

# IFRS 9 FINANCIAL INSTRUMENTS

## FACT SHEET

This fact sheet is based on existing requirements as at 31 December 2015 and does not take into account recent standards and interpretations that have been issued but are not yet effective.

### **IMPORTANT NOTE**

**This fact sheet is based on the requirements of the International Financial Reporting Standards (IFRSs). In some jurisdictions, the IFRSs are adopted in their entirety; in other jurisdictions the individual IFRSs are amended. In some jurisdictions the requirements of a particular IFRS may not have been adopted. Consequently, users of the fact sheet in various jurisdictions should ascertain for themselves the relevance of the fact sheet to their particular jurisdiction. The application date included below is the effective date of the initial version of the standard.**

## IASB APPLICATION DATE (NON-JURISDICTION SPECIFIC)

IFRS 9 is applicable for annual reporting periods commencing on or after 1 January 2018.

## OBJECTIVE

The objective of IFRS 9 is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of the entity's future cash flows.

## SCOPE

The scope of IFRS 9 is substantially the same as that of its predecessor Standard, IAS 39 *Financial Instruments: Recognition and Measurement*. One difference is that all loan commitments are within the scope of IFRS 9's impairment requirements. IAS 39 excluded some loan commitments from its scope, requiring them to be accounted for under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

## RECOGNITION AND MEASUREMENT

### Financial assets

#### Initial Recognition

Financial assets should be recognised in the statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument.

#### Classification

An entity classifies financial assets as subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss on the basis of both:

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

If both of the following conditions are met, then the financial asset is measured at amortised cost:

- a. the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- b. the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A financial asset is measured at fair value through other comprehensive income if both of the following conditions are met:

- The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

While this category has specifically been introduced for certain debt instruments, as discussed below, entities are able to make an irrevocable election at initial recognition for particular investments in equity instruments that would otherwise be measured at fair value through profit or loss to present subsequent changes in fair value in other comprehensive income.

A financial asset is required to be measured at fair value through profit or loss unless it is measured at amortised cost (in accordance with IFRS 9.4.1.2) or at fair value through other comprehensive income (in accordance with IFRS 9.4.1.2A).

#### Exception

As an exception to the rules above, an entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency ('accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

#### Reclassification

When, and only when, an entity changes its business model for managing financial assets, it reclassifies all affected financial assets.

Where an asset is reclassified, the reclassification is applied prospectively from the reclassification date and previously recognised gains, losses or interest should not be restated.

If the asset is reclassified to fair value, the fair value should be determined at the reclassification date and any gain / loss arising from a difference between the previous carrying amount and fair value is recognised in profit or loss.

**Embedded derivatives**

An embedded derivative is a component of a hybrid contract that also includes a non-derivative host – with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

If a hybrid contract contains a host that is an asset within the scope of IFRS 9 then the classification requirements discussed above apply.

If a hybrid contract contains a host that is not an asset within the scope of this IFRS, an embedded derivative shall be separated from the host and accounted for as a derivative under this IFRS if, and only if:

- a. the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host;
- b. a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- c. the hybrid contract is not measured at fair value with changes in fair value recognised in profit or loss (i.e. a derivative that is embedded in a financial liability at fair value through profit or loss is not separated).

If the embedded derivative is required to be separated then the host is accounted for in accordance with the relevant IFRS.

Nevertheless, if a contract contains one or more embedded derivatives and the host is not an asset within the scope of IFRS 9, an entity may designate the entire hybrid contract as at fair value through profit or loss unless:

- a. the embedded derivative(s) do(es) not significantly modify the cash flows that otherwise would be required by the contract; or
- b. it is clear with little or no analysis when a similar hybrid instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortised cost.

If an entity is required by this IFRS to separate an embedded derivative from its host, but is unable to measure the embedded derivative separately either at acquisition or at the end of a subsequent financial reporting period, it shall designate the entire hybrid contract as at fair value through profit or loss.

