



An Overview of IFRS 9 *Financial Instruments* vs. IAS 39 *Financial Instruments: Recognition and Measurement*

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Purpose

The International Accounting Standards Board (IASB) published the final version of IFRS 9 *Financial Instruments* in July 2014. 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 recent financial crisis.

The purpose of this guide is to highlight the significant differences between IFRS 9 and IAS 39 that may be important to MNP LLP's practitioners and clients, specifically Credit Unions. Key definitions, references and extracts from the standards have been provided in the guide where relevant. Refer to the IFRS 9 glossary for a complete list of definitions used in this guide.

Summary of Key Changes

The key changes between IFRS 9 and IAS 39 are summarized below. Please refer to the sections below for further detail.

Scope

- Financial instruments that are in the scope of IAS 39 are also in the scope of IFRS 9. However, in accordance with IFRS 9, an entity can designate certain instruments subject to the own-use exception at fair value through profit or loss (FVTPL); hence, IFRS 9 will apply to these instruments.
- The IFRS 9 impairment requirements apply to all loan commitments and contract assets in the scope of IFRS 15 *Revenue from Contracts with Customers*.

Recognition and Derecognition

- IFRS 9 provides specific guidance on accounting for debt modifications/exchanges that do not result in extinguishment.

Classification and Measurement

- The classification categories for financial assets under IAS 39 of held to maturity, loans and receivables, FVTPL, and available-for-sale determine their measurement. These are replaced in IFRS 9 with categories that reflect the measurement, namely amortized cost, fair value through other comprehensive income (FVOCI) and FVTPL.
- IFRS 9 bases the classification of financial assets on the contractual cash flow characteristics and the entity's business model for managing the financial asset, whereas IAS 39 bases the classification on specific definitions for each category. Overall, the IFRS 9 financial asset classification requirements are considered more principle based than under IAS 39.
- Under IFRS 9, embedded derivatives are not separated (or bifurcated) if the host contract is an asset within the scope of the standard. Rather, the entire hybrid contract is assessed for classification and measurement. This removes the complex IAS 39 bifurcation assessment for financial asset host contracts.
- Under IAS 39, derivative financial assets/liabilities that are linked to, and settled by, delivery of unquoted equity instruments, and whose fair value cannot be reliably determined are required to be measured at cost. IFRS 9 removes this cost exception for derivative financial assets/liabilities; therefore, all derivative liabilities will be measured at FVTPL.
- IAS 39 allows certain equity investments in private companies for which the fair value is not reliably determinable to be measured at cost, while under IFRS 9 all equity investments are measured at fair value.

- For certain financial liabilities designated at FVTPL under IFRS 9, changes in the fair value that relate to an entity's own credit risk are recognized in other comprehensive income (OCI) while the remaining change in fair value is recognized in profit or loss. Exceptions to this recognition principle include when this treatment creates, or enlarges, an accounting mismatch and also does not apply to loan commitments or financial guarantee contracts designated as FVTPL. In such instances, IFRS 9 requires the recognition of all changes in fair value in profit or loss.
- Reclassification of financial assets under IFRS 9 is required only when an entity changes its business model for managing financial assets and is prohibited for financial liabilities; hence, reclassifications are expected to be very rare.

Impairment

- IFRS 9 applies a single impairment model to all financial instruments subject to impairment testing while IAS 39 has different models for different financial instruments. Impairment losses are recognized on initial recognition, and at each subsequent reporting period, even if the loss has not yet been incurred.
- In addition to past events and current conditions, reasonable and supportable forecasts affecting collectability are also considered when determining the amount of impairment in accordance with IFRS 9.

Hedge Accounting

- Hedge accounting has been significantly reformed under IFRS 9 to better reflect risk management and treasury operations.

Scope of IFRS 9

IFRS 9 carries forward the scope of IAS 39 with the following additions:

- 1) Contracts subject to the own-use exception which are irrevocably designated as measured at FVTPL.

IAS 39.5 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, as if the contracts were financial instruments, if they 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. This is referred to as "the own-use exception". IFRS 9 retains this own-use exception but allows an entity to irrevocably designate instruments subject to the own-use exception as measured at FVTPL. This designation is available only at inception of the contract and only if it eliminates, or significantly reduces, a recognition inconsistency (sometimes referred to as an "accounting mismatch") that would otherwise arise from not recognizing that contract because it is excluded from the scope of IFRS 9. (IFRS 9.2.5)

2) The impairment requirements of IFRS 9 apply to the following items:

(a) Loan commitments that are not otherwise in the scope of IFRS 9.

