An Overview of the Transition Requirements of IFRS 9 *Financial Instruments*

March 2017

Scope and Purpose

In July 2014, the International Accounting Standards Board (IASB) completed Phase 2 of its financial instruments project and, as such, published the final version of IFRS 9 *Financial Instruments*. IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement*, and is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

The new standard aims to simplify the accounting for financial instruments and address perceived deficiencies which were highlighted by the financial crisis.

The purpose of this guide is to highlight relevant IFRS 9 transition requirements and provide application guidance, including examples, to ensure a smooth transition to IFRS 9. The guide focuses on key issues that may affect MNP's clients, including lenders such as Mortgage Investments Companies and Credit Unions, which may be significantly impacted.

This guide was developed assuming that the reader has a working knowledge of the new IFRS 9 requirements pertaining to classification, measurement, impairment and hedge accounting. As such, these requirements will not be discussed in detail but rather only referred to in the context of the IFRS 9 transition requirements.

Further, this guide does not cover transition requirements for an entity that:

- Early adopted any of the previous versions of IFRS 9 (i.e., any versions prior to the final version of IFRS 9 released in July 2014); and
- Are first time adopters of IFRS that apply IFRS 1 *First Time Adoption of International Financial Reporting Standards.*

An entity must refer to the applicable standard for the transition requirements specific to these situations.

Early Application

If an entity elects to apply IFRS 9 early, the entity must disclose that fact and apply <u>all</u> requirements of IFRS 9 at the same time, including the consequential amendments to other standards. However, IFRS 9 includes an exception to full early application relating to the "own credit risk" requirements. This relates to the requirements for the presentation of gains and losses in other comprehensive income (OCI), instead of profit or loss, due to changes in an entity's own credit risk on financial liabilities designated as at fair value through profit or loss (FVTPL). IFRS 9 allows an entity to elect to apply only these requirements[1] without applying the other requirements of IFRS 9.

[1] The requirements for the presentation of gains and losses on financial liabilities designated as at FVTPL include paragraphs 5.7.1(c), 5.7.7 – 5.7.9, 7.2.14 and B5.7.5 – B5.7.20. If an entity elects to apply only these paragraphs, it must disclose that fact and provide on an ongoing basis the related disclosures set out in paragraphs 10-11 of IFRS 7 *Financial Instruments: Disclosures.*

Overall Transition Requirements

IFRS 9 must be applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.* However, the standard includes some transition relief to full retrospective application, which is discussed below.

Note! Retrospective application results in the most useful information to users because the information presented for all periods is comparable. Under retrospective application, an entity must present its financial statements as if the entity had always applied IFRS 9.

IFRS 9 shall not be applied to items that have already been derecognized at the date of initial application.

Date of Initial Application

The IFRS 9 transition requirements refer to the "date of initial application" which is defined as the date when an entity first applies the requirements of IFRS 9. An entity's date of initial application must be after the release of the final version of IFRS 9 (i.e., after July 24, 2014) and must be the beginning of a reporting period after the issue of IFRS 9. However, it is possible to have more than one date of initial application if an entity adopted any of the earlier versions of IFRS 9. An entity that did not adopt any earlier versions of IFRS 9 will have only one date of initial application.

Note! A reporting period could be the beginning of an interim reporting period. However, this may cause some additional complexities. Therefore, most entities will likely elect the beginning of an annual reporting period as the date of initial application.

Examples of Date of Initial Application Assuming No Early Adoption	
Details of Entity	**Date of Initial Application**
Entity has a December 31 year-end and first applies IFRS 9 for the year ended December 31, 2018.	January 1, 2018
Entity has an October 31 year-end and first applies IFRS 9 for the year ended October 31, 2019.	November 1, 2018

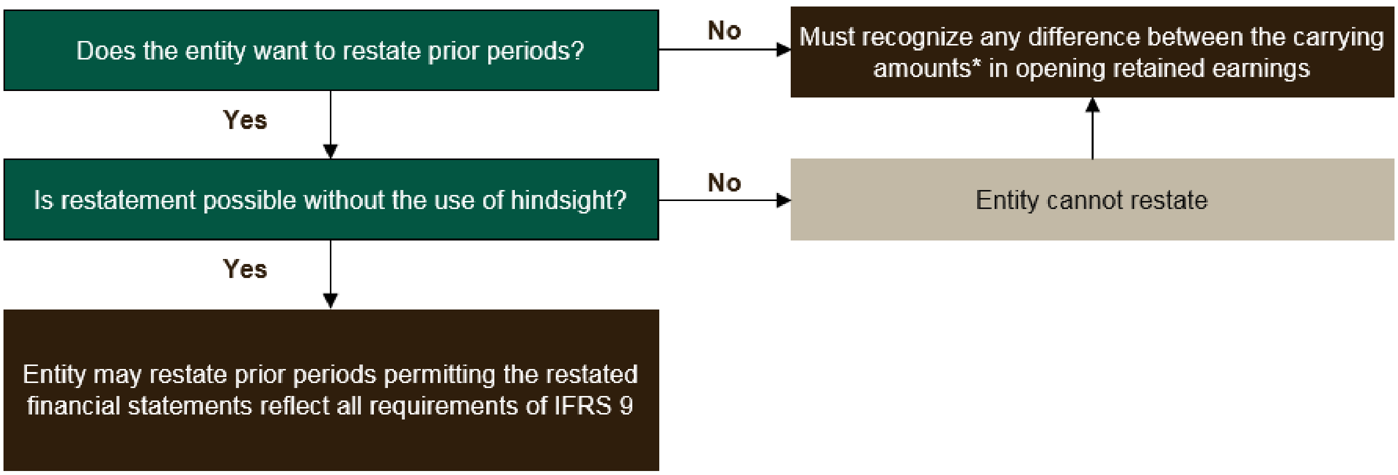
The following assessments must be performed on the date of initial application for instruments that the entity already owns:

Assessment to be Performed on the Date of Initial Application
Assessing the objective of the business model the financial asset is held within.
Assessing whether the financial asset meets the solely payments of principal and interest requirement.
Determining the fair value of a financial instrument when it is impracticable to apply the effective interest rate method retrospectively.
Designating or revoking a designation to measure a financial instrument as measured at FVTPL if it will eliminate or significantly reduce an accounting mismatch.
Assessing whether an accounting mismatch would be created or enlarged by presenting the effects of changes in a financial liability's credit risk in OCI.
Designating to measure subsequent changes in the fair value of an equity instrument in OCI.
Designating to measure existing contracts to buy or sell a non-financial item at FVTPL to eliminate or significantly reduce an accounting mismatch.
If restating prior periods, determining the adjustment to opening retained earnings for hybrid contracts where their fair value was not measured in comparative periods.
Determining the fair value of an equity investment or derivative linked to an equity instrument that was previously accounted for at cost under IAS 39.
Determining whether there has been a significant increase in credit risk since initial recognition.
Assessing the entity's compliance with qualifying hedge accounting criteria.

