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Technical Accounting Alert

IASB completes IFRS 9 *Financial Instruments*

Introduction

On 24 July 2014, the International Accounting Standards Board (IASB) published IFRS 9 *Financial Instruments* (2014) which marks the completion of its project to replace IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39).

The IASB began its overhaul of the accounting for financial instruments in 2009 in response to the widespread criticism of IAS 39 and its alleged role in contributing to the global financial crisis in 2007-2008. In order to allow for a phased completion of the Standard, IFRS 9 was divided into chapters with the first chapter of IFRS 9 being published in 2009. The publication of IFRS 9 (2014) completes these chapters and therefore the Standard as a whole.

Changes made by IFRS 9 (2014)

IFRS 9 (2014):

- adds requirements dealing with expected credit losses (impairment);
- amends the Standard's classification and measurement requirements by adding a new measurement category of fair value through other comprehensive income; and
- introduces a new mandatory effective date of accounting periods beginning on or after 1 January 2018.

Expected credit losses

IFRS 9 (2014) contains the Standard's requirements on expected credit losses. IAS 39's impairment requirements had been criticised for being overly complicated and resulting in impairment being recognised at too late a stage. IFRS 9 (2014) addresses these criticisms by applying the same impairment model to all financial instruments that are subject to impairment accounting and by using more forward-looking information. In applying this more forward-looking approach, a distinction is made between:

- financial instruments that have not deteriorated significantly in credit quality since initial recognition or that have low credit risk and
- financial instruments that have deteriorated significantly in credit quality since initial recognition and whose credit risk is not low.

'12-month expected credit losses' are recognised for the first category while 'life-time expected credit losses' are recognised for the second category. There is also a third step to the model in the sense that for assets which actually become credit-impaired after initial recognition, interest is calculated on the asset's amortised cost (i.e. the amount net of the loss allowance) as opposed to its gross carrying amount.

Amendments to the Standard's classification and measurement requirements

IFRS 9 (2014) introduces a 'fair value through other comprehensive income' measurement category for particular simple debt instruments. The Standard requires an entity to measure a financial asset 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; and
- 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.

This business model will typically involve greater frequency and volume of sales.

However, entities are still 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.

New mandatory effective date

IFRS 9 (2014) introduces a new mandatory effective date for the Standard of accounting periods beginning on or after 1 January 2018.

Extensive transition provisions have been included due to the complexity of the material and the phased way in which the project has been completed.

Grant Thornton Comment

IFRS 9 (2014) is likely to result in significant changes to many entities' financial statements. While its effective date of 2018 may seem a long way off, we strongly advise companies to start evaluating the new Standard now as it may have important ramifications in terms of system requirements and ratios.

Grant Thornton plans to issue a special edition IFRS newsletter on IFRS 9 (2014) in the near future which will cover the requirements of the Standard in more depth and prepare you for the changes.

Australian context

The Australian Accounting Standards Board (AASB) has already amended the effective date of AASB 9 to '1 January 2018' through its Amending Standard AASB 2014-1 *Amendments to Australian Accounting Standards*. It is expected that the AASB will issue the remaining amendments arising from IFRS 9 (2014) in the near future.

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 at NAS@grantthornton.com.au.