IFRS 9 — Financial Instruments

Overview

IFRS 9 Financial Instruments issued on 24 July 2014 is the IASB's replacement of IAS 39 Financial Instruments: Recognition and Measurement. The Standard includes requirements for recognition and measurement, impairment, derecognition and general hedge accounting. The IASB completed its project to replace IAS 39 in phases, adding to the standard as it completed each phase.

The version of IFRS 9 issued in 2014 supersedes all previous versions and is mandatorily effective for periods beginning on or after 1 January 2018 with early adoption permitted (subject to local endorsement requirements). For a limited period, previous versions of IFRS 9 may be adopted early if not already done so provided the relevant date of initial application is before 1 February 2015.

IFRS 9 does not replace the requirements for portfolio fair value hedge accounting for interest rate risk (often referred to as the 'macro hedge accounting' requirements) since this phase of the project was separated from the IFRS 9 project due to the longer term nature of the macro hedging project which is currently at the discussion paper phase of the due process. In April 2014, the IASB published a Discussion Paper Accounting for Dynamic Risk management: a Portfolio Revaluation Approach to Macro Hedging. Consequently, the exception in IAS 39 for a fair value hedge of an interest rate exposure of a portfolio of financial assets or financial liabilities continues to apply.

History of IFRS 9

Date	Development	Comments
14 July 2009	Exposure Draft ED/2009/7 Financial Instruments: Classification and Measurement published	Comment deadline 14 September 2009
12 November 2009	IFRS 9 Financial Instruments issued, covering classification and measurement of financial assets	Original effective date 1 January 2013, later removed
11 May 2010	Exposure Draft ED/2010/4 Fair Value Option for Financial Liabilities published	Comment deadline 16 July 2010
28 October 2010	IFRS 9 Financial Instruments reissued, incorporating new requirements on accounting for financial liabilities and carrying over from IAS 39 the requirements for derecognition of financial assets and financial liabilities	Original effective date 1 January 2013, later removed
4 August 2011	ED/2011/3 Amendments to IFRS 9 (2009) and IFRS 9 (2010): Mandatory Effective Date published, proposing the adjust the mandatory effective date of IFRS 9 from 1 January 2013 to 1 January 2015	Comment deadline 21 October 2011
16 December 2011	Mandatory Effective Date and Transition Disclosures (Amendments to IFRS 9 and IFRS 7) published	Amended the effective date of IFRS 9 to annual periods beginning on or after 1 January 2015 (removed in 2013), and modified the relief from restating comparative periods and the associated disclosures in IFRS 7
28 November 2012	Exposure Draft ED/2012/4 Classification and Measurement: Limited Amendments to IFRS 9 (proposed amendments to IFRS 9 (2010)) published	Comment deadline 28 March 2013
19 November 2013	IASB issues IFRS 9 Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) amending IFRS 9 to: include the new general hedge accounting model; allow early adoption of the requirement to present fair value changes due to own credit on liabilities designated as at fair value through profit or loss to be presented in other comprehensive income; and remove the 1 January 2015 effective date	Removed the mandatory effective date of IFRS 9 (2009) and IFRS 9 (2010)
24 July 2014	IASB issues IFRS 9 Financial Instruments	IFRS 9 (2014) was issued as a complete standard including the requirements previously issued and the additional amendments to introduce a new expected loss impairment model and limited changes to the classification and measurement requirements for financial assets. This amendment completes the IASB's financial instruments project and the Standard is effective for reporting periods beginning on or after 1 January 2018 with early adoption permitted (subject to local endorsement requirements).
12 September 2016	IASB issues Applying IFRS 9 'Financial Instruments' with IFRS 4 'Insurance Contracts' (Amendments to IFRS 4) to address concerns about the different effective dates of IFRS 9 and the new insurance contracts standard	An entity choosing to apply the overlay approach retrospectively to qualifying financial assets does so when it first applies IFRS 9. An entity choosing to apply the deferral approach does so for annual periods beginning on or after 1 January 2018.
12 October 2017	IASB issues Prepayment Features with Negative Compensation (Amendments to IFRS 9) to address the concerns about how IFRS 9 classifies particular prepayable financial assets	The amendments are to be applied retrospectively for fiscal years beginning on or after 1 January 2019; early application is permitted.