These assessments are discussed in further detail under the *Classification and Measurement*, *Impairment* and *Hedge Accounting* sections of this guide.

Restatement of Prior Periods

IFRS 9 does not require restatement of prior periods except in limited circumstances related to hedge accounting. However, an entity may still choose to restate its prior periods. The following decision tree outlines the IFRS 9 requirements related to restatement and required disclosures on transition:



** If an entity does not restate prior periods, the entity must recognize any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application in the opening retained earnings of the annual reporting period that includes the date of initial application.*

Consider the following factors when deciding whether to restate comparative periods, which are by no means exhaustive:

- Even if an entity chooses to not restate its comparative figures, it must still quantify the required adjustments to opening retained earnings. The difference between the new carrying amount under IFRS 9 and the previous carrying amount on the date of initial application must be recognized in opening retained earnings, or other component of equity (e.g. OCI), at the beginning of the reporting period that includes the date of initial application.
- Restatement may enhance the comparability of the prior year information and hence increase the usefulness to users of the financial statements. However, given that IFRS 9 includes exceptions to the full retrospective application and IAS 39 continues to be applied for derecognized financial assets prior to the date of initial application, the results may not be comparable despite being restated.
- An entity that chooses to restate comparative periods must also apply IAS 1 *Presentation of Financial Statements*. IAS 1 requires that a third balance sheet be presented at the beginning of the prior year in situations where an accounting policy is retrospectively applied and the change has a material effect on the information in the balance sheet at the beginning of the preceding period.

Note! If an entity chooses not to restate comparative periods, approval from a regulator may be required. Therefore, it is important for an entity to communicate with their regulator(s) early and prior to implementing the decision of not restating comparative periods.

Interim Financial Statements

In Canada, reporting issuers, including public companies, apply IAS 34 *Interim Financial Reporting* to their quarterly interim financial reports that are publicly filed. If an entity prepares interim financial reports in accordance with IAS 34, the entity need not apply the requirements of IFRS 9 to interim periods prior to the date of initial application if it is impracticable.[2]

Classification and Measurement

Please refer to Appendix A for a high-level refresher of the IFRS 9 classification and measurement requirements.

The Business Model Test

At the date of initial application, an entity must assess whether a financial asset is held within a business model whose objective is:

- To collect contractual cash flows; or
- To collect contractual cash flows and sell the financial assets.

This assessment must be performed based on the facts and circumstances that exist at the date of initial application. The resulting classification shall be applied retrospectively irrespective of the entity's business model in prior reporting periods.

Note! This assessment will assist in determining whether the financial asset should be classified as measured at:
- Amortized cost;
- Fair value through other comprehensive income (FVOCI); or
- FVTPL.

The Solely Payments of Principal and Interest ("SPPI") Test

IFRS 9 does not provide specific transition requirements for the date which an entity assesses if the SPPI test is met. As such, in accordance with the objective of retrospective application, the entity performs this assessment based on information that existed at the time the financial asset was initially recognized. However, transition relief has been included in IFRS 9 for the following:

- Modified time value of money element;
- Prepayment features; and
- Application of the effective interest rate method.

[2] Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a prior period, it is impracticable to apply a change in an accounting policy retrospectively if:
(a) The effects of the retrospective application are not determinable;
(b) The retrospective application requires assumptions about what management's intent would have been in that period; or
(c) The retrospective application requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
    (i) Provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognized, measured or disclosed; and
    (ii) Would have been available when the financial statements for that prior period were authorized for issue from other information.

Exception for Assessing a Modified Time Value of Money Element or Determining the Fair Value of a Prepayment Feature

It may be impracticable for an entity to assess based on the facts and circumstances that existed at the date of initial recognition of the financial asset:

- A modified time value of money element; or
- Whether the fair value of a prepayment feature was insignificant.

If so, the entity is required to assess the contractual cash flow characteristics of that financial asset without considering the requirements related to the modification of the time value of money element or the exception for prepayment features.[3]

> **Note!** If an entity applies the above exception for a modified time value of money element or prepayment feature, it will likely result in the financial asset being measured at FVTPL. This is because:
> - Ignoring the requirements to assess the significance of a mismatch between the interest rate (e.g. a 3-month LIBOR rate) and the reset period (e.g. annually) for a financial asset with a modified time value of money element would generally result in the financial asset failing the SPPI test.
> - The exception relating to prepayment features in IFRS 9.B4.1.12 allows the financial instrument to be measured at amortized cost or FVOCI if certain criteria are met. Since the exception is ignored, the instrument will be measured at FVTPL.

Exception for Applying the Effective Interest Rate Method Retrospectively

It may be impracticable for an entity to apply the effective interest method retrospectively (e,g. for financial instruments previously classified as FVTPL under IAS 39 but measured at amortized cost under IFRS 9). In such situations, the fair value of the financial instrument under IAS 39 becomes the instrument's measurement base under IFRS 9.

If the entity restates prior periods:

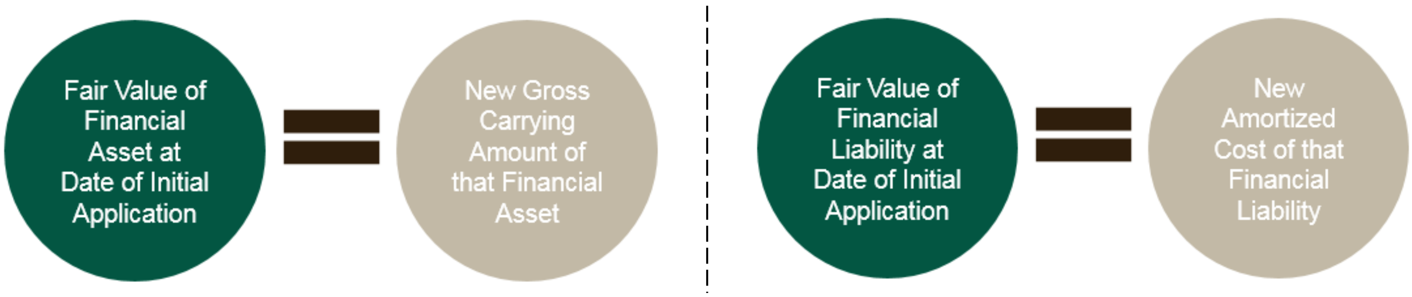
Fair Value of Financial Asset at End of Each Comparative Period = Gross Carrying Amount of that Financial Asset

Fair Value of Financial Liability at End of Each Comparative Period = Amortized Cost of that Financial Liability

[3] A financial asset that would otherwise meet the SPPI condition but does not do so only because of a contractual term that permits, or requires, the issuer to prepay a debt instrument, or the holder to put a debt instrument back to the issuer before maturity, is eligible to be measured at amortized cost or FVOCI if:

(a) The entity acquires or originates the financial asset at a premium or discount to the contractual par amount;
(b) The prepayment amount substantially represents the contractual par amount and accrued (but unpaid) contractual interest, which may include reasonable additional compensation for the early termination of the contract; and
(c) When the entity initially recognized the financial asset, the fair value of the prepayment feature is insignificant.