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* fully applies to all loan commitments that are not in the scope of IAS 39. Conversely, the IFRS 9 impairment requirements apply to loan commitments that are not measured at FVTPL. This is because commitments to provide a loan at a below market interest rate and loan commitments that are derivatives (hence, classified as measured at FVTPL) or designated at FVTPL are already otherwise included in the scope of IFRS 9. (IFRS 9.2.3)

(b) Contract assets in the scope of IFRS 15.

IFRS 15 defines contract assets as an “entity’s right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity’s future performance)”. (IFRS 15, Appendix A)

Recognition and Derecognition

Write-offs

IFRS 9 explicitly states that write-offs constitute a derecognition event. (IFRS 9.5.4.4)

There should not be a significant impact on recognition and derecognition of financial assets/liabilities because of adopting IFRS 9. A write-off under IFRS 9 will result in a debit to the loss allowance and a credit to the financial asset which is consistent with past practice.

Non-substantial Debt Modifications/Exchanges (Non-extinguishment)

If the modification or exchange of debt is not substantial, it is not accounted for as an extinguishment under both IAS 39 and IFRS 9. Any directly attributable costs or fees adjust the carrying amount of the existing liability and are amortized over the remaining term of the modified liability (IFRS 9.B3.3.6 and IAS 39.AG62).

However, IAS 39 did not provide clear guidance on how to account for the difference between the present value of the cashflows (using the original effective interest rate “EIR”) under the original and modified terms.

In the absence of clear guidance under IAS 39, entities made an accounting policy choice to either:

- Not recognize any gain or loss, only adjusting the carrying amount of the liability for the costs/fees noted above.
 - Instead the EIR was adjusted to amortize the difference between the original and revised cash flows over the term of the modified liability; or
- Recognize a gain or loss for the difference between the present value of the original and revised cash flows, calculated using the original EIR, adjusting the carrying amount of the financial liability at the date of modification/exchange (maintaining the original EIR for remaining term of the liability).

On the other hand, IFRS 9 explicitly requires the net present value of changes to the future contractual cash flows (discounted using the original EIR) to adjust carrying amount of the liability, with the difference immediately recognized in profit or loss (i.e., the second method above). The adjusted carrying amount is then amortized over the remaining term of the modified debt liability using the original EIR (IFRS 9.B5.4.6, BC4.252 and BC4.253).

The IFRS Interpretations Committee (“IFRIC”) issued an updated in November 2016, which clarified that upon transition to IFRS 9, when applying IFRS 9.B5.4.6 to a non-substantial modification, if an entity was required to change its accounting policy in relation to the recognition of a modification gain or loss, then this change in policy would need to be applied retrospectively at the date of modification to all liabilities that are still recognized at the date of initial application.

Classification and Measurement of Financial Assets

The classification and measurement of financial assets is one of the principal differences between IFRS 9 and IAS 39.

The table below shows the financial asset classification and measurement categories for IFRS 9 vs. IAS 39.

IAS 39 Categories	IFRS 9 Categories
<ul style="list-style-type: none"> ▪ Held to maturity investments which are measured at amortized cost. ▪ Loans and receivables which are measured at amortized cost. ▪ FVTPL which included held for trading investments and derivatives and certain instruments designated at FVTPL. ▪ Available-for-sale which are measured at fair value with changes in fair value recognized in OCI unless the cost exemption applies. This category includes instruments designated as available-for-sale or that are not already classified into one of the other categories. 	<ul style="list-style-type: none"> ▪ Amortized cost ▪ FVOCI ▪ FVTPL