Related Interpretations

None

Related projects

Financial instruments — Macro hedge accounting

Summary of IFRS 9

The phased completion of IFRS 9

On 12 November 2009, the IASB issued IFRS 9 Financial Instruments as the first step in its project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 introduced new requirements for classifying and measuring financial assets that had to be applied starting 1 January 2013, with early adoption permitted. Click for IASB Press

On 28 October 2010, the IASB reissued IFRS 9, incorporating new requirements on accounting for financial liabilities, and carrying over from IAS 39 the requirements for derecognition of financial assets and financial liabilities. Click for IASB Press Release (PDF 33k).

On 16 December 2011, the IASB issued Mandatory Effective Date and Transition Disclosures (Amendments to IFRS 9 and IFRS 7), which amended the effective date of IFRS 9 to annual periods beginning on or after 1 January 2015, and modified the relief from restating comparative periods and the associated disclosures in IFRS 7.

On 19 November 2013, the IASB issued IFRS 9 Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) amending IFRS 9 to include the new general hedge accounting model, allow early adoption of the treatment of fair value changes due to own credit on liabilities designated at fair value through profit or loss and remove the 1 January 2015 effective date.

On 24 July 2014, the IASB issued the final version of IFRS 9 incorporating a new expected loss impairment model and introducing limited amendments to the classification and measurement requirements for financial assets. This version supersedes all previous versions and is mandatorily effective for periods beginning on or after 1 January 2018 with early adoption permitted (subject to local endorsement requirements). For a limited period, previous versions of IFRS 9 may be adopted early if not already done so provided the relevant date of initial application is before 1 February 2015.

Overview of IFRS 9

Initial measurement of financial instruments

All financial instruments are initially measured at fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs. [IFRS 9, paragraph 5.1.1]

Subsequent measurement of financial assets

IFRS 9 divides all financial assets that are currently in the scope of IAS 39 into two classifications - those measured at amortised cost and those measured at fair value.

Where assets are measured at fair value, gains and losses are either recognised entirely in profit or loss (fair value through profit or loss, FVTPL), or recognised in other comprehensive income (fair value through other comprehensive income, FVTOCI).

For debt instruments the FVTOCI classification is mandatory for certain assets unless the fair value option is elected. Whilst for equity investments, the FVTOCI classification is an election. Furthermore, the requirements for reclassifying gains or losses recognised in other comprehensive income are different for debt instruments and equity investments.

The classification of a financial asset is made at the time it is initially recognised, namely when the entity becomes a party to the contractual provisions of the instrument. [IFRS 9, paragraph 4.1.1] If certain conditions are met, the classification of an asset may subsequently need to be reclassified.

Debt instruments

A debt instrument that meets the following two conditions must be measured at amortised cost (net of any write down for impairment) unless the asset is designated at FVTPL under the fair value option (see below):

[IFRS 9, paragraph 4.1.2]

Business model test: The objective of the entity's business model is to hold the financial asset to collect the contractual cash flows (rather than to sell the instrument prior to its contractual maturity to realise its fair value changes).

Cash flow characteristics test: 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.

Assessing the cash flow characteristics also includes an analysis of changes in the timing or in the amount of payments. It is necessary to assess whether the cash flows before and after the change represent only repayments of the nominal amount and an interest rate based on them.

The right of termination may for example be in accordance with the cash flow condition if, in the case of termination, the only outstanding payments consist of principal and interest on the principal amount and an appropriate compensation payment where applicable. In October 2017, the IASB clarified that the compensation payments can also have a negative sign.*

*Prepayment Features with Negative Compensation (Amendments to IFRS 9); to be applied retrospectively for fiscal years beginning on or after 1 January 2019; early application permitted

A debt instrument that meets the following two conditions must be measured at FVTOCI unless the asset is designated at FVTPL under the fair value option (see below):

[IFRS 9, paragraph 4.1.2A]

Business model test: The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

Cash flow characteristics test: 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.

All other debt instruments must be measured at fair value through profit or loss (FVTPL). [IFRS 9, paragraph 4.1.4]

Fair value option

Even if an instrument meets the two requirements to be measured at amortised cost or FVTOCI, IFRS 9 contains an option to designate, at initial recognition, a financial asset as measured at FVTPL if 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 or recognising the gains and losses on them on different bases. [IFRS 9, paragraph 4.1.5]

Equity instruments

All equity investments in scope of IFRS 9 are to be measured at fair value in the statement of financial position, with value changes recognised in profit or loss, except for those equity investments for which the entity has elected to present value changes in 'other comprehensive income'. There is no 'cost exception' for unquoted equities.

