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Technical Accounting Alert

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Designation of non-derivative equity investments at fair value through other comprehensive income under AASB 9

Introduction

AASB 9 *Financial Instruments* is applicable to reporting periods beginning on or after 1 January 2018 and will replace AASB 139 *Financial Instruments: Recognition and Measurement*.

AASB 9 is available for early adoption and some entities have already early adopted or are considering doing so, including those not-for-profit entities that see benefits in the ability to designate non-derivative equity investments at fair value through other comprehensive income.

Designation of non-derivative equity investments at fair value through other comprehensive income

Equity investments almost always fail the solely payments of principal and interest test, meaning that they are normally accounted for at fair value through profit or loss under AASB 9. However, there is one exception to this rule. An entity may on initial recognition 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 and is not contingent consideration of an acquirer in a business combination. This election is available on an instrument-by-instrument (i.e. share-by share) basis.

The particular attraction of this classification for certain entities, particularly not-for-profit entities, is that gains and losses (including any related foreign exchange component, but excluding most dividends received) are recognised in other comprehensive income. Amounts presented in other comprehensive income are never subsequently transferred to profit or loss on derecognition, although the cumulative gain or loss may be transferred within equity, such as to retained earnings. There is also no requirement to consider possible impairment of these investments.

Dividends from these investments should be recognised in profit or loss when the right to receive payment of the dividend is established, it is probable that economic benefits associated with the dividends will flow to the entity and the amount can be measured reliably unless the dividend clearly represents a recovery of part of the cost of the investment, in which case the dividend will reduce the carrying value of the investment.

For the purpose of determining eligibility for this election, the term ‘equity instrument’ uses the strict definition in AASB 132 *Financial Instruments: Presentation*. In certain circumstances, AASB 132 requires 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 (or a puttable instrument) to be classified by the issuer as an equity instrument. This is because of an exception to the general definitions of financial liabilities and equity instruments. However, such instruments do not actually meet the definition of an equity instrument and therefore the related asset cannot be designated at fair value through other comprehensive income by the holder.

This mainly relates to entities with a limited life such as managed investment funds. Such entities will commonly classify their issued units as equity because they are relying on the exception to the general definitions of financial liabilities and equity instruments in paragraphs 16C-16D of AASB 132. Most of these would not be able to classify their units as equity without relying on this exception. The definition of equity instrument in AASB 9 references the definition in AASB 132 and the Basis for Conclusions to IFRS 9 (the international equivalent of AASB 9) incudes that the IASB noted that such instruments that utilise the exception to be classified as equity do not meet the definition of an equity instrument.

Transition requirements

On the first-time application of AASB 9, entities have the opportunity to make designations in accordance with AASB 9. This includes, at the date of initial application, that any investment in a non-derivative equity instrument that is not held for trading and is not contingent consideration of an acquirer in a business combination may be designated as at fair value through other comprehensive income. The date of initial application is the date when an entity first applies those requirements of the standard, which is the beginning of the period in which it first reports under AASB 9, not the earliest period presented as comparatives. Such a designation should be made on the basis of the facts and circumstances that exist at the date of initial application, including whether equity-type investments meet the definition of equity instrument at that date and whether equity instruments meet the definition of held for trading as if they had been acquired at that date.

Further information

If you wish to discuss any of the information included in this Technical Accounting Alert, please get in touch with your local Grant Thornton Australia contact or a member of the National Assurance Quality Team at national.assurance.quality@au.gt.com.