Classification Basis

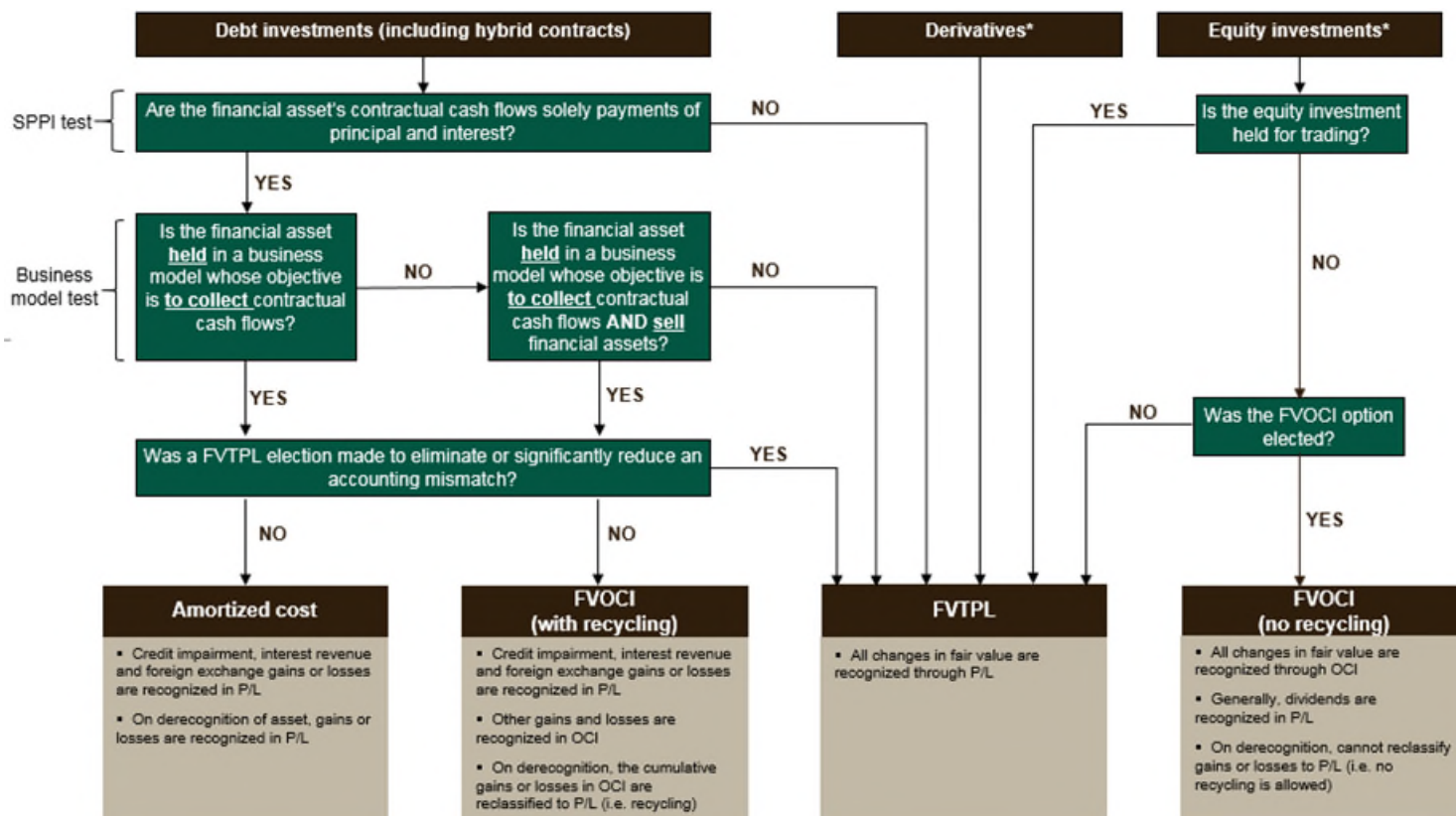
Under IAS 39, classification of financial assets is mostly based on specific definitions for each category which then determines the measurement. Under IFRS 9, the classification categories are aligned with the measurement which enhances simplicity. The classification of financial assets is also more principle based and depends on two assessments:

- The financial asset’s contractual cash flow characteristics.
- The entity’s business model for managing the financial asset.

As under IAS 39, IFRS 9 allows specific designations, which is further discussed below.

Classification Decision Tree

The following decision tree may be used to determine the appropriate classification of a financial asset consistent with IFRS 9.



* Assuming the contractual terms of the financial asset do not 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.

The table below summarizes the financial asset classification requirements under IFRS 9:

Categories	Conditions to be Met	Impact
Amortized Cost	<ul style="list-style-type: none"> The financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows (<i>"business model test"</i>). 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 (<i>"SPPI contractual cash flow characteristics test"</i>). <p style="text-align: right;"><i>(IFRS 9.4.1.2)</i></p>	<ul style="list-style-type: none"> Investments classified as held to maturity under IAS 39 and measured at amortized cost will likely fall into this category. This category will also contain other debt investments, which are classified as loans and receivables under IAS 39, if it meets the SPPI contractual cash flow characteristics and business model test.
FVOCI	<ul style="list-style-type: none"> The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets (<i>"business model test"</i>). 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 (<i>"SPPI contractual cash flow characteristics test"</i>). An entity may, at initial recognition, make an irrevocable election to present in OCI subsequent changes in the fair value of an investment in an equity instrument within the scope of IFRS 9 that is neither held for trading nor contingent consideration recognized by an acquirer in a business combination to which IFRS 3 <i>Business Combinations</i> applies. <p style="text-align: right;"><i>(IFRS 9.4.1.2A & IFRS 9.5.7.5-6)</i></p>	<ul style="list-style-type: none"> Although debt investments and equity investments that are designated at FVOCI could fall into this category, the measurement for such debt and equity investments are different as demonstrated in the decision tree above.

