description	**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.)

IGA5 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)

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.)

IGA6 Paragraph IG14 is amended as follows:

IG14 ... In these circumstances, the difference will be recognised in profit or loss in subsequent periods in accordance with IAS 39 (for financial liabilities) or IFRS 9 (for financial assets) and the entity's accounting policy. Such recognition ...

In the illustrative disclosure following paragraph IG14, the references to 'IAS 39' are replaced with 'IFRS 9'.

IGA7 Paragraph IG36 is amended 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~~, and other comprehensive income would have been CU2.8 million (20X1—CU3.2 million) higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as available for sale~~. 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~~, and other comprehensive income would have been CU3.0 million (20X1—CU3.4 million) lower, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as available for sale~~. 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*

IGA8 In the guidance on implementing IAS 1, the heading above paragraph IG7 and paragraphs IG7–IG9 are deleted. Paragraph IG2 is amended as follows:

IG2 The guidance is in ~~three~~ <u>two</u> sections. Paragraphs IG3–IG6 provide examples of the presentation of financial statements. Paragraphs IG7–IG9 <u>have been deleted.</u> ~~provide an example of the determination of reclassification adjustments for available-for-sale financial assets in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.~~ Paragraphs IG10 and IG11 provide examples of capital disclosures.

IGA9 In the illustrative financial statements, references to 'Available-for-sale financial assets' are replaced by 'Investments in equity instruments'. In the single statements 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 I: 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	(667)	–	(4,000)
Gains on property revaluation		933		3,367
Actuarial gains (losses) on defined benefit pension plans				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 [footnote omitted]		14,000		(9,334)
Other comprehensive income for the year		**(14,000)**		**28,000**

IGA10 The second paragraph in footnote (k) to the illustrative financial statements is amended as follows:

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

IGA11 The second paragraph in footnote (l) to the illustrative financial statements is amended as follows:

(l) The amount included in the translation, investment in equity instruments ~~available-for-sale~~ and cash flow hedge reserves represent 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*

IGA12 In the appendix to IAS 18, examples 5 and 14(a) are amended 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* and IAS 39 *Financial Instruments: Recognition and Measurement* apply ~~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 ~~IAS 39~~ is measured ~~classified~~ ~~as a financial asset '~~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.

...

IAS 27 *Consolidated and Separate Financial Statements*

IGA13 In the guidance on implementing IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates*, and IAS 31 *Interests in Joint Ventures*, paragraph IG7 is amended as follows:

IG7 IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments* do~~es~~ 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 IAS 39 and IFRS 9. In all other cases, instruments containing potential voting rights are accounted for in accordance with IAS 39 and IFRS 9.

IAS 39 *Financial Instruments: Recognition and Measurement*

IGA14 In the guidance on implementing IAS 39 the following Questions and Answers (Q&A) are deleted:

- Section B Definitions: B.12–B.23
- Section C Embedded Derivatives: C.3, C.5, C.11
- Section E Measurement: E.3.1, E.3.2, 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

IGA15 In the answer to Question B.4, the last paragraph is amended as follows:

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 IAS 39 and IFRS 9.

IGA16 In the answer to Question B.5, the reference to 'IAS 39' in the second last sentence is replaced with 'IAS 39 or IFRS 9'.

IGA17 Question B.26 is amended as follows:

~~Financial assets that are excluded from fair valuation and have a fixed maturity should be measured at amortised cost.~~ How is amortised cost calculated <u>for financial assets measured at amortised cost in accordance with IFRS 9</u>?

IGA18 In Q&As C.1 and C.2, references to ‘hybrid instrument’ are replaced with ‘hybrid contract’.

IGA19 Q&A C.6 is amended as follows:

Entity A <u>issues</u> ~~acquires~~ a five-year floating rate debt instrument ~~issued by Entity B~~. At the same time, it enters into a five-year pay-<u>fixed</u> ~~variable~~, receive-<u>variable</u> ~~fixed~~ interest rate swap with Entity <u>B</u>~~C~~. Entity A regards the combination of the debt instrument and swap as a synthetic fixed rate instrument ~~and classifies the instrument as a held-to-maturity investment, since it has the positive intention and ability to hold it to maturity~~. Entity A contends that separate accounting for the swap is inappropriate since IAS 39.AG33(a) 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 IAS 39 <u>or IFRS 9</u>. 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.