At the date of initial application of IFRS 9:



Making and Revoking Designations

FVTPL Designation to Eliminate or Reduce Accounting Mismatch

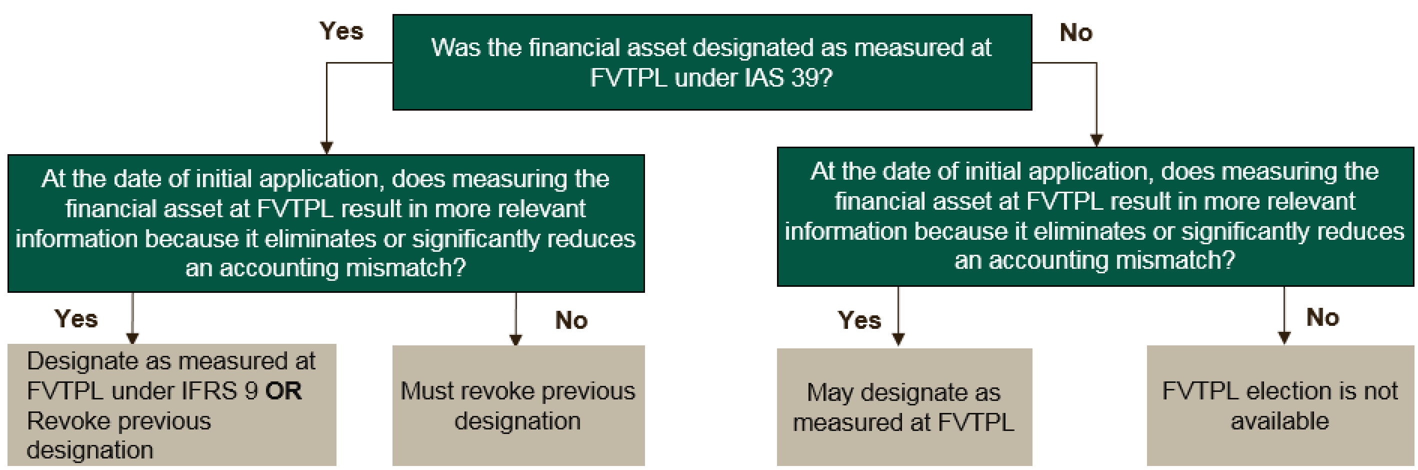
FVTPL Designation for Financial Assets

IAS 39 allows an entity to designate certain financial assets as measured at FVTPL. This relates to situations where:

a) A contract contains one or more embedded derivatives; or
b) The designation eliminates or significantly reduces an accounting mismatch; or
c) A group of financial assets, or a combination of financial assets and financial liabilities, is managed and its performance is evaluated on a fair value basis.

Under IFRS 9, the FVTPL designation for financial assets is only allowed in the case of b). As such, financial assets that were previously designated at FVTPL based on a) or c) may no be longer eligible for the FVTPL election.

The following diagram may be used to assist in determining when the FVTPL designation is available at the date of initial application:



This assessment must be made based on the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

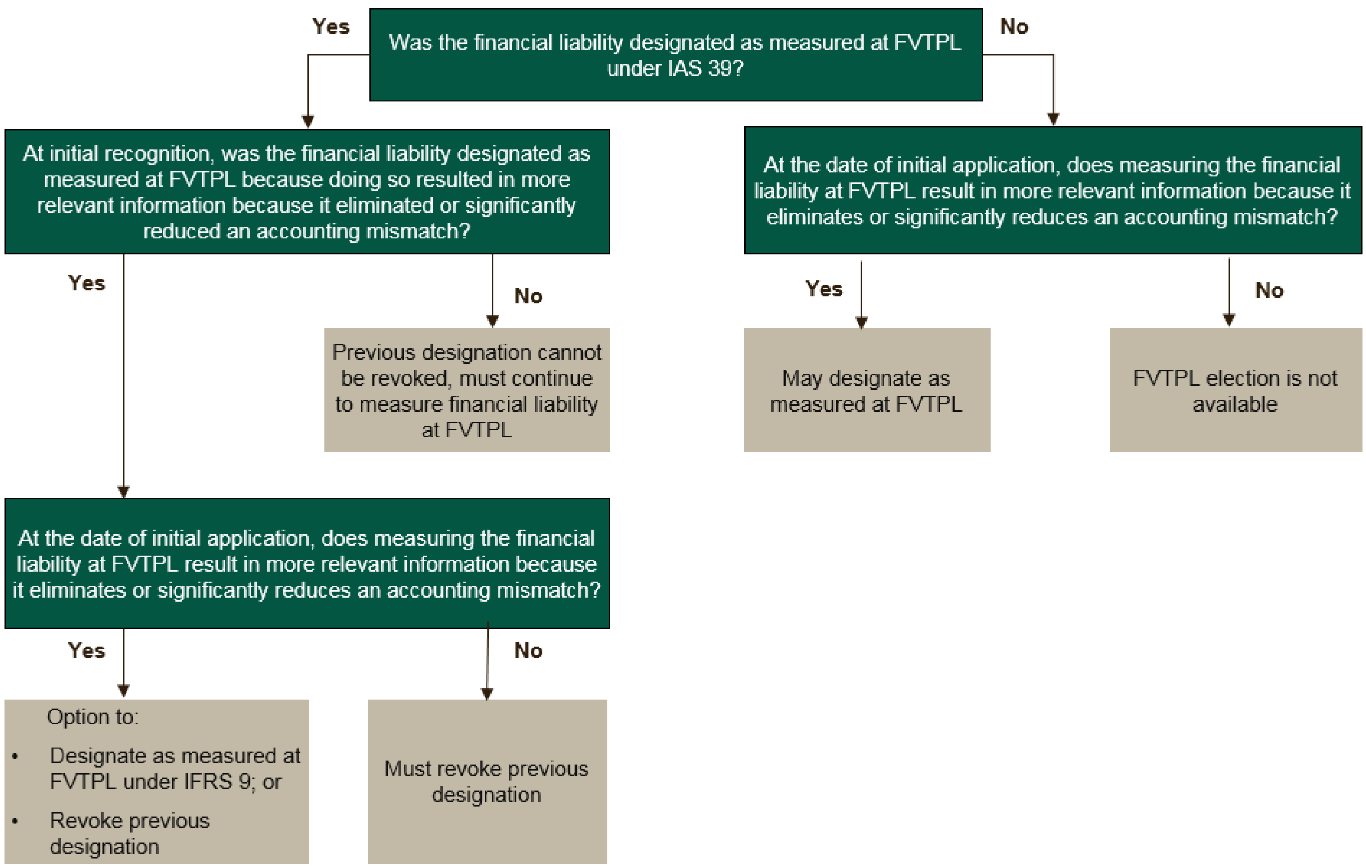
FVTPL Designation for Financial Liabilities