**Measurement***Initial measurement*

At initial measurement, a financial asset is measured at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset. However, trade receivables that do not have a significant financing component must be measured at their transaction price.

*Subsequent measurement*

After initial recognition, a financial asset is measured in accordance with IFRS 9.4.1.1-4.1.5 at:

- amortised cost
- fair value through other comprehensive income; or
- fair value through profit or loss

An entity applies the impairment requirements in IFRS 9.5.5 to financial assets that are measured at amortised cost in accordance with IFRS 9.4.1.2 and to financial assets that are measured at fair value through other comprehensive income in accordance with IFRS 9.4.1.2A.

An entity shall apply the hedge accounting requirements in paragraphs 6.5.8–6.5.14 (and, if an entity elects to continue to apply the hedge accounting requirements in IAS 39 instead of IFRS 9 as permitted by IFRS 9.7.2.21, paragraphs 89–94 of IAS 39 for the fair value hedge accounting for a portfolio hedge of interest rate risk) to a financial asset that is designated as a hedged item.

*Gains and losses*

A gain or loss on a financial asset that is measured at fair value shall be recognised in profit or loss unless:

- it is an investment in an equity instrument and the entity has elected to present gains and losses on that investment in other comprehensive income in accordance with paragraph 5.7.5; or
- it is a financial asset measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A and the entity is required to recognise some changes in fair value in other comprehensive income in accordance with paragraph 5.7.10.

A gain or loss on a financial asset that is measured at amortised cost and is not part of a hedging relationship is recognised in profit or loss when the asset is derecognised, impaired or reclassified and through the amortisation process.

A gain or loss on financial assets that are hedged items are recognised in accordance with paragraphs 6.5.8–6.5.14 and, if applicable, paragraphs 89–94 of IAS 39 for the fair value hedge accounting for a portfolio hedge of interest rate risk.

If an entity recognises financial assets using settlement date accounting, any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not recognised for assets measured at amortised cost.

For assets measured at fair value, however, the change in fair value is recognised in profit or loss or in other comprehensive income, as appropriate. The trade date shall be considered the date of initial recognition for the purposes of applying the impairment requirements.

#### **Election for equity instruments**

At initial recognition, an entity may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument within the scope of IFRS 9 that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 *Business Combinations* applies.

This election allows subsequent changes in the fair value of the instrument to be presented in other comprehensive income. Note: dividends on these instruments continue to be presented in profit or loss.

### **Financial liabilities**

#### **Initial Recognition**

Financial liabilities are recognised in the statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument.

#### **Classification**

An entity shall classify all financial liabilities as subsequently measured at amortised cost using the effective interest method, except for:

- a. financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value;
- b. financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. IFRS 9.3.2.15 and IFRS 9.3.2.17 apply to measurement of such liabilities;
- c. financial guarantee contracts. After initial recognition, an issuer of such a contract shall subsequently measure it at the higher of:
  - i. the amount of loss allowance determined in accordance with IFRS 9.5.5; and
  - ii. the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IFRS 15 *Revenue from Contracts with Customers*; and
- d. commitments to provide a loan at a below-market interest rate. After initial recognition, an issuer of such a commitment shall subsequently measure it at the higher of:
  - i. the amount of loss allowance determined in accordance with IFRS 9.5.5; and
  - ii. the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IFRS 15.

- e. contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies. Such contingent consideration shall subsequently be measured at fair value with changes recognised in profit or loss.

#### **Exception**

An entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through profit or loss when permitted by the standard, or when doing so results in more relevant information, because either:

- a. it eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as 'an accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- b. a group of financial liabilities or financial assets and financial liabilities 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.

#### **Reclassification**

An entity shall not reclassify any financial liability.

The above discussion about embedded derivatives under financial assets is also relevant in the context of financial liabilities.

### **Measurement**

#### **Initial measurement**

At initial recognition, an entity shall measure a financial liability at its fair value minus, in the case of a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the issue of the financial liability.

#### **Subsequent measurement**

After initial recognition, an entity shall measure a financial liability in accordance with IFRS 9.4.2.1–4.2.2.

An entity shall apply the hedge accounting requirements in paragraphs IFRS 9.6.5.8–6.5.14 to a financial liability that is designated as a hedged item.

#### **Gains and losses**

A gain or loss on a financial liability that is measured at fair value and is not part of a hedging relationship is recognised in profit or loss unless it is a financial liability designated as at fair value through profit or loss and the entity is required to present the effects of changes in the liability's credit risk in other comprehensive income.

A gain or loss on a financial liability that is measured at amortised cost and is not part of a hedging relationship shall be recognised in profit or loss when the financial liability is derecognised and through the amortisation process.

A gain or loss on financial liabilities that are hedged items in a hedging relationship shall be recognised in accordance with paragraphs 6.5.8–6.5.14 and, if applicable, paragraphs 89–94 of IAS 39 for the fair value hedge accounting for a portfolio hedge of interest rate risk.

An entity shall present a gain or loss on a financial liability designated as at fair value through profit or loss as follows:

- a. the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability shall be presented in other comprehensive income; and
- b. the remaining amount of change in the fair value of the liability shall be presented in profit or loss;

unless the treatment of the effects of changes in the liability's credit risk described in (a) would create or enlarge an accounting mismatch in profit or loss. If this is the case, an entity shall present all gains or losses on that liability (including the effects of changes in the credit risk of that liability) in profit or loss.

## Impairment

### General Approach

An entity shall recognise a loss allowance for expected credit losses on a financial asset that is measured in accordance with IFRS 9, a lease receivable, a contract asset or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with IFRS 9.

Except for purchased or originated credit-impaired financial assets, trade receivables, contract assets and lease receivables:

- at each reporting date, an entity shall measure the loss allowance for a financial instrument at an amount equal to the **lifetime expected credit losses** if the credit risk on that financial instrument has increased significantly since initial recognition.
- if, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, an entity shall measure the loss allowance for that financial instrument at an amount equal to **12-month expected credit losses**.

### Determining significant increases in credit risk

At each reporting date, an entity shall assess whether the credit risk on a financial instrument has increased significantly since initial recognition. In order to do this, an entity may either use past due information or reasonable and supportable forward-looking information which is available without undue cost or effort.

Regardless of the way in which an entity assesses significant increases in credit risk, there is a rebuttable presumption that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due. An entity can rebut this presumption if the entity has reasonable and supportable information that is available without undue cost or effort, that demonstrates that the credit risk has not increased significantly since initial recognition even though the contractual payments are

more than 30 days past due. When an entity determines that there have been significant increases in credit risk before contractual payments are more than 30 days past due, the rebuttable presumption does not apply.

An entity may assume that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have low credit risk at the reporting date.

### Purchased or originated credit-impaired financial assets

At the reporting date, an entity shall only recognise the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance for purchased or originated credit-impaired financial assets.

At each reporting date, an entity shall recognise in profit or loss the amount of the change in lifetime expected credit losses as an impairment gain or loss. An entity shall recognise favourable changes in lifetime expected credit losses as an impairment gain, even if the lifetime expected credit losses are less than the amount of expected credit losses that were included in the estimated cash flows on initial recognition.

### Simplified approach for trade receivables, contract assets and lease receivables

An entity shall always measure the loss allowance at an amount equal to lifetime expected credit losses for:

- a. trade receivables or contract assets that result from transactions that are within the scope of IFRS 15, and that:
  - i. do not contain a significant financing component (or when the entity applies the practical expedient for contracts that are one year or less) in accordance with IFRS 15; or
  - ii. contain a significant financing component in accordance with IFRS 15, if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses.
- b. lease receivables that result from transactions that are within the scope of IAS 17 *Leases*, if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime expected credit losses.