'Other comprehensive income' option

If an equity investment is not held for trading, an entity can make an irrevocable election at initial recognition to measure it at FVTOCI with only dividend income recognised in profit or loss. [IFRS 9, paragraph 5.7.5]

Measurement guidance

Despite the fair value requirement for all equity investments, IFRS 9 contains guidance on when cost may be the best estimate of fair value and also when it might not be representative of fair value.

Subsequent measurement of financial liabilities

IFRS 9 doesn't change the basic accounting model for financial liabilities under IAS 39. Two measurement categories continue to exist: FVTPL and amortised cost. Financial liabilities held for trading are measured at FVTPL, and all other financial liabilities are measured at amortised cost unless the fair value option is applied. [IFRS 9, paragraph 4.2.1]

Fair value option

IFRS 9 contains an option to designate a financial liability as measured at FVTPL if [IFRS 9, paragraph 4.2.2]:

- 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 or recognising the gains and losses on them on different bases, or
- the liability is part or a group of financial liabilities or financial assets and financial liabilities that 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.

A financial liability which does not meet any of these criteria may still be designated as measured at FVTPL when it contains one or more embedded derivatives that sufficiently modify the cash flows of the liability and are not clearly closely related. [IFRS 9, paragraph 4.3.5]

IFRS 9 requires gains and losses on financial liabilities designated as at FVTPL to be split into the amount of change in fair value attributable to changes in credit risk of the liability, presented in other comprehensive income, and the remaining amount presented in profit or loss. The new guidance allows the recognition of the full amount of change in the fair value in profit or loss only if the presentation of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. That determination is made at initial recognition and is not reassessed. [IFRS 9, paragraphs 5.7.7-5.7.8]

Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss, the entity may only transfer the cumulative gain or loss within equity.

Derecognition of financial assets

The basic premise for the derecognition model in IFRS 9 (carried over from IAS 39) is to determine whether the asset under consideration for derecognition is: [IFRS 9, paragraph 3.2.2]

- an asset in its entirety or
- specifically identified cash flows from an asset (or a group of similar financial assets) or
- a fully proportionate (pro rata) share of the cash flows from an asset (or a group of similar financial assets). or
- a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets)

Once the asset under consideration for derecognition has been determined, an assessment is made as to whether the asset has been transferred, and if so, whether the transfer of that asset is subsequently eligible for derecognition.

An asset is transferred if either the entity has transferred the contractual rights to receive the cash flows, or the entity has retained the contractual rights to receive the cash flows from the asset, but has assumed a contractual obligation to pass those cash flows on under an arrangement that meets the following three conditions: [IFRS 9, paragraphs 3.2.4-3.2.5]

- the entity has no obligation to pay amounts to the eventual recipient unless it collects equivalent amounts on the original asset
- the entity is prohibited from selling or pledging the original asset (other than as security to the eventual recipient),
- the entity has an obligation to remit those cash flows without material delay

Once an entity has determined that the asset has been transferred, it then determines whether or not it has transferred substantially all of the risks and rewards of ownership of the asset. If substantially all the risks and rewards have been transferred, the asset is derecognised. If substantially all the risks and rewards have been retained, derecognition of the asset is precluded. [IFRS 9, paragraphs 3.2.6(a)-(b)]

If the entity has neither retained nor transferred substantially all of the risks and rewards of the asset, then the entity must assess whether it has relinquished control of the asset or not. If the entity does not control the asset then derecognition is appropriate; however if the entity has retained control of the asset, then the entity continues to recognise the asset to the extent to which it has a continuing involvement in the asset. [IFRS 9, paragraph 3.2.6(c)]

These various derecognition steps are summarised in the decision tree in paragraph B3.2.1.

Derecognition of financial liabilities

A financial liability should be removed from the balance sheet when, and only when, it is extinguished, that is, when the obligation specified in the contract is either discharged or cancelled or expires. [IFRS 9, paragraph 3.3.1] Where there has been an exchange between an existing borrower and lender of debt instruments with substantially different terms, or there has been a substantial modification of the terms of an existing financial liability, this transaction is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. A gain or loss from extinguishment of the original financial liability is recognised in profit or loss. [IFRS 9, paragraphs 3.3.2-3.3.3]

Derivatives

All derivatives in scope of IFRS 9, including those linked to unquoted equity investments, are measured at fair value. Value changes are recognised in profit or loss unless the entity has elected to apply hedge accounting by designating the derivative as a hedging instrument in an eligible hedging relationship.