IGA20 In Q&A C.10, references to ‘combined instrument’ are replaced with ‘combined contract’.

IGA21 The tables in Q&A D.2.1 are amended to read as follows:

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)

IGA22 The tables in Q&A D.2.2 are amended to read as follows:

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

IGA23 In the answer to Question D.2.3, the second paragraph is amended as follows:

To illustrate: on 29 December 20X2 (trade date) Entity A enters into a contract to sell Note Receivable A, which is ~~carried~~ measured at amortised cost, in exchange for Bond B, which meets the definition of ~~will be classified as~~ 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 ~~loans and receivables~~ 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:

…

IGA24 The answer to Question E.1.1 is amended as follows:

For financial assets not measured at fair value through profit or loss, ~~incremental costs that are directly attributable to the acquisition of the asset, for example fees and commissions,~~ transaction costs are added to the fair value at initial recognition ~~amount originally recognised~~. For financial liabilities, transaction costs are deducted from the fair value at initial recognition. ~~directly related costs of issuing debt are deducted from the amount of debt originally recognised. For financial instruments that are measured at fair value through profit or loss, transaction costs are not added to the fair value measurement at initial recognition.~~

For financial instruments that are ~~carried~~ measured at amortised cost, ~~such as held-to-maturity investments, loans and receivables, and financial liabilities that are not at fair value through profit or loss,~~ 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.

~~For available-for-sale financial assets, transaction costs are recognised in other comprehensive income as part of a change in fair value at the next remeasurement. If an available-for-sale financial asset has fixed or determinable payments and does not have an indefinite life, the transaction costs are amortised to profit or loss using the effective interest method. If an available-for-sale financial asset does not have fixed or determinable payments and has an indefinite life, the transaction costs are recognised in profit or loss when the asset is derecognised or becomes impaired.~~

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

IGA25 Q&A E.3.3 is amended as follows:

E3.3 IFRS 9, IAS 39 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 states 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 ~~both~~ financial assets ~~classified as~~ measured at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* ~~and financial assets that are available for sale~~.

~~IAS 39.55 requires that changes in fair value of financial assets classified as at fair value through profit or loss should be recognised in profit or loss and changes in fair value of available-for-sale investments should be recognised in other comprehensive income.~~

If the foreign operation is a subsidiary whose financial statements are consolidated with those of its parent, in the consolidated financial statements how are ~~IAS 39.55~~ IFRS 9 and IAS 21.39 applied?

~~IAS 39~~ 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 ~~is~~ meets the definition of held for trading and is therefore measured ~~carried~~ at fair value ~~under IAS 39~~.

...

IGA26 Q&A E.3.4 is amended as follows:

E.3.4 IFRS 9, IAS 39 and IAS 21 Interaction between IFRS 9, IAS 39 and IAS 21

IFRS 9 and IAS 39 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 and IAS 39 applied?

Statement of financial position

Generally, the measurement of a financial asset or financial liability at fair value, cost or amortised cost is first determined in the foreign currency in which the item is denominated in accordance with IFRS 9 and IAS 39. Then, the foreign currency amount is translated into the functional currency using the closing rate or a historical rate in accordance with IAS 21 (IAS 39.AG83). For example, if a monetary financial asset (such as a debt instrument) is measured ~~carried~~ at amortised cost in accordance with IFRS 9 ~~under IAS 39~~, 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 cost, 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 ~~carried~~ measured at fair value in the foreign currency (IAS 21.23(c)) ~~and at a historical rate if it is not carried at fair value under IAS 39 because its fair value cannot be reliably measured (IAS 21.23(b) and IAS 39.46(c))~~.

...

Profit or loss

...

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 or in other comprehensive income in accordance with IAS 21 (IAS 39.AG83, 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 or in other comprehensive income in accordance with IFRS 9 or IAS 39. ~~For example, although an entity recognises gains and losses on available-for-sale monetary financial assets in other comprehensive income (IAS 39.55(b)), the entity nevertheless recognises the changes in the carrying amount relating to changes in foreign exchange rates in profit or loss (IAS 21.23(a)).~~

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 or IAS 39 (IAS 39.AG83). ~~For example, for available-for-sale financial assets the entire change in the carrying amount, including the effect of changes in foreign currency rates, is recognised in other comprehensive income.~~ 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, ~~for example, if the amortised cost of a foreign currency bond classified as available for sale has increased in foreign currency (resulting in a gain in profit or loss) but its fair value has decreased in the functional currency (resulting in a loss recognised in other comprehensive income),~~ 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.