FVTPL	<ul style="list-style-type: none"> A financial asset shall be measured at FVTPL unless it is measured at amortized cost or at FVOCI. An entity may, at initial recognition, irrevocably designate a financial asset as measured at FVTPL if doing so eliminates or significantly reduces a measurement or recognition inconsistency (“accounting mismatch”) that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases. <i>(IFRS 9.4.1.4-5)</i> 	<ul style="list-style-type: none"> Derivatives and held for trading investments will fall into this category as under IAS 39. In addition, some loans and receivables and equity investments (which under IAS 39 are measured at amortized cost or classified as available-for-sale and carried at cost or FVOCI respectively), may also fall into this category. IAS 39 contains two other instances where a FVTPL designation can be made. These designations disappear under IFRS 9 because of the new classification model and further simplifies the financial instrument accounting requirements. The available-for-sale category under IAS 39 (where changes in fair value are recognized in OCI) is a default category that financial instruments fall into if they do not meet the criteria for classification into the other categories. As can be seen from the table and decision tree above, under IFRS 9, FVOCI is the equivalent category.
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Note! The criteria for classifying financial assets for measurement are significantly different. Upon adoption of IFRS 9, all financial assets will need to be reassessed for classification based on the objective of the business model the asset is held in and their cash flow characteristics. New processes and systems will need to be developed to ensure financial assets are allocated to the appropriate measurement category and judgement is exercised consistently throughout the entity.

Entities should ensure that the investment objective is appropriately documented and that there is evidence of approval of the objective to assist in classification and for audit purposes.

FVTPL Designation

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

- A contract contains one or more embedded derivatives.
- Designation eliminates, or significantly reduces, an accounting mismatch.
- A group of financial assets, financial liabilities or both is managed, and its performance is evaluated, on a fair value basis.

IFRS 9 only allows designation when it eliminates, or significantly reduces, an accounting mismatch. *(IFRS 9.4.1.5)*

This is a natural result of the following changes (discussed elsewhere in this document) that eliminate the need for the other IAS 39 designation options:

- Under IFRS 9, embedded derivatives are not separated from a hybrid financial asset; instead, the entire instrument is assessed for classification.
- A group of financial assets that is managed, and its performance evaluated, on a fair value basis will typically be classified as measured at FVTPL under IFRS 9 because of the business model criteria of the new classification model. (IFRS 9.B4.1.6)

Investments in Private Entities Measured at Cost Under IAS 39

IAS 39 allows certain equity investments to be measured at cost. Specifically, when:

- There is no quoted market price in an active market; and
- The fair value cannot be reliably measured because either:
 - The variability in the range of reasonable fair value estimates is significant; or
 - The probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value. (IAS 39.AG80)

IFRS 9 requires that all investments in equity instruments be measured at fair value.

IFRS 9 mentions that in limited circumstances cost may approximate fair value, for example, when:

- Insufficient more recent information is available to measure fair value; or
- There is a wide range of possible fair value measurements and cost represents the best estimate of fair value in the range. (IFRS 9.B5.2.3)

Note! Entities that invest in unquoted equity instruments that are measured at cost under IAS 39 must proactively consider how fair value will be determined when adopting IFRS 9. This may include consulting with a valuation specialist and establishing processes to obtain information from relevant investees in order to measure fair value and provide the IFRS 13 *Fair Value Measurement* disclosures at each reporting period.

Indicators that cost might not be representative of fair value include, but are not limited to:

- A significant change in the:
 - Performance of the investee compared with budgets, plans or milestones.
 - Market for the investee's equity or its products/potential products.
 - Performance of comparable entities, or in the valuations implied by the overall market.
 - Global economy or economic environment in which the investee operates.
- Changes in expectation that the investee's technical product milestones will be achieved.
- Internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.
- Evidence from external transactions in the investee's equity, either by the investee (such as a fresh issue of equity), or by transfers of equity instruments between third parties. (IFRS 9.B5.2.4)

All information about the performance and operations of the investee that becomes available after the date of initial recognition should be considered in determining whether cost might not be representative of fair value.

Note! There is an expectation that more instruments will be measured at fair value under IFRS 9 compared to IAS 39 because of the exclusion of the limited exception for measuring unquoted equity instruments at cost that exists under IAS 39.

The impact of this change will particularly affect unquoted equity investments in start-up companies and companies involved in evaluation and exploration of resources where measurement at cost may be justified as a result of high variability in the range of reasonable fair value estimates and/or the probability of the various estimates are not reasonably assessable.

In accordance with IFRS 9, these investments will be measured at fair value. While it may be fairly easy to justify that cost approximates fair values at inception, it is unlikely to be the case at subsequent reporting periods.