IFRS 9, consistent with IAS 39, allows an entity to designate certain financial liabilities as measured at FVTPL. This relates to situations where:

a) A contract contains one or more embedded derivatives;
b) The designation eliminates or significantly reduces an accounting mismatch; or
c) A group of financial liabilities, or a combination of financial assets and financial liabilities, is managed and its performance is evaluated on a fair value basis;

These designations for financial liabilities have not changed under IFRS 9 and are usually performed at an instrument's initial recognition date. However, the transition requirements of IFRS 9 allows an entity to designate a financial liability as measured at FVTPL, or requires an entity to revoke its previous designation, depending on whether b) is applicable at the date of initial application. If the financial liability was previously designated as measured at FVTPL because of the circumstances described in a) or c), an entity cannot revoke this designation.

The following diagram may be used to assist in determining when the FVTPL designation under b) is available at the date of initial application:



**The financial liability will continue to be measured at FVTPL based on a) and c) since b) does not apply and the designation was done before initial application.*

Such a designation and revocation must be made based on the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

Presentation of Gains and Losses in OCI Relating to Own-Credit Risk

When an entity designates a financial liability as at FVTPL, it must determine whether presenting the effects of changes in the liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss. To make that determination, an entity must assess whether it expects that the effects of changes in the liability's credit risk will be offset in profit or loss by a change in the fair value of another instrument measured at FVTPL. Such an expectation must be based on an economic relationship between the characteristics of the liability and those of the other financial instrument. Further, this assessment must be performed at the date of initial application and is not subsequently reassessed for that specific instrument.

Designation of Investments in Equity Instruments as at FVOCI

Under IFRS 9, an entity may make an irrevocable election to classify investments in equity instruments as measured at FVOCI if such investments are neither:

- Held for trading [4]; nor
- Contingent consideration recognized by an acquirer in a business combination to which IFRS 3 *Business Combinations* applies.

This assessment must be made based on the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

Designation of Contracts to Buy or Sell a Non-Financial Item as at FVTPL

IAS 39 excludes from its scope contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

These contracts may fall within the scope of IFRS 9 if an entity designates them as measured at FVTPL to eliminate or significantly reduce an accounting mismatch. At the date of initial application, an entity is permitted to make this designation for contracts that already exist at that date if it designates all similar instruments. The change in the net assets resulting from such designations must be recognized in retained earnings at the date of initial application.

[4] An entity must determine whether the investments meet the definition of held for trading as if the entity had purchased the assets at the date of initial application.

Relief for Hybrid Contracts where their Fair Value was not Measured in Comparative Periods

An entity may not have previously determined the fair value of a hybrid contract in its entirety and, thus, may not have the necessary information to determine the fair value retrospectively without using hindsight. Consequently, IFRS 9 provides transition relief if the fair value was not measured in comparative reporting periods and the entity restates prior periods. The fair value of the hybrid contract is required to be measured as follows at the end of each comparative period:

Note! An entity is required to measure both the embedded derivative(s) and host at fair value, separately, to apply the disclosure requirements of IFRS 7 *Financial Instruments: Disclosures.* Consequently, an entity should have the fair value of both the embedded derivative(s) and host readily available.

At the date of initial application, the entity must recognize any difference between the fair value of the entire hybrid contract and the sum of the fair values of the components of the hybrid contract in opening retained earnings, or other component of equity, of the reporting period that includes the date of initial application.

Instruments (Including Unquoted Equity Instruments) Subject to IAS 39 Cost Exceptions

Under IAS 39, an entity may account for the following instruments at cost when their fair value is not reliably measurable:

- Equity investments not quoted in an active market;
- Derivative liabilities linked to equity investments not quoted in an active market; or
- Derivative assets linked to equity investments not quoted in an active market.

Since IFRS 9 eliminates this exception, an entity is required to measure such instruments at fair value at the date of initial application. Any difference between the previous carrying amount of the instrument and its fair value must be recognized in opening retained earnings, or other component of equity, of the reporting period that includes the date of initial application.

Impairment

Please refer to the diagrams in Appendix B for a refresher of the general IFRS 9 impairment requirements.

An entity must apply the impairment requirements of IFRS 9 retrospectively in accordance with IAS 8.