### Measurement of expected credit losses

An entity shall measure expected credit losses of a financial instrument in a way that reflects:

- a. an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- b. the time value of money; and
- c. reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

## HEDGE ACCOUNTING

### Qualifying Instruments

A derivative measured at fair value through profit or loss may be designated as a hedging instrument, except for some written options.

A non-derivative financial asset or a non-derivative financial liability measured at fair value through profit or loss may be designated as a hedging instrument unless it is a financial liability designated as at fair value through profit or loss for which the amount of its change in fair value that is attributable to changes in the credit risk of that liability is presented in other comprehensive income.

For a hedge of foreign currency risk, the foreign currency risk component of a non-derivative financial asset or a non-derivative financial liability may be designated as a hedging instrument provided that it is not an investment in an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income.

For hedge accounting purposes, only contracts with a party external to the reporting entity (i.e. external to the group or individual entity that is being reported on) can be designated as hedging instruments.

### Qualifying Items

A hedged item can be a recognised asset or liability, an unrecognised *firm commitment*, a *forecast transaction* or a *net investment in a foreign operation*. The hedged item must be reliably measurable. The hedged item can be:

- a. a single item;
- b. a group of items; or
- c. a component of a. or b. above.

If a hedged item is a forecast transaction (or a component thereof), that transaction must be highly probable.

An aggregated exposure that is a combination of an exposure that could qualify as a hedged item and a derivative may be designated as a hedged item. This includes a forecast transaction of an aggregated exposure (i.e. uncommitted but anticipated future transactions that would give rise to an exposure and a derivative) if that aggregated exposure is highly probable and, once it has occurred and is therefore no longer forecast, is eligible as a hedged item.

For hedge accounting purposes, only assets, liabilities, firm commitments or highly probable forecast transactions with a party external to the reporting entity can be designated as hedged items. Hedge accounting can be applied to transactions between entities in the same group only in the individual or separate financial statements of those entities and not in the consolidated financial statements of the group, except for the consolidated financial statements of an investment entity, as defined in IFRS 10 *Consolidated Financial Statements*, where transactions between an investment entity and its subsidiaries measured at fair value through profit or loss will not be eliminated in the consolidated financial statements.

### Qualifying criteria for hedge accounting

A hedging relationship qualifies for hedge accounting only if all of the following criteria are met:

- a. the hedging relationship consists only of eligible hedging instruments and eligible hedged items.
- b. at the inception of the hedging relationship there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge.
- c. the hedging relationship meets all of the following hedge effectiveness requirements:
  - i. there is an economic relationship between the hedged item and the hedging instrument;
  - ii. the effect of credit risk does not dominate the value changes that result from that economic relationship; and
  - iii. the hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of the hedging instrument that the entity actually uses to hedge that quantity of hedged item.

### Hedging relationships

There are three types of hedging relationships:

- a. **fair value hedge:** a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or a component of any such item, that is attributable to a particular risk and could affect profit or loss;
- b. **cash flow hedge:** a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all, or a component of, a recognised asset or liability (such as all or some future interest payments on variable-rate debt) or a highly probable forecast transaction, and could affect profit or loss; and
- c. **hedge of a net investment** in a foreign operation as defined in IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

### Fair value hedges

Fair value hedges that meet the qualifying criteria shall be accounted for as follows:

- a. the gain or loss on the hedging instrument shall be recognised in profit or loss (or other comprehensive income, if the hedging instrument hedges an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income); and
- b. the hedging gain or loss on the hedged item shall adjust the carrying amount of the hedged item (if applicable) and be recognised in profit or loss. However, if the hedged item is an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income, those amounts shall remain in other comprehensive income. When a hedged item is an unrecognised firm commitment (or a component thereof), the cumulative change in the fair value of the hedged item subsequent to its designation is recognised as an asset or a liability with a corresponding gain or loss recognised in profit or loss.

**Cash flow hedges**

Cash flow hedges that meet the qualifying criteria shall be accounted for as follows:

- a. the separate component of equity associated with the hedged item (cash flow hedge reserve) is adjusted to the lower of the following (in absolute amounts):
  - i. the cumulative gain or loss on the hedging instrument from inception of the hedge; and
  - ii. the cumulative change in fair value (present value) of the hedged item (i.e. the present value of the cumulative change in the hedged expected future cash flows) from inception of the hedge;
- b. the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (i.e. the portion that is offset by the change in the cash flow hedge reserve shall be recognised in other comprehensive income;
- c. any remaining gain or loss on the hedging instrument (or any gain or loss required to balance the change in the cash flow hedge reserve is hedge ineffectiveness that shall be recognised in profit or loss; and
- d. the amount that has been accumulated in the cash flow hedge reserve shall be accounted for as follows:
  - i. if a hedged forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, or a hedged forecast transaction for a non-financial asset or a non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, the entity shall remove that amount from the cash flow hedge reserve and include it directly in the initial cost or other carrying amount of the asset or the liability. This is not a reclassification adjustment (see IAS 1 *Presentation of Financial Statements*) and hence it does not affect other comprehensive income.
  - ii. for cash flow hedges other than those covered by (i) above, that amount shall be reclassified from the cash flow hedge reserve to profit or loss as a reclassification adjustment (see IAS 1) in the same period or periods during which the hedged expected future cash flows affect profit or loss (for example, in the periods that interest income or interest expense is recognised or when a forecast sale occurs).
  - iii. however, if that amount is a loss and an entity expects that all or a portion of that loss will not be recovered in one or more future periods, it shall immediately reclassify the amount that is not expected to be recovered into profit or loss as a reclassification adjustment (see IAS 1).

**Hedges of a net investment in a foreign operation**

Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment (see IAS 21), shall be accounted for similarly to cash flow hedges:

- a. the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge shall be recognised in other comprehensive income; and
- b. the ineffective portion shall be recognised in profit or loss.

The cumulative gain or loss on the hedging instrument relating to the effective portion of the hedge that has been accumulated in the foreign currency translation reserve shall be reclassified from equity to profit or loss as a reclassification adjustment (see IAS 1) in accordance with paragraphs 48–49 of IAS 21 on the disposal or partial disposal of the foreign operation.



## DISCLOSURES

There are no disclosure requirements in IFRS 9 as the relevant disclosure requirements are contained in IFRS 7 *Financial Instruments: Disclosure*.

## DEFINITIONS

<b>12-month expected credit losses</b>	The portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.
<b>Contract assets</b>	Those rights that IFRS 15 specifies are accounted for in accordance with this Standard for the purposes of recognising and measuring impairment gains or losses.
<b>Derivative</b>	A financial instrument or other contract within the scope of this Standard with all three of the following characteristics. <ol style="list-style-type: none"> <li>its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying');</li> <li>it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and</li> <li>it is settled at a future date.</li> </ol>
<b>Effective interest rate</b>	the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).
<b>Expected credit losses</b>	The weighted average of credit losses with the respective risks of a default occurring as the weights.
<b>Lifetime expected credit losses</b>	The expected credit losses that result from all possible default events over the expected life of a financial instrument.
The following terms are defined in IAS 32, IFRS 7, IFRS 13 or IFRS 15 and are used in IFRS 9 with the same meanings:	
<ul style="list-style-type: none"> <li>• Credit risk</li> <li>• Equity instrument</li> <li>• Fair value</li> <li>• Financial asset</li> <li>• Financial instrument</li> <li>• Financial liability</li> <li>• Transaction costs.</li> </ul>	

## AUSTRALIAN SPECIFIC REQUIREMENTS

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The Australian equivalent standard is AASB 9 *Financial Instruments*.

## OTHER MATTERS

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