IGA27 The answer to Question E.4.2 is amended as follows:

No. ~~IAS 39.43~~ Paragraph 5.1 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 ~~IAS 39.43~~ paragraph 5.1 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.

IGA28 Question E.4.5 is amended as follows:

A financial institution calculates impairment in the unsecured portion of ~~loans and receivables~~ financial assets measured at amortised cost on the basis of a provision matrix that specifies fixed provision rates for the number of days a ~~loan~~ 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 ~~loans and receivables~~ under IAS 39.63?

IGA29 The last sentence of the answer to Question F.1.4 is deleted.

IGA30 The answer to Question F.2.1 is amended as follows:

No. Derivative instruments ~~are~~ always meet the definition of ~~deemed~~ 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 4.1–4.5, 5.4.1 and 5.4.3). As an exception, IAS 39.AG94 permits the designation of a purchased option as the hedged item in a fair value hedge.

IGA31 The answer to Question F.2.5 is amended 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, …

IGA32 Q&A F.2.13 is amended as follows:

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

Yes. Under IFRS 9, ~~IAS 39, loans and receivables~~ some fixed rate loans are ~~carried~~ measured at amortised cost. Banking institutions in many countries hold the bulk of their fixed rate loans to collect their contractual cash flows ~~and receivables until maturity~~. Thus, changes in the fair value of such fixed rate loans ~~and receivables~~ 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 ~~and receivables~~. However, ~~it follows from IAS 39.79 that loans and receivables can be hedged items with respect to interest rate risk since they are not designated as held-to-maturity investments. T~~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 ~~and receivables~~.

IGA33 The last paragraph of the answer to Question F.2.17 is amended 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 ~~available for sale~~ 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. …

IGA34 In the answer to Question F.5.6, references to 'IAS 39.55(a)' are replaced with 'IAS 39.55'.

IGA35 In the answer to Question F.6.4, the reference to 'IAS 39' in the second sentence is amended to 'IAS 39 or IFRS 9'.

IGA36 Q&A G.1 is amended as follows:

IAS 39 and IFRS 9 requires ~~financial assets classified as available for sale (AFS) and~~ remeasurement of financial assets and financial liabilities measured at fair value ~~through profit or loss to be~~

~~remeasured to 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 ~~AFS assets~~ financial assets designated 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)~~ ~~AFS assets, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount that was reclassified from equity to profit or loss for the period as a reclassification adjustment;~~

(~~b~~a) financial assets or financial liabilities at fair value through profit or loss, showing separately those fair value changes on financial assets or financial liabilities (i) designated as such upon initial recognition and (ii) mandatorily classified as such ~~held for trading~~ in accordance with ~~IAS 39~~ IFRS 9; and

(~~c~~b) hedging instruments.

In addition, IFRS 7.20A requires 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 ~~in accordance with~~ meet the definition of held for trading in IAS 39 ~~it categorises as held for trading~~, 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 and (ii) those mandatorily classified as such ~~held for trading~~ in accordance with IAS 39 and IFRS 9.

IFRIC 12 *Service Concession Arrangements*

IGA37 In the illustrative examples accompanying IFRIC 12, paragraphs IE7 and IE28 are amended as follows:

IE7 IFRS 9 *Financial Instruments* may require the entity to measure the ~~The~~ amounts due from the grantor at amortised cost, unless the entity designates those amounts as measured at fair value through profit or loss ~~meet the definition of a receivable in IAS 39~~ ~~*Financial Instruments: Recognition and Measurement*~~. If the ~~The~~ receivable is measured at amortised cost in accordance with IFRS 9, it is measured initially at fair value and~~. It is~~ subsequently ~~measured~~ 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 ~~The~~ amount due from or at the direction of the grantor in exchange for the construction services at amortised cost ~~meets the definition of a receivable in IAS 39~~ ~~*Financial Instruments: Recognition and Measurement*~~. If the ~~The~~ receivable is measured at amortised cost in accordance with IFRS 9, it is measured initially at fair value and~~. It is~~ subsequently ~~measured~~ at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount minus repayments.