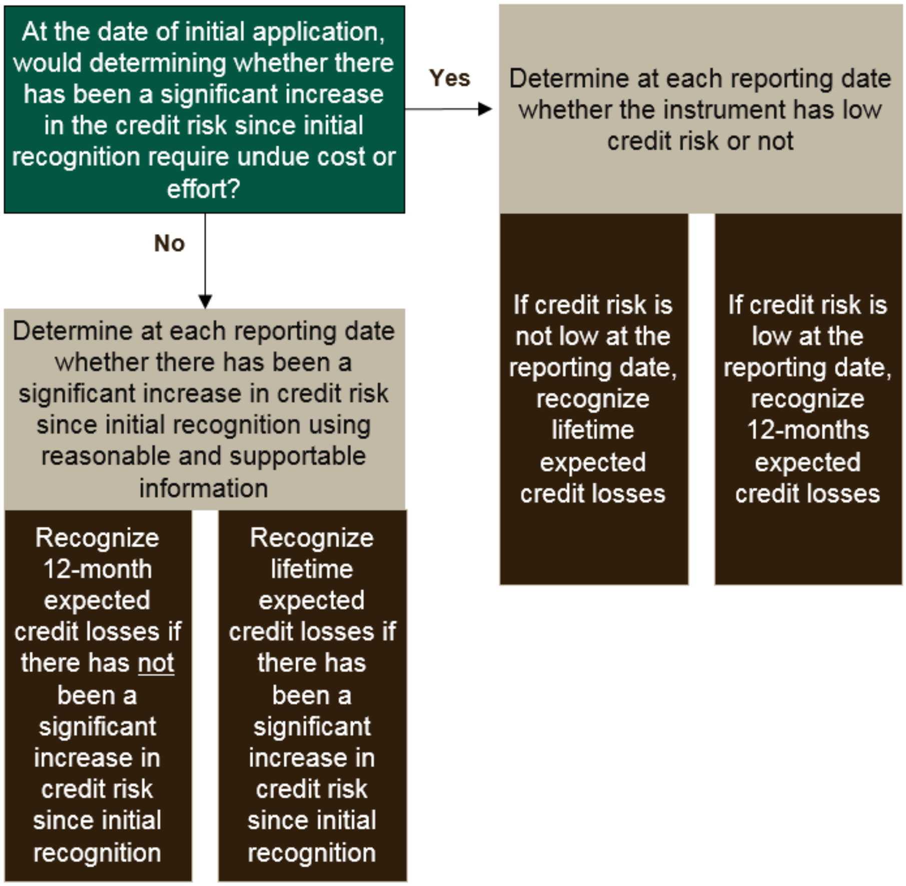
At the date of initial application, an entity must use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that a financial instrument was initially recognized. For loan commitments and financial guarantee contracts, it would be the date that the entity became a party to the irrevocable commitment. This credit risk must then be compared to the credit risk at the date of initial application of IFRS 9 to determine if there has been a significant increase in credit risk since initial recognition.

The process to determine whether there has been a significant increase in credit risk since initial recognition on transition is similar to the process applied at each reporting period. As a result, the guidance in IFRS 9.B5.5.15-24 and B5.5.49-B5.5.54 is relevant to the assessment of credit risk on transition. This includes the requirement to assess whether the rebuttable presumption that the credit risk has increased significantly since initial recognition if the financial asset is more than 30 days overdue and the assumption that credit risk has not increased significantly if the financial instrument has low credit risk applies on the transition date.

Undue Cost or Effort

Determining whether there has been a significant increase in credit risk on the initial application date since initial recognition of the financial instrument can be challenging in some situations. Therefore, some relief is provided to assist with this assessment.

The following diagram may be used to apply the impairment transition requirement on initial application of IFRS 9 and to determine its effect on subsequent reporting periods:



The IFRS Discussion Group discussed the impact of this transition requirement in more detail at their December 3, 2015 meeting. The discussion dealt with a scenario where, at initial application (e.g. January 1, 2018), determining whether there has been a significant increase in credit risk since initial recognition required undue cost or effort. However, in a subsequent reporting period (e.g. December 31, 2018), the credit risk for this instrument was assessed at low and at a later reporting period (e.g. December 31, 2019), the credit risk was no longer considered low. The discussion confirmed that for such instruments the loss allowance would be based on lifetime expected credit losses for all reporting periods after initial application until derecognition (e.g. including the December 31, 2019 reporting period in the scenario discussed above) except for those reporting periods where the credit risk is considered low (e.g. December 31, 2018). In other words, if determining whether there has been a significant increase in credit risk was considered to require undue cost or effort on the date of initial application, then subsequently only the absolute credit risk is considered (i.e. whether credit risk is low or not) to determine whether the loss allowance is based on 12-month or lifetime expected credit losses.

Note! IFRS 9 does not provide a definition of "undue cost or effort". As such, management must exercise judgment to determine what would constitute "undue cost or effort". An entity may consider the cost or effort in comparison to the benefits received from users of the financial statements in determining the work to be performed. This may be a high hurdle to overcome as also noted at the IFRS Discussion Group December 3, 2015 meeting.

Hedge Accounting

When an entity first applies IFRS 9, it may choose as its accounting policy to either:

- Continue to apply the hedge accounting requirements [5] of IAS 39; or
- Apply the hedge accounting requirements of IFRS 9.

An entity must apply the chosen policy to all its hedging relationships, including relationships existing at the time of application of IFRS 9 and new relationships initiated after transition. If an entity chooses to apply the IFRS 9 hedge accounting requirements, the entity must apply them prospectively.

Note! Under prospective application, the hedge accounting requirements are applied going forward from the date of initial application and not applied to prior periods. Hedge accounting is applied prospectively to avoid the use of hindsight.

Hedging Relationships that Qualify for Hedge Accounting Under Both IAS 39 & IFRS 9

A continuing hedging relationship is one that qualified for IAS 39 hedge accounting and continues to qualify under IFRS 9, after any required rebalancing of the hedging relationship on transition.

On initial application of the hedge accounting requirements of IFRS 9, an entity:

- May start to apply those requirements from the same point in time as it ceases to apply the hedge accounting requirements of IAS 39; and
- Shall consider the hedge ratio in accordance with IAS 39 as the starting point for rebalancing the hedge ratio of a continuing hedging relationship, if applicable. Any gain or loss from such a rebalancing is recognized in profit or loss.

To apply the hedge accounting requirements of IFRS 9 from the date of initial application, all qualifying criteria must be met as at that date. However, there are three limited exceptions to the full prospective application, which are discussed below.

Limited Exceptions to Full Prospective Application of Hedge Accounting Requirements

IFRS 9 allows three limited exceptions to the full prospective application of the following new requirements.

Time Value of Options

Under IAS 39, an entity may designate only the change in an option's intrinsic value as a hedging instrument in a hedging relationship (i.e., exclude the change in the option's time value). An entity that made this designation must apply IFRS 9.6.5.15 relating to the accounting for the time value of options retrospectively if those hedging relationships existed at the beginning of the earliest comparative period or were designated thereafter.

[5] An entity that chooses to continue to apply the hedge accounting requirements of IAS 39 shall also apply IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* without the amendments that conform that Interpretation to the hedge accounting requirements of IFRS 9.

Forward Element of Forward Contracts and Foreign Currency Basis Spreads of a Financial Instrument

Under IAS 39, an entity may designate only the spot price of a forward contract as a hedging instrument in a hedging relationship (i.e., exclude the forward element). A forward price is different from the spot price because the forward price is for a purchase or sale in the future and, thus, is affected by interest rates. If an entity only designates the changes in the spot rate as part of the hedging relationship then the changes in fair value of the hedging instrument that are not due to changes in the spot price, and consequently are due to the forward element, are immediately recognized in profit or loss as a cost of hedging.