Classification and Measurement of Financial Liabilities

The IFRS 9 requirements for the classification and measurement of financial liabilities are substantially unchanged from IAS 39 except for the following:

- Removal of the cost exception for derivative financial liabilities.
- Changes in fair value as a result of an entity's own credit risk are recognized in OCI.

Overall, financial liabilities are still measured at amortized cost except for:

- Financial liabilities measured at FVTPL (i.e., those held for trading, designated at FVTPL or contingent consideration recognized by an acquirer in a business combination).
- Loan commitments and financial guarantee contracts for which specific measurement guidance exists.

Cost Exception for Derivative Financial Liabilities

IAS 39 requires derivative financial liabilities that are linked to, and must be settled by, delivery of an unquoted equity instrument, and whose fair value cannot otherwise be reliably measured, to be measured at cost. This requirement is not included under IFRS 9. Instead, these instruments must be measured at FVTPL.

Changes in Fair Value Attributable to a Change in an Entity's Own Credit Risk

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

- A contract contains one or more embedded derivatives.
- Designation eliminates, or significantly reduces, an accounting mismatch.
- A group of financial liabilities, or financial assets and financial liabilities, is managed, and its performance is evaluated, on a fair value basis. (*IFRS 9.4.2.2 & IFRS 9.4.3.5*)

IAS 39 requires that all fair value changes on financial liabilities which are irrevocably designated as measured at FVTPL be recognized in profit or loss. This treatment causes concern because it results in an entity recognizing gains in profit or loss when its credit standing deteriorates (and vice versa). This is counterintuitive and creates volatility in profit or loss.

IFRS 9 addresses this concern by requiring that the amount of the change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability (“an entity’s own credit risk”) is presented in OCI. The remaining change is presented in profit or loss. (*IFRS 9.5.7.7*)

However, if this treatment creates, or enlarges, an accounting mismatch in profit or loss, or the liability is a loan commitment or financial guarantee contract designated at FVTPL, the entity must present all gains or losses on that liability (including the effects of changes in the credit risk of that liability) in profit or loss. (*IFRS 9.5.7.8-9*)

Embedded Derivatives

The IAS 39 definition and guidance on separation of embedded derivatives and accounting for hybrid instruments is carried forward to IFRS 9 for instruments where the host contract is not a financial asset within the scope of IFRS 9.

If the host contract is a financial asset within the scope of IFRS 9, the embedded derivative is not separated from the host. Rather, the hybrid instrument is assessed for classification as a whole using the classification requirements for financial assets discussed above.

Note! The bifurcation requirements and guidance are complex to apply to financial asset host contracts. Other hybrid contracts are not subject to the same application issues. Therefore, this change further reduces complexity surrounding these types of instruments.

Reclassification

The IFRS 9 requirements for reclassification of financial instruments are significantly different from those in IAS 39.

IAS 39	IFRS 9
<ul style="list-style-type: none"> IAS 39 contains numerous reclassification rules for the various categories of financial instruments. For instance, a change in intention or ability causes the initial classification to be inappropriate, a reliable measure of fair value becomes available or is no longer available, etc. <p>(<i>IAS 39.50-54</i>)</p>	<ul style="list-style-type: none"> There is only one principle for reclassification of financial assets. Reclassification of financial assets is required only when an entity changes its business model for managing them. No reclassification of financial liabilities is allowed. <p>(<i>IFRS 9.4.4.1-2</i>)</p>

Changes in an entity’s business model that will result in a reclassification of financial assets are expected to be very infrequent, for example, when the entity has acquired, disposed of or terminated a business line.

The following examples from IFRS 9, which do not represent a change in business model, reiterate how rare reclassifications will be:

- A change in intention related to particular financial assets (even in circumstances of significant changes in market conditions).
- The temporary disappearance of a particular market for financial assets.
- A transfer of financial assets between parts of the entity with different business models. (*IFRS 9.B4.4.3*)

Note! Financial assets are only reclassified when there are changes in the business model for managing the assets. A change in the entity's business model is a significant event and, thus, is expected to be uncommon. Financial liabilities cannot be reclassified under IFRS 9. Overall, this simplifies the reclassification of financial instruments under IFRS 9 compared to IAS 39.

Impairment

The impairment requirements under IFRS 9 are significantly different from those under IAS 39. The following table highlights the key differences between the two standards.

