Grant Thornton

Technical Accounting Alert

IASB amends IFRS 9 Financial Instruments

Introduction

The purpose of this alert is to provide an overview of the recent amendments by the IASB IFRS 9 Financial Instruments. The IASB has made two changes to IFRS 9 *Financial Instruments*, by adding requirements for

- classifying and measuring financial liabilities; and
- derecognising financial assets and financial liabilities.

Relevant standards

References are made to standards issued by the International Accounting Standards Board. The Australian equivalent to each standard included in this alert is shown below:

International Standard reference	Australian equivalent standard
IFRS 9 Financial Instruments	AASB 9 Financial Instruments
IAS 39 Financial Instruments: Recognition and Measurements	AASB 139 Financial Instruments: Recognition and Measurement

Overview

IFRS 9 was first published in November 2009 in reaction to the financial crisis, but addressed only the classification and measurement of financial assets. The latest changes are in line with the IASB's phased approach to the completion of IFRS 9, under which chapters will be added to the existing Standard as and when other phases of the overall project are completed (work is currently being undertaken on impairment methodology and hedge accounting). When complete, IFRS 9 will replace IAS 39 *Financial Instruments: Recognition and Measurement* in its entirety.

The changes

Classifying and measuring financial liabilities

Most of the requirements in IAS 39 for the classification and measurement of financial liabilities have been carried forward unchanged to IFRS 9. Changes have however been made to address issues related to own credit risk where an entity takes the option to measure financial liabilities at fair value.

Majority of requirements retained

Under IAS 39 most liabilities are measured at amortised cost or bifurcated into a host instrument measured at amortised cost, and an embedded derivative, measured at fair value. Liabilities that are held for trading (including all derivative liabilities) are measured at fair value. These requirements have been retained.

Own credit risk

The requirements related to the fair value option for financial liabilities have however been changed to address own credit risk. Where an entity chooses to measure its own debt at fair value, IFRS 9 now requires the amount of the change in fair value due to changes in the entity's own credit risk to be presented in other comprehensive income. This change addresses the counter-intuitive way in which a company in financial trouble was previously able to recognise a gain based on its theoretical ability to buy back its own debt at a reduced cost.

The only exception to the new requirement is where the effects of changes in the liability's credit risk would create or enlarge an accounting mismatch in profit or loss, in which case all gains or losses on that liability are to be presented in profit or loss.

Elimination of the exception from fair value measurement for certain derivative liabilities

The new version of IFRS 9 also eliminates the exception from fair value measurement for derivative liabilities that are linked to and must be settled by delivery of an unquoted equity instrument. Under IAS 39, if those derivatives were not reliably measurable, they were required to be measured at cost. IFRS 9 requires them to be measured at fair value.

Derecognising financial assets and financial liabilities.

The requirements in IAS 39 related to the derecognition of financial assets and financial liabilities have been incorporated unchanged into the new version of IFRS 9.

The IASB had originally envisaged making changes to the derecognition requirements of IAS 39. In the summer of 2010, however, the IASB revised its strategy and decided to retain the existing requirements in IAS 39 for the derecognition of financial assets and financial liabilities but to finalise improved disclosure requirements. Accordingly new disclosure requirements were issued in October 2010 as an amendment to IFRS 7 *Financial Instruments: Disclosures* (see TA Alert 2010-48), while IAS 39's derecognition requirements have been incorporated into IFRS 9 unchanged.

Effective date

IFRS 9 is effective for annual periods beginning on or after 1 January 2013. It may be adopted early subject to the requirements of local legislation.

Grant Thornton comment

Given the extent of change planned in other areas of IFRS in the near future, limiting the changes to IAS 39's requirements is likely to be welcomed by many constituents at this time.

The financial asset derecognition requirements of IAS 39 were seen as having performed favourably during the financial crisis. As such, the IASB has quite reasonably concluded that the existing derecognition criteria remain fit for purpose and need not be replaced in the near future.

The change to accounting for own credit risk where an entity opts to measure its own debt under the fair value option meanwhile addresses an area where many people found the effects of applying IAS 39's requirements counter-intuitive, while leaving other areas unchanged. One consequence of retaining IAS 39's requirements for the classification and measurement of financial liabilities, however, is that IFRS 9's requirements for assets and liabilities are not symmetrical.

Further information

For further information on any of the information included in this TA Alert, please contact your local Grant Thornton Australia contact or a member of the National Audit Support team via the GTAL Helpdesk.