MNP LLP

IAS 39 *Financial Instruments: Recognition and Measurement*

Last updated: March 2017

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SCOPE

Same as IAS 32 with additional exceptions relating to **CERTAIN:**

- Rights & obligations under leases (see IAS 17).
- Equity instruments issued by entity per IAS 32 classification (holder still applies IAS 39).
- Forward contracts that will result in IFRS 3 business combination.
- Loan commitments.
- Reimbursement rights on IAS 37 provisions.

CATEGORIES OF FINANCIAL INSTRUMENTS

FINANCIAL ASSET/LIABILITY @ FV THROUGH P/L meets any of these conditions:

(1) Classified as held for trading (HFT) = acquired/incurred principally for selling/ repurchasing in near term **OR** on initial recognition part of portfolio of identified financial instruments that are managed together & evidence of recent actual pattern of short-term profit-taking **OR** a derivative (EXCEPT a derivative that is a financial guarantee contract or designated effective hedging instruments).

(2) It is contingent consideration of an acquirer in a business combination (IFRS 3)

(3) Designated as such upon initial recognition = permitted for certain *embedded derivative* contracts **OR** when doing so results in *more relevant information* (disclosure required on how conditions satisfied) **EXCEPT** equity investments with NO quoted price in active market & FV NOT reliably measurable → CANNOT be designated.

- **More relevant information** = eliminates/significantly reduces measurement/ recognition inconsistency ("accounting mismatch" – e.g. Δ in asset FV through equity but Δ in related liability through P/L) **OR** group of financial assets/liabilities/both managed & performance evaluated on FV basis, per documented risk management/ investment strategy & group information provided internally on that basis to key management personnel (e.g. Board of Directors & CEO).

OTHER FINANCIAL LIABILITIES

All other financial liabilities (i.e., those NOT carried @ FV) measured @ amortized cost.

HELD-TO-MATURITY (HTM) INVESTMENTS

Non-derivative financial assets with fixed or determinable payments & fixed maturity & positive intention & ability to hold to maturity **EXCEPT**:

- Designated as *@ FV through P/L* or *AFS* or *L&Rs*.
- If during current financial year/two preceding financial years, sold/ reclassified more than insignificant (in relation to total *HTM*) amount before maturity → reclassify all *HTM* to *AFS* **EXCEPT** those that:
  - Are so close to maturity/call date (e.g. 3 months) that Δs in market interest rate NOT significant effect on FV.
  - Occur after substantially all original principal collected through scheduled payments/ prepayments.
  - Are attributable to an isolated event beyond entity's control, are non-recurring & could not reasonably be anticipated.

LOANS & RECEIVABLES (L&R)

Non-derivative financial assets with determinable/ fixed payments & NOT quoted in active market **EXCEPT** those:

- Intended for sale immediately/in near term → classify as *HFT.*
- Designated *@ FV through P/L* or *AFS.*
- Where holder may not recover substantially all of initial investment (OTHER than because of credit deterioration) → classify as *AFS.*

AVAILABLE-FOR-SALE (AFS) FINANCIAL ASSETS

Non-derivative financial assets that are designated as available for sale **OR** NOT classified as *L&Rs*, *HTM* OR *@ FV through P/L.*

See IAS 39 requirements on reclassification in/out of the above as not always allowed (e.g. cannot reclassify as *@ FV through P/L* after initial recognition).

INITIAL RECOGNITION & MEASUREMENT

Recognize financial asset/liability in statement of financial position when entity becomes party to instrument's contractual provisions (i.e., trade date) (*see *regular way purchases* exception).

Measure as follows:

- *@ FV through P/L*→ FV.
- Other categories → FV plus direct transaction costs.

See IAS 39.AG76 if FV ≠ transaction price.

*REGULAR WAY PURCHASES OR SALES

Regular way purchases or sales = delivery required within time frame established generally by regulation/convention in marketplace.

Recognize/derecognize (as applicable) using **EITHER:**

- **Trade date accounting:** regular recognition & derecognition.
- **Settlement accounting**

Financial assets NOT carried @ cost/amortized cost:

- Purchase → recognize receivable/payable for Δ in FV from trade to settlement date and apply to asset on settlement date.
- Sale → stop recognizing Δ in FV on trade date (i.e., carrying amount used to calculate gain/loss on disposal does NOT include Δ in FVs from trade date).

Financial assets @ cost/ amortized cost:

- Recognize initially @ FV on trade date.
- Subsequent Δ in FV (excluding impairment) NOT recognized.

SUBSEQUENT MEASUREMENT (*see *regular way purchases* exception)

FINANCIAL ASSETS

L&Rs* and *HTM → amortized cost using effective interest method.

@ FV through P/L* & *AFS → FV.

Equity investments NOT quoted in active market whose FV is not reliably measurable AND derivatives linked to & settled by delivery of such equity instruments → cost.

FINANCIAL LIABILITIES

Amortized cost using effective interest method, except for:

@ FV through P/L → FV.

Derivative liability linked to & must be settled by delivery of equity instrument NOT quoted in active market whose FV is not reliably measurable → cost.

Financial guarantee contract & commitment to provide loan @ below-market interest rate (that do not fall into another category) → higher of:

- Amount determined per IAS 37; and
- Amount initially recognized LESS any cumulative amortization per IAS 18.

GAINS/LOSSES

@ amortized cost using effective interest method:

- When derecognized/ impaired & through the amortization process → P/L.

@ FV through P/L → P/L.

AFS:

- Δ in FV→ other comprehensive income. (when derecognized → reclassify cumulative gain/loss to P/L).
- Impairment losses, foreign exchange gains/losses, dividends & effective interest rate interest → P/L.

EMBEDDED DERIVATIVES

Embedded derivative = component of hybrid (combined) instrument that also includes a non-derivative host contract. Is NOT attached to a financial instrument but independently contractually transferable or has a different counterparty.

- Effect = CFs of combined instrument vary similar to stand-alone derivative (see IAS 32 snapshot for derivative definition).
- Refer to IAS 39 for requirements/guidance on separately accounting for the derivative/designating the combined instruments as *@ FV through P/L.*

This communication contains a general overview of the topic and is current as of March 31, 2017. The application of the principles addressed will depend upon the particular facts and circumstances of each individual case. Accordingly, this publication is not a substitute for professional advice and we recommend that any decisions you take about the application or not of any of the information presented be made in consultation with a qualified professional, who can address any variance that may be required to reflect your circumstances. Please contact your local MNP representative for customized assistance with the application of this material. MNP LLP accepts no responsibility or liability for any loss related to any person's use of or reliance upon this material. © MNP LLP 2017. All rights reserved.

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DERECOGNITION OF FINANCIAL LIABILITIES

- Remove (part of) financial liability from statement of financial position when extinguished (i.e., when specified obligation discharged/cancelled/expires).
- Exchange between existing borrower and lender with substantially different terms OR substantial modification to (part of) existing financial liability (whether/not attributable to debtor's financial difficulty) → account as extinguishment of original & recognition of new financial liability.
- Carrying amount extinguished/transferred to another party LESS consideration paid (including non-cash assets transferred/liabilities assumed) → recognize in P/L.

IMPAIRMENT & REVERSAL OF IMPAIRMENT

@ amortized cost:

- Impairment = carrying amount MINUS PV of estimated future CFs discounted using original effective interest rate → recognize in P/L.
- Reverse (also in P/L) in subsequent period, if impairment loss ↓ & ↓relate objectively to event after impairment recognized. Cannot result in carrying amount > amortized cost if no impairment recognized.

@ cost:

- Impairment loss = carrying amount MINUS PV of estimated future CFs discounted @ current market rate of return for similar financial assets → recognize in P/L.
- NOT reversed!

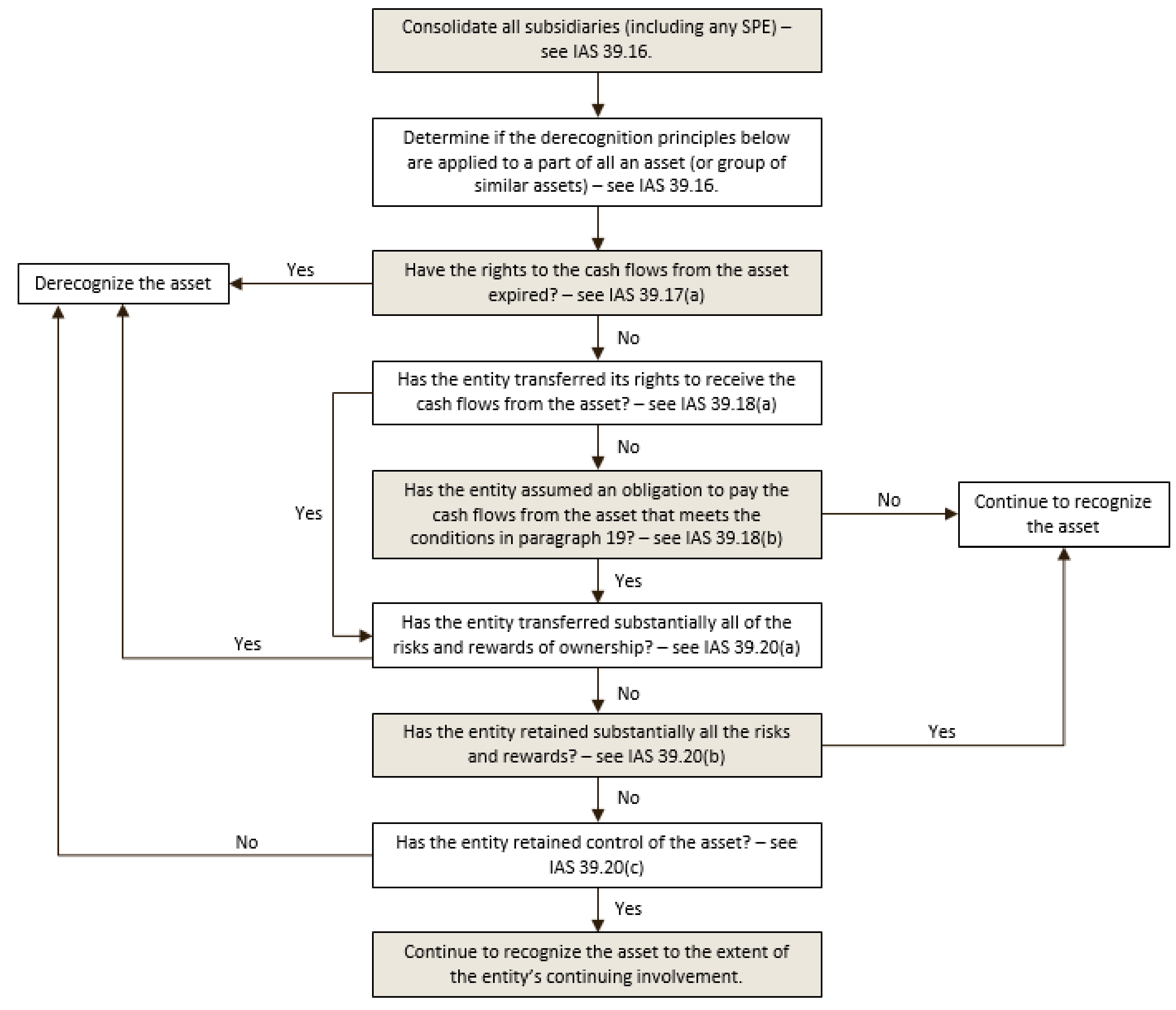
AFS:

- Reclassify cumulative loss from comprehensive income to P/L.
- Cumulative loss reclassified = acquisition cost (net of principal payment & amortization) MINUS FV (less previous impairment recognized in P/L).
- Equity instrument → impairment not reversed through P/L.
- Debt instrument → reverse (also in P/L) in subsequent period, if FV ↑ & ↑relate objectively to event after impairment was recognized.

FV through P/L:

- Already measured @ FV; thus, no impairment.

DERECOGNITION OF FINANCIAL ASSETS



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