IAS 39 Incurred Loss Model	IFRS 9 Expected Credit Loss Model
<ul style="list-style-type: none"> ▪ Delays the recognition of credit losses until there is objective evidence of impairment. ▪ Only past events and current conditions are considered when determining the amount of impairment (i.e., the effects of future credit loss events cannot be considered, even when they are expected). 	<ul style="list-style-type: none"> ▪ Expected credit losses (ECLs) are recognized at each reporting period, even if no actual loss events have taken place. ▪ In addition to past events and current conditions, reasonable and supportable forward-looking information that is available without undue cost or effort is considered in determining impairment.
<ul style="list-style-type: none"> ▪ Different impairment models for different financial instruments subject to impairment testing, including equity investments classified as available-for-sale. 	<ul style="list-style-type: none"> ▪ The model will be applied to all financial instruments subject to impairment testing.

Note! All entities need to reconsider the information used in their impairment models to incorporate relevant forward-looking information. Systems, processes and models used for impairment need to be redesigned.

Scope of the New IFRS 9 Impairment Model

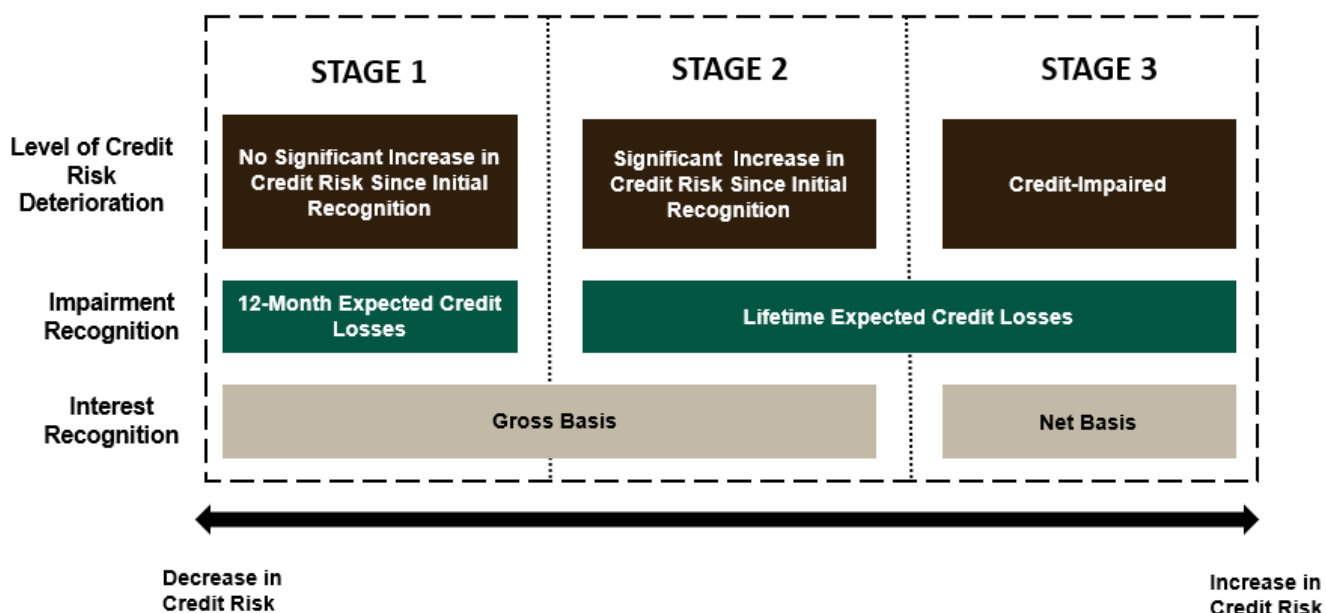
IFRS 9 requires impairment testing of the following instruments:

- Financial assets that are measured at amortized cost.
- Debt investments that are measured at FVOCI.
- Lease receivables within the scope of IAS 17 *Leases*.
- Trade receivables and contract assets within the scope of IFRS 15.
- Loan commitments that are not measured at FVTPL.
- Financial guarantee contracts within the scope of IFRS 9 that are not measured at FVTPL.

The impairment requirements of IFRS 9 do not apply to equity investments or items at FVTPL, or equity investments elected to be measured at FVOCI.