An entity that made this designation can choose to apply IFRS 9.6.5.16 relating to the accounting for the forward element of forward contracts retrospectively if those hedging relationships existed at the beginning of the earliest comparative period or were designated thereafter.

This election is not available on a relationship-by-relationship basis; thus, if an entity elects retrospective accounting, it must be applied to all hedging relationships that qualify for the election.

IAS 39 did not speak to the accounting for currency basis spreads (i.e., the charge above the risk-free rate of a foreign country to compensate for liquidity risk). The IFRS 9 requirements treat the currency basis spreads as a cost of hedging which is recognized in profit or loss at the same time as the hedged transaction. If an entity excludes the foreign currency basis spread from a financial instrument designated as a hedging instrument, the accounting for the spread depends on whether the hedged item is transaction-related or time-period related, as follows:

- Transaction-related hedged item – changes in the spread are recognized in OCI and adjusted out of the separate component of equity as a reclassification adjustment when the hedged transaction occurs.
- Time-period related hedged item – changes in the spread are recognized in OCI and amortized on a systematic and rational basis to profit or loss over the hedging period.

The accounting for foreign currency basis spreads may also be applied retrospectively for those hedging relationships that existed at the beginning of the earliest comparative period or were designated thereafter.

Termination of the Hedging Instrument

IFRS 9.6.5.6 clarifies that there is no expiration or termination of a hedging instrument in certain situations where the counterparty for the hedging instrument changes as consequence of new, or changes in, laws or regulations and this is the only change to the hedging instrument. An entity must apply this IFRS 9 requirement retrospectively.

Disclosure

The disclosures that are required on transition to IFRS 9 are included in IFRS 7.42I-42S and are summarized below.

Initial Application Disclosures [6]

The disclosures provided in the reporting period that includes the initial application date relate to:

Original and New Measurement	For each class of financial assets or financial liabilities (in tabular format unless another format is more appropriate): ▪ Original measurement category and carrying amount determined via IAS 39 or previous version of IFRS 9. ▪ New measurement category and carrying amount determined via IFRS 9. ▪ Amount of any financial assets or liabilities in the statement of financial position previously designated at FVTPL but are no longer so designated. • Distinguish between those reclassified as a requirement of IFRS 9 and those reclassified through election at the date of initial application.
Additional Qualitative Disclosures	Qualitative disclosures to enable users to understand: ▪ How the entity applied the classification requirements in IFRS 9 to financial assets whose classification changes as a result of applying IFRS 9. ▪ The reasons for any designation or de-designation of financial assets or financial liabilities measured at FVTPL at the date of initial application.

Note! In the reporting period that includes the date of initial application of IFRS 9, an entity is not required to disclose line item amounts that would have otherwise been reported in accordance with classification and measurement requirements of IFRS 9 for prior periods, and IAS 39 for the current period. This includes the requirements related to amortized cost measurement of financial assets and impairment in IFRS 9.

[6] If the entity has more than one date of initial application, the quantitative and qualitative disclosure may have to be disclosed on more than one date of initial application. An entity that did not early adopt any version of IFRS 9 will only have one date of initial application.

Classification and Measurement Disclosures[7]

The disclosures relating to the impact of the new IFRS 9 classification and measurement requirements relate to:

Changes in Classification	Changes in the classifications of financial assets and liabilities as at the date of initial application, showing separately: ▪ The changes in carrying amounts on the basis of their measurement categories in accordance with IAS 39. ▪ Changes in carrying amounts resulting from changes in measurement attributes on transition to IFRS 9.
Reclassified Financial Assets and Liabilities	For financial assets and financial liabilities reclassified to amortized cost and, in the case of financial assets, reclassified out of FVTPL to be measured at FVOCI as a result of transition to IFRS 9, disclose: ▪ The fair value of the financial assets or financial liabilities at the end of the reporting period. ▪ The fair value gain or loss that would have been recognized in profit or loss or OCI during the reporting period if reclassification had not taken place. For financial assets and financial liabilities that have been reclassified out of FVTPL as a result of transition to IFRS 9, the effective interest rate determined on the date of initial application and the interest revenue or expense recognized.[8]

Impairment Disclosures

The disclosures relating to the impact of the new IFRS 9 impairment requirements relate to:

Impairment Allowances	Information that permits the reconciliation of the ending impairment allowances calculated in accordance with IAS 39 and the provisions in accordance with IAS 37 to the opening loss allowances calculated in accordance with IFRS 9.
Effect of Changes in Measurement Category on Loss Allowance	For financial assets, disclosure is provided by the related measurement categories in accordance with IAS 39 and IFRS 9, showing separately the effect of the changes in the measurement category on the loss allowance at that date.

[7] The disclosures must permit reconciliation at the date of initial application between:
- The measurement categories presented in accordance with IAS 39 and IFRS 9; and
- The class of financial instrument.

[8] These disclosures need not be made after the annual reporting period in which the entity initially applies the classification and measurement requirements for financial assets in IFRS 9 with one exception. If an entity treats the fair value of a financial asset or financial liability as the new gross carrying amount at the date of initial application in which case the disclosures are required for each period until derecognition.

Disclosures for Modified Time Value of Money Elements and Fair Value of Prepayment Features

Carrying Amount	When an entity uses the exemptions in IFRS 9.7.2.4-5 relating to assessing a modified time value of money element or determining the fair value of a prepayment feature, an entity discloses the carrying amount of such financial assets at each reporting date until the financial assets are derecognized.

Audit & Other Business Considerations

Although IFRS 9 is not effective until annual periods beginning on or after January 1, 2018, an entity should consider the potential impacts of IFRS 9 as soon as possible to ensure sufficient plans are developed for its adoption. Below is a possible timeline for an entity with a December year-end which has been significantly impacted by the transition:

The adoption of IFRS 9 may significantly impact various areas of business. Expected key impacts include:

- Changes in processes and systems to comply with the new classification, measurement, impairment and hedging requirements.
- Collaboration between the finance and credit risk management departments is needed to align the IFRS 9 impairment model with the entity's risk management processes and to identify relevant information to use.
- Use of experts may be needed to assist in the implementation.
- Increased use of judgment especially for the impairment model assumptions.
- Key financial ratios may be impacted, which may in turn impact loan covenants. Therefore, it is important that an entity identify any potential risk of non-compliance with loan covenants and communicate with lenders and other stakeholders to mitigate these risks as soon as possible.

An entity must be prepared to provide information required by auditors. Documentation requested by auditors may include, but is not limited to:

- Management's assessment of the appropriate classification of its financial assets based on their contractual cash flow characteristics and the entity's business model for managing the financial assets.
- Management's calculations of the impact of any changes in classification on the measurement of its financial assets, including the determination of fair value for equity investments previously measured at cost.
- Management's impairment model including a description of the reasonable and supportable information used in its model to determine whether there has been a significant increase in credit risk since initial recognition of its financial assets and to support all inputs and assumptions relating to the model.
- Management's assessment of any changes in its hedging relationships including documentation of the qualifying criteria for new hedging relationships.
- A list of the practical expedients and transitional relief options applied.

Additional Resources

External Resources

- IFRS 9 can be found in Part I of the CPA Canada Handbook - Accounting.
- More information about IFRS 9 and background to the updates can be found in the press release for the standard.
- The IASB's Project Summary provides an overview of the new standard.

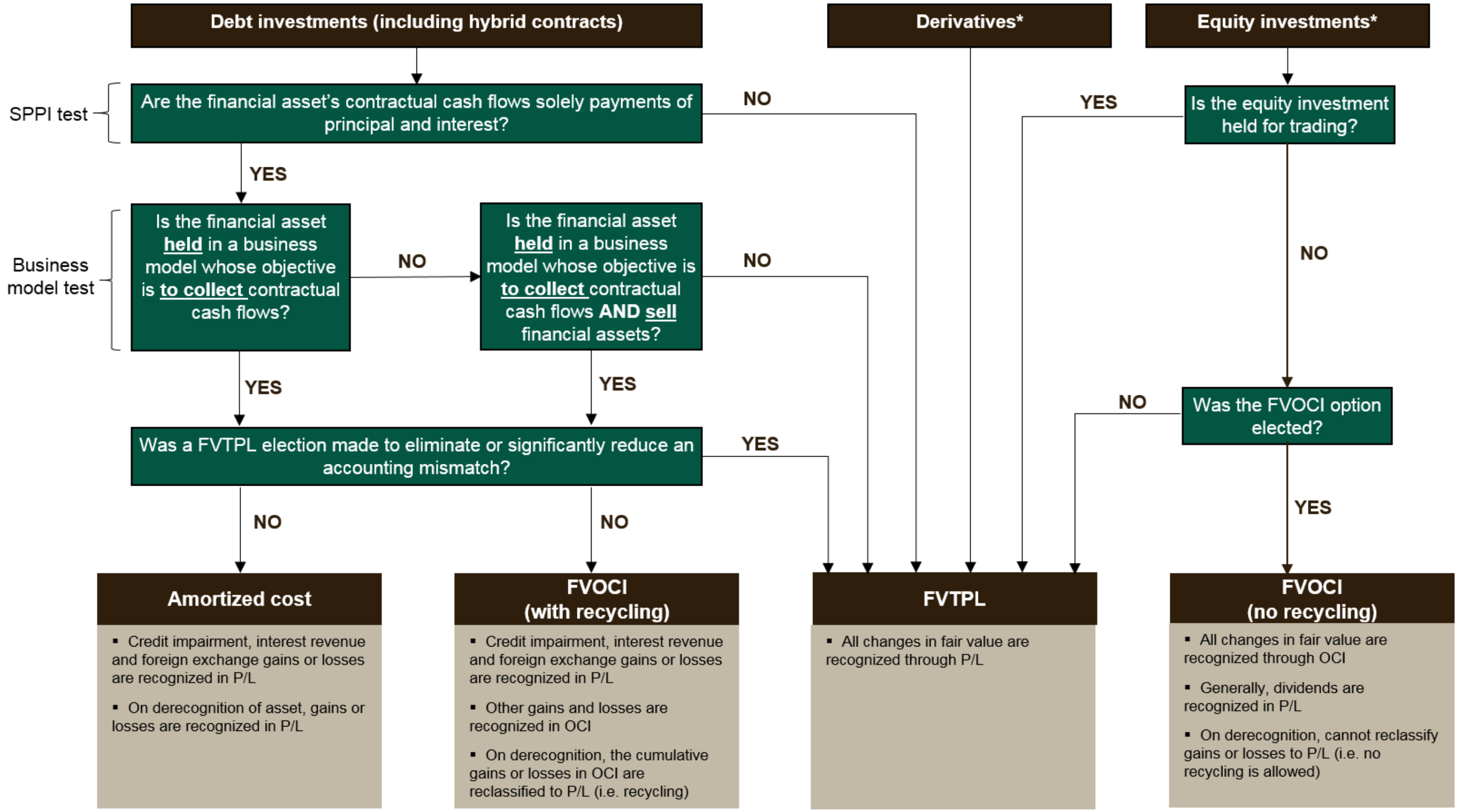
IFRS 9 has several Illustrative Examples that accompany, but are not part of the International Standard. These examples illustrate the underlying concepts, methodology and computations of the IFRS 9 requirements.

Other MNP Technical Guidance

- IFRS 9 Snapshot
- An Overview of IFRS 9 *Financial Instruments* versus IAS 39 *Financial Instruments: Recognition and Measurement*
- An Overview of the New Financial Asset Classification and Measurement Requirements of IFRS 9 *Financial Instruments*
- An Overview of the Impairment Requirements of IFRS 9 *Financial Instruments*
- An Overview of the Hedging Requirements of IFRS 9 *Financial Instruments* *(coming soon)*

Appendix A: Classification of Financial Assets Diagram

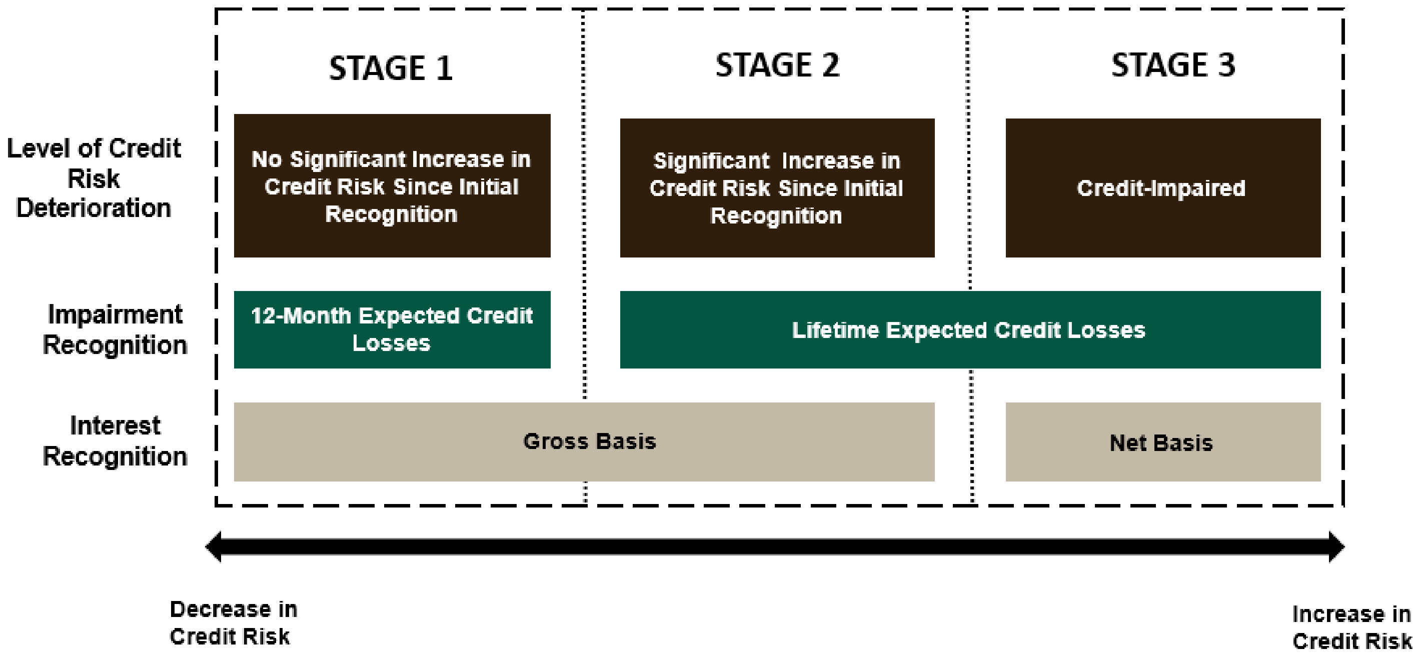
The following diagram may be used to determine the appropriate classification of a financial asset under IFRS 9.



** Assuming the contractual terms of the financial asset do <u>not</u> give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. This is generally the case for equity investments and derivatives; hence we recommend this simplified approach to the classification of these instruments.*

Appendix B: Impairment Diagrams

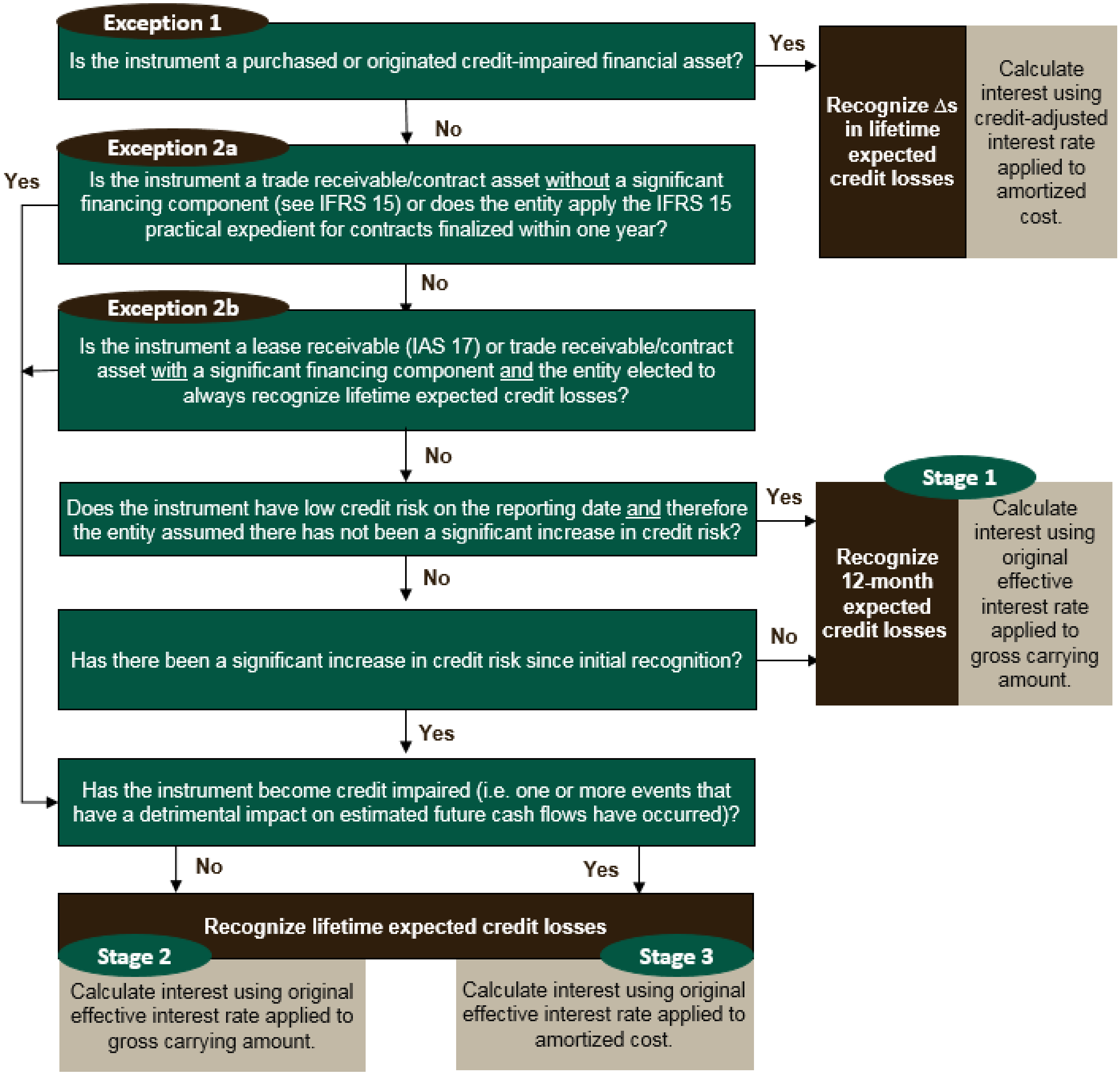
The following diagram provides a high-level overview of the general IFRS 9 impairment approach:



There are two exceptions to the general approach depicted above. These relate to:

- Purchased or originated credit-impaired financial assets
- Trade receivables, contract assets *(as defined in IFRS 15)* and lease receivables *(within the scope of IAS 17)*

The following diagram describes the thought process to follow when determining the impairment loss and how interest is recognized. It includes the general approach (i.e., the three stages) and the two exceptions to the general approach.



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