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. A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty, is not an embedded derivative, but a separate financial instrument. [IFRS 9, paragraph 4.3.1]

The embedded derivative concept that existed in IAS 39 has been included in IFRS 9 to apply only to hosts that are not financial assets within the scope of the Standard. Consequently, embedded derivatives that under IAS 39 would have been separately accounted for at FVTPL because they were not closely related to the host financial asset will no longer be separated. Instead, the contractual cash flows of the financial asset are assessed in their entirety, and the asset as a whole is measured at FVTPL if the contractual cash flow characteristics test is not passed (see above).

The embedded derivative guidance that existed in IAS 39 is included in IFRS 9 to help preparers identify when an embedded derivative is closely related to a financial liability host contract or a host contract not within the scope of the Standard (e.g. leasing contracts, insurance contracts, contracts for the purchase or sale of a non-financial items).

Reclassification

For financial assets, reclassification is required between FVTPL, FVTOCI and amortised cost, if and only if the entity's business model objective for its financial assets changes so its previous model assessment would no longer apply. [IFRS 9, paragraph 4.4.1]

If reclassification is appropriate, it must be done prospectively from the reclassification date which is defined as the first day of the first reporting period following the change in business model. An entity does not restate any previously recognised gains, losses, or interest.

IFRS 9 does not allow reclassification:

for equity investments measured at FVTOCI, or

where the fair value option has been exercised in any circumstance for a financial assets or financial liability.

Hedge accounting

The hedge accounting requirements in IFRS 9 are optional. If certain eligibility and qualification criteria are met, hedge accounting allows an entity to reflect risk management activities in the financial statements by matching gains or losses on financial hedging instruments with losses or gains on the risk exposures they hedge.

The hedge accounting model in IFRS 9 is not designed to accommodate hedging of open, dynamic portfolios. As a result, for a fair value hedge of interest rate risk of a portfolio of financial assets or liabilities an entity can apply the hedge accounting requirements in IAS 39 instead of those in IFRS 9. [IFRS 9 paragraph 6.1.3]

In addition when an entity first applies IFRS 9, it may choose as its accounting policy choice to continue to apply the hedge accounting requirements of IAS 39 instead of the requirements of Chapter 6 of IFRS 9 [IFRS 9 paragraph 7.2.21]

Qualifying criteria for hedge accounting

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

1. the hedging relationship consists only of eligible hedging instruments and eligible hedged items.
2. 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.
3. the hedging relationship meets all of the hedge effectiveness requirements (see below) [IFRS 9 paragraph 6.4.1]

Hedging instruments

Only contracts with a party external to the reporting entity may be designated as hedging instruments. [IFRS 9 paragraph 6.2.3]

A hedging instrument may be a derivative (except for some written options) or non-derivative financial instrument measured at FVTPL unless it is a financial liability designated as at FVTPL for which changes due to credit risk are presented in OCI. For a hedge of foreign currency risk, the foreign currency risk component of a non-derivative financial instrument, except equity investments designated as FVTOCI, may be designated as the hedging instrument. [IFRS 9 paragraphs 6.2.1-6.2.2]

IFRS 9 allows a proportion (e.g. 60%) but not a time portion (eg the first 6 years of cash flows of a 10 year instrument) of a hedging instrument to be designated as the hedging instrument. IFRS 9 also allows only the intrinsic value of an option, or the spot element of a forward to be designated as the hedging instrument. An entity may also exclude the foreign currency basis spread from a designated hedging instrument. [IFRS 9 paragraph 6.2.4]

IFRS 9 allows combinations of derivatives and non-derivatives to be designated as the hedging instrument. [IFRS 9 paragraph 6.2.5]

Combinations of purchased and written options do not qualify if they amount to a net written option at the date of designation. [IFRS 9 paragraph 6.2.6]

Hedged items

A hedged item can be a recognised asset or liability, an unrecognised firm commitment, a highly probable forecast transaction or a net investment in a foreign operation and must be reliably measurable. [IFRS 9 paragraphs 6.3.1-6.3.3]

An aggregated exposure that is a combination of an eligible hedged item as described above and a derivative may be designated as a hedged item. [IFRS 9 paragraph 6.3.4]

The hedged item must generally be with a party external to the reporting entity, however, as an exception the foreign currency risk of an intragroup monetary item may qualify as a hedged item in the consolidated financial statements if it results in an exposure to foreign exchange rate gains or losses that are not fully eliminated on consolidation. In addition, the foreign currency risk of a highly probable forecast intragroup transaction may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss. [IFRS 9 paragraphs 6.3.5 -6.3.6]

An entity may designate an item in its entirety or a component of an item as the hedged item. The component may be a risk component that is separately identifiable and reliably measurable; one or more selected contractual cash flows; or components of a nominal amount. [IFRS 9 paragraph 6.3.7]

A group of items (including net positions is an eligible hedged item only if:

1. it consists of items individually, eligible hedged items;
2. the items in the group are managed together on a group basis for risk management purposes; and
3. in the case of a cash flow hedge of a group of items whose variabilities in cash flows are not expected to be approximately proportional to the overall variability in cash flows of the group:
   1. it is a hedge of foreign currency risk; and
   2. the designation of that net position specifies the reporting period in which the forecast transactions are expected to affect profit or loss, as well as their nature and volume [IFRS 9 paragraph 6.6.1]

For a hedge of a net position whose hedged risk affects different line items in the statement of profit or loss and other comprehensive income, any hedging gains or losses in that statement are presented in a separate line from those affected by the hedged items. [IFRS 9 paragraph 6.6.4]

Accounting for qualifying hedging relationships

There are three types of hedging relationships:

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 (or OCI in the case of an equity instrument designated as at FVTOCI). [IFRS 9 paragraphs 6.5.2(a) and 6.5.3]

For a fair value hedge, the gain or loss on the hedging instrument is recognised in profit or loss (or OCI, if hedging an equity instrument at FVTOCI and the hedging gain or loss on the hedged item adjusts the carrying amount of the hedged item and is recognised in profit or loss. However, if the hedged item is an equity instrument at FVTOCI, those amounts remain in OCI. When a hedged item is an unrecognised firm commitment the cumulative hedging gain or loss is recognised as an asset or a liability with a corresponding gain or loss recognised in profit or loss. [IFRS 9 paragraph 6.5.8]

If the hedged item is a debt instrument measured at amortised cost or FVTOCI any hedge adjustment is amortised to profit or loss based on a recalculated effective interest rate. Amortisation may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for hedging gains and losses. [IFRS 9 paragraph 6.5.10]

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. [IFRS 9 paragraph 6.5.2(b)]

For a cash flow hedge the cash flow hedge reserve in equity is adjusted to the lower of the following (in absolute amounts):

- the cumulative gain or loss on the hedging instrument from inception of the hedge; and
- the cumulative change in fair value of the hedged item from inception of the hedge.

The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in OCI and any remaining gain or loss is hedge ineffectiveness that is recognised in profit or loss.

If a hedged forecast transaction subsequently results in the recognition of a non-financial item or becomes a firm commitment for which fair value hedge accounting is applied, the amount that has been accumulated in the cash flow hedge reserve is removed and included directly in the initial cost or other carrying amount of the asset or the liability. In other cases the amount that has been accumulated in the cash flow hedge reserve is reclassified to profit or loss in the same period(s) as the hedged cash flows affect profit or loss. [IFRS 9 paragraph 6.5.11]

When an entity discontinues hedge accounting for a cash flow hedge, if the hedged future cash flows are still expected to occur, the amount that has been accumulated in the cash flow hedge reserve remains there until the future cash flows occur; if the hedged future cash flows are no longer expected to occur, that amount is immediately reclassified to profit or loss [IFRS 9 paragraph 6.5.12]

A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or a cash flow hedge. [IFRS 9 paragraph 6.5.4]

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

- the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in OCI; and
- the ineffective portion is recognised in profit or loss. [IFRS 9 paragraph 6.5.13]

The cumulative gain or loss on the hedging instrument relating to the effective portion of the hedge is reclassified to profit or loss on the disposal or partial disposal of the foreign operation. [IFRS 9 paragraph 6.5.14]

Hedge effectiveness requirements

In order to qualify for hedge accounting, the hedge relationship must meet the following effectiveness criteria at the beginning of each hedged period:

- there is an economic relationship between the hedged item and the hedging instrument;
- the effect of credit risk does not dominate the value changes that result from that economic relationship; and
- the hedge ratio of the hedging relationship is the same as that actually used in the economic hedge [IFRS 9 paragraph 6.4.1(c)]

Rebalancing and discontinuation

If a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio but the risk management objective for that designated hedging relationship remains the same, an entity adjusts the hedge ratio of the hedging relationship (i.e. rebalances the hedge) so that it meets the qualifying criteria again. [IFRS 9 paragraph 6.5.5]

An entity discontinues hedge accounting prospectively only when the hedging relationship (or a part of a hedging relationship) ceases to meet the qualifying criteria (after any rebalancing). This includes instances when the hedging instrument expires or is sold, terminated or exercised. Discontinuing hedge accounting can either affect a hedging relationship in its entirety or only a part of it (in which case hedge accounting continues for the remainder of the hedging relationship). [IFRS 9 paragraph 6.5.6]

Time value of options

When an entity separates the intrinsic value and time value of an option contract and designates as the hedging instrument only the change in intrinsic value of the option, it recognises some or all of the change in the time value in OCI which is later removed or reclassified from equity as a single amount or on an amortised basis (depending on the nature of the hedged item) and ultimately recognised in profit or loss. [IFRS 9 paragraph 6.5.15] This reduces profit or loss volatility compared to recognising the change in value of time value directly in profit or loss.

Forward points and foreign currency basis spreads

When an entity separates the forward points and the spot element of a forward contract and designates as the hedging instrument only the change in the value of the spot element, or when an entity excludes the foreign currency basis spread from a hedge the entity may recognise the change in value of the excluded portion in OCI to be later removed or reclassified from equity as a single amount or on an amortised basis (depending on the nature of the hedged item) and ultimately recognised in profit or loss. [IFRS 9 paragraph 6.5.16] This reduces profit or loss volatility compared to recognising the change in value of forward points or currency basis spreads directly in profit or loss.

Credit exposures designated at FVTPL

If an entity uses a credit derivative measured at FVTPL to manage the credit risk of a financial instrument (credit exposure) it may designate all or a proportion of that financial instrument as measured at FVTPL if:

- the name of the credit exposure matches the reference entity of the credit derivative ('name matching'); and
- the seniority of the financial instrument matches that of the instruments that can be delivered in accordance with the credit derivative.

An entity may make this designation irrespective of whether the financial instrument that is managed for credit risk is within the scope of IFRS 9 (for example, it can apply to loan commitments that are outside the scope of IFRS 9). The entity may designate that financial instrument at, or subsequent to, initial recognition, or while it is unrecognised and shall document the designation concurrently. [IFRS 9 paragraph 6.7.1]

If designated after initial recognition, any difference in the previous carrying amount and fair value is recognised immediately in profit or loss [IFRS 9 paragraph 6.7.2]

An entity discontinues measuring the financial instrument that gave rise to the credit risk at FVTPL if the qualifying criteria are no longer met and the instrument is not otherwise required to be measured at FVTPL. The fair value at discontinuation becomes its new carrying amount. [IFRS 9 paragraphs 6.7.3 and 6.7.4]

Impairment

The impairment model in IFRS 9 is based on the premise of providing for expected losses.

Scope

IFRS 9 requires that the same impairment model apply to all of the following:

[IFRS 9 paragraph 5.5.1]

- Financial assets measured at amortised cost;
- Financial assets mandatorily measured at FVTOCI;
- Loan commitments when there is a present obligation to extend credit (except where these are measured at FVTPL);
- Financial guarantee contracts to which IFRS 9 is applied (except those measured at FVTPL);
- Lease receivables within the scope of IAS 17 Leases; and
- Contract assets within the scope of IFRS 15 Revenue from Contracts with Customers (i.e. rights to consideration following transfer of goods or services).

General approach

With the exception of purchased or originated credit impaired financial assets (see below), expected credit losses are required to be measured through a loss allowance at an amount equal to:

[IFRS 9 paragraphs 5.5.3 and 5.5.5]

- the 12-month expected credit losses (expected credit losses that result from those default events on the financial instrument that are possible within 12 months after the reporting date); or
- full lifetime expected credit losses (expected credit losses that result from all possible default events over the life of the financial instrument).

A loss allowance for full lifetime expected credit losses is required for a financial instrument if the credit risk of that financial instrument has increased significantly since initial recognition, as well as to contract assets or trade receivables that do not constitute a financing transaction in accordance with IFRS 15. [IFRS 9 paragraphs 5.5.3 and 5.5.15]

Additionally, entities can elect an accounting policy to recognise full lifetime expected losses for all contract assets and/or all trade receivables that do constitute a financing transaction in accordance with IFRS 15. The same election is also separately permitted for lease receivables. [IFRS 9 paragraph 5.5.16]

For all other financial instruments, expected credit losses are measured at an amount equal to the 12-month expected credit losses. [IFRS 9 paragraph 5.5.5]

Significant increase in credit risk

With the exception of purchased or originated credit-impaired financial assets (see below), the loss allowance for financial instruments is measured at an amount equal to lifetime expected losses if the credit risk of a financial instrument has increased significantly since initial recognition, unless the credit risk of the financial instrument is low at the reporting date in which case it can be assumed that credit risk on the financial instrument has not increased significantly since initial recognition. [IFRS 9 paragraphs 5.5.3 and 5.5.10]

The Standard considers credit risk low if there is a low risk of default, the borrower has a strong capacity to meet its contractual cash flow obligations in the near term and adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations. The Standard suggests that 'investment grade' rating might be an indicator for a low credit risk. [IFRS 9 paragraphs B5.5.22 – B5.5.24]

The assessment of whether there has been a significant increase in credit risk is based on an increase in the probability of a default occurring since initial recognition. Under the Standard, an entity may use various approaches to assess whether credit risk has increased significantly (provided that the approach is consistent with the requirements). An approach can be consistent with the requirements even if it does not include an explicit probability of default occurring as an input. The application guidance provides a list of factors that may assist an entity in making the assessment. Also, whilst in principle the assessment of whether a loss allowance should be based on lifetime expected credit losses is to be made on an individual basis, some factors or indicators might not be available at an instrument level. In this case, the entity should perform the assessment on appropriate groups or portions of a portfolio of financial instruments.

The requirements also contain a rebuttable presumption that the credit risk has increased significantly when contractual payments are more than 30 days past due. IFRS 9 also requires that (other than for purchased or originated credit impaired financial instruments) if a significant increase in credit risk that had taken place since initial recognition and has reversed by a subsequent reporting period (i.e., cumulatively credit risk is not significantly higher than at initial recognition) then the expected credit losses on the financial instrument revert to being measured based on an amount equal to the 12-month expected credit losses. [IFRS 9 paragraph 5.5.11]

Purchased or originated credit-impaired financial assets

Purchased or originated credit-impaired financial assets are treated differently because the asset is credit-impaired at initial recognition. For these assets, an entity would recognise changes in lifetime expected losses since initial recognition as a loss allowance with any changes recognised in profit or loss. Under the requirements, any favourable changes for such assets are an impairment gain even if the resulting expected cash flows of a financial asset exceed the estimated cash flows on initial recognition. [IFRS 9 paragraphs 5.5.13 – 5.5.14]

Credit-impaired financial asset

Under IFRS 9 a financial asset is credit-impaired when one or more events that have occurred and have a significant impact on the expected future cash flows of the financial asset. It includes observable data that has come to the attention of the holder of a financial asset about the following events:

[IFRS 9 Appendix A]

- significant financial difficulty of the issuer or borrower;
- a breach of contract, such as a default or past-due event;
- the lenders for economic or contractual reasons relating to the borrower's financial difficulty granted the borrower a concession that would not otherwise be considered;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for the financial asset because of financial difficulties; or
- the purchase or origination of a financial asset at a deep discount that reflects incurred credit losses.

Basis for estimating expected credit losses

Any measurement of expected credit losses under IFRS 9 shall reflect an unbiased and probability-weighted amount that is determined by evaluating the range of possible outcomes as well as incorporating the time value of money. Also, the entity should consider reasonable and supportable information about past events, current conditions and reasonable and supportable forecasts of future economic conditions when measuring expected credit losses. [IFRS 9 paragraph 5.5.17]

The Standard defines expected credit losses as the weighted average of credit losses with the respective risks of a default occurring as the weightings. [IFRS 9 Appendix A] Whilst an entity does not need to consider every possible scenario, it must consider the risk or probability that a credit loss occurs by considering the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the probability of a credit loss occurring is low. [IFRS 9 paragraph 5.5.18]

In particular, for lifetime expected losses, an entity is required to estimate the risk of a default occurring on the financial instrument during its expected life. 12-month expected credit losses represent the lifetime cash shortfalls that will result if a default occurs in the 12 months after the reporting date, weighted by the probability of that default occurring.

An entity is required to incorporate reasonable and supportable information (i.e., that which is reasonably available at the reporting date). Information is reasonably available if obtaining it does not involve undue cost or effort (with information available for financial reporting purposes qualifying as such).

For applying the model to a loan commitment an entity will consider the risk of a default occurring under the loan to be advanced, whilst application of the model for financial guarantee contracts an entity considers the risk of a default occurring of the specified debtor. [IFRS 9 paragraphs B5.5.31 and B5.5.32]

An entity may use practical expedients when estimating expected credit losses if they are consistent with the principles in the Standard (for example, expected credit losses on trade receivables may be calculated using a provision matrix where a fixed provision rate applies depending on the number of days that a trade receivable is outstanding). [IFRS 9 paragraph B5.5.35]

To reflect time value, expected losses should be discounted to the reporting date using the effective interest rate of the asset (or an approximation thereof) that was determined at initial recognition. A "credit-adjusted effective interest" rate should be used for expected credit losses of purchased or originated credit-impaired financial assets. In contrast to the "effective interest rate" (calculated using expected cash flows that ignore expected credit losses), the credit-adjusted effective interest rate reflects expected credit losses of the financial asset. [IFRS 9 paragraphs B5.5.44-45]

Expected credit losses of undrawn loan commitments should be discounted by using the effective interest rate (or an approximation thereof) that will be applied when recognising the financial asset resulting from the commitment. If the effective interest rate of a loan commitment cannot be determined, the discount rate should reflect the current market assessment of time value of money and the risks that are specific to the cash flows but only if, and to the extent that, such risks are not taken into account by adjusting the discount rate. This approach shall also be used to discount expected credit losses of financial guarantee contracts. [IFRS 9 paragraphs B5.5.47]

Presentation

Whilst interest revenue is always required to be presented as a separate line item, it is calculated differently according to the status of the asset with regard to credit impairment. In the case of a financial asset that is not a purchased or originated credit-impaired financial asset and for which there is no objective evidence of impairment at the reporting date, interest revenue is calculated by applying the effective interest rate method to the gross carrying amount. [IFRS 9 paragraph 5.4.1]

In the case of a financial asset that is not a purchased or originated credit-impaired financial asset but subsequently has become credit-impaired, interest revenue is calculated by applying the effective interest rate to the amortised cost balance, which comprises the gross carrying amount adjusted for any loss allowance. [IFRS 9 paragraph 5.4.1]

In the case of purchased or originated credit-impaired financial assets, interest revenue is always recognised by applying the credit-adjusted effective interest rate to the amortised cost carrying amount. [IFRS 9 paragraph 5.4.1] The credit-adjusted effective interest rate is the rate that discounts the cash flows expected on initial recognition (explicitly taking account of expected credit losses as well as contractual terms of the instrument) back to the amortised cost at initial recognition. [IFRS 9 Appendix A]

Consequential amendments of IFRS 9 to IAS 1 require that impairment losses, including reversals of impairment losses and impairment gains (in the case of purchased or originated credit-impaired financial assets), are presented in a separate line item in the statement of profit or loss and other comprehensive income.

Disclosures

IFRS 9 amends some of the requirements of IFRS 7 Financial Instruments: Disclosures including adding disclosures about investments in equity instruments designated as at FVTOCI, disclosures on risk management activities and hedge accounting and disclosures on credit risk management and impairment.

Interaction with IFRS 4

On 12 September 2016, the IASB issued amendments to IFRS 4 providing two options for entities that issue insurance contracts within the scope of IFRS 4:

- an option that permits entities to reclassify, from profit or loss to other comprehensive income, some of the income or expenses arising from designated financial assets; this is the so-called overlay approach;
- an optional temporary exemption from applying IFRS 9 for entities whose predominant activity is issuing contracts within the scope of IFRS 4; this is the so-called deferral approach.

An entity choosing to apply the overlay approach retrospectively to qualifying financial assets does so when it first applies IFRS 9. An entity choosing to apply the deferral approach does so for annual periods beginning on or after 1 January 2018. The application of both approaches is optional and an entity is permitted to stop applying them before the new insurance contracts standard is applied.