Overview of Impairment Requirements Under the New IFRS 9 Expected Loss Model

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

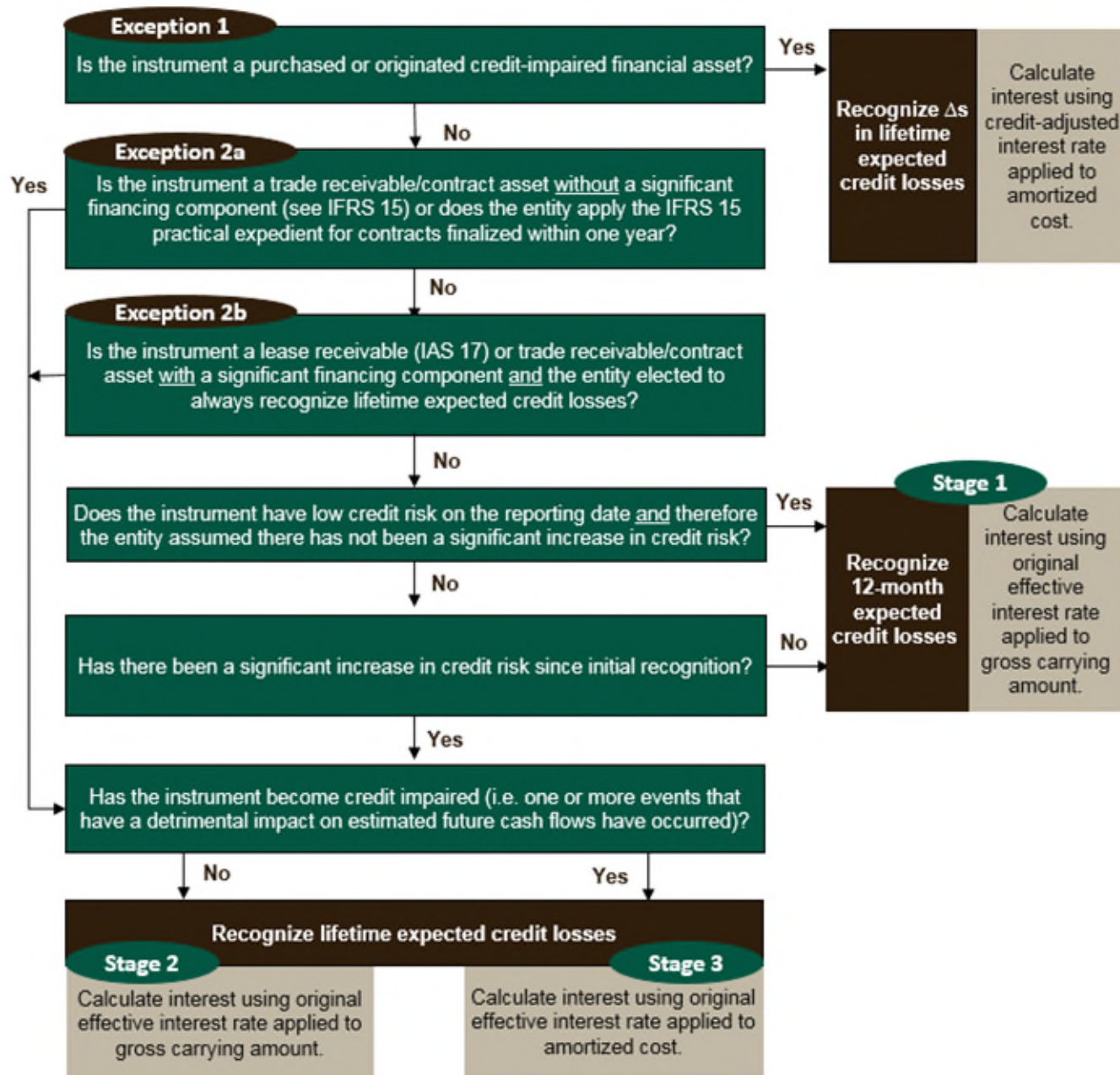


In the diagram above, the three stages in the new impairment model reflect the general pattern of the deterioration in credit risk of a financial instrument that ultimately defaults. At each reporting period, subsequent to initial recognition, an entity assesses which stage a financial instrument which is subject to impairment testing falls into. The stage determines the relevant impairment requirements.

Stage 1 includes financially healthy financial assets that are expected to perform in line with their contractual terms and which have no signs of increased credit risk. When the credit risk of a certain financial asset has significantly increased since initial recognition, the instrument no longer falls into stage 1.. In that case, if the instrument is not credit-impaired, the instrument will fall into Stage 2. Lastly, Stage 3 applies to credit-impaired financial instruments.

The following decision tree describes in more detail the thought process to follow when determining the impairment loss and how interest is recognized. It includes the general approach (i.e., the 3 stages) and the two exceptions to the general approach which apply to:

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



Example of General Impairment Approach

- Entity A provides a term loan to Entity B on January 1, 2018.
- The loan's principal amount is \$1,000 with 3% interest per year payable at the end of each month.
- The principal is due on December 31, 2021.
- The loan is secured by a portion of Entity B's fixed assets.

Stage 1	Stage 2	Stage 3
Deterioration of credit quality since initial recognition		
<p>On December 31, 2018, Entity A determines the credit risk of the loan has not increased significantly since initial recognition.</p> <p>Entity A estimates that the loan has a 10% probability of default in the next 12 months.</p> <p>Entity A calculates that \$50 will be lost if the loan defaults. The \$50 is calculated as the present value of the cash shortfalls expected over the life of the instrument if the default occurs in the next 12 months. The expectation is based on past experience updated for current conditions and forward-looking information.</p>	<p>On December 31, 2019, Entity A determines the credit risk of the loan has increased significantly*, as evidenced by:</p> <ul style="list-style-type: none"> Significant decline in Entity B's revenue. Significant adverse changes in the economic environment because of a shift in technology that reduces demand for products. Some interest payments were paid late during the year although there are no outstanding amounts. <p>Entity A estimates that the probability of default occurring over the remaining life of the loan is 50%. The ECLs from all possible default events over the life of the loan are expected to be \$100.</p>	<p>On December 31, 2020, Entity A determines the loan to be a credit-impaired financial asset, as evidenced by:</p> <ul style="list-style-type: none"> Entity B experienced significant financial difficulty and has been placed into receivership. The monthly interest payments were not made during the year. Significant reduction in value of collateral. <p>The estimated present value of the collateral that Entity A expects to recover minus associated costs is \$800.</p> <p>The gross carrying amount of the loan (which excludes the impairment allowance) is \$1030 comprising the loan amount and the unpaid interest for the year.</p>
Stage 1	Stage 2	Stage 3
Deterioration of credit quality since initial recognition		
<p>12-month ECLs = \$5 ($\\$50 \times 10\%$) which are the ECLs that result from default events on a financial instrument that are possible within the next 12 months.</p> <p>2018 interest revenue = \$30 ($3\% \times \\$1,000$) which is based on the effective interest rate applied to the gross carrying amount (which is the amortized cost before adjusting for any loss allowance).</p>	<p>Lifetime ECLs = \$50 ($\\$100 \times 50\%$) which are the ECLs that result from all possible default events over the expected life of the instrument.</p> <p>The change in the cumulative impairment allowance is recognized in profit or loss as \$45.</p> <p>2019 interest revenue = \$30 ($3\% \times \\$1,000$) which is based on the effective interest rate applied to the gross carrying amount (which is the amortized cost before adjusting for any loss allowance).</p>	<p>Lifetime ECLs = \$230 ($\\$1,030 - \\$800$)</p> <p>The change in the cumulative impairment allowance of \$180 is recognized in profit or loss.</p> <p>2020 interest revenue = \$30 ($3\% \times \\$1,000$) interest revenue in 2020.</p> <p>2021 interest revenue = \$24 ($3\% \times \\800) which is based on the effective interest rate applied to the amortized cost (gross carrying amount minus loss allowance) of the instrument from the date it became credit-impaired.</p>

* Only an increase in credit risk vs. credit-impaired because there is no conclusive evidence at that time that Entity B will not pay (e.g. although late on interest payments during the year, there are no outstanding amounts at reporting date).

Note!

- A significant consideration and area of judgement that will affect most entities when implementing IFRS 9 is determining when a significant increase in credit risk has taken place. It is expected that an initial credit risk rating should be assigned and updated at each reporting period to identify when a significant increase in credit risk has taken place.
- Capital Adequacy Standards require Credit Unions to maintain, at all times, a minimum amount of capital resources, which is typically based on a percentage of its total assets. The Credit Union's minimum required capital resources may be affected by the way the Credit Union classifies and measures its financial assets when transitioning from IAS 39 to IFRS 9. Impairment will also have a significant effect on total assets as an increase in loss allowances are expected. As a result, Credit Unions will need to assess and manage the impact of the transition and appropriately communicate with stakeholders.
- Entities should consider the impact of higher loss allowances on performance measures and compensation which may need revision.

Hedge Accounting

IFRS 9 introduces a substantially-reformed model for hedge accounting, with enhanced disclosures about risk management activity. The new model represents a significant overhaul of hedge accounting that aligns the accounting treatment with risk management activities, enabling entities to better reflect these activities in their financial statements.

Note! Many entities that engage in economic hedging activities that have not previously applied hedge accounting could benefit from applying the new hedge accounting requirements. Applying hedge accounting under IFRS 9 is considered less onerous and restrictive than under IAS 39 because of the alignment with an entity's risk management activities. Therefore, entities should reconsider the use of hedge accounting in their financial statements.

Despite the major overhaul, some of the IAS 39 basics of hedge accounting are retained; these include:

- The three types of hedges namely, cash flow, fair value and a hedge of a net investment in a foreign operation.
- Hedge accounting is still optional.
- Hedge effectiveness is still measured with inefficiencies recognized in profit or loss.
- Hedge documentation is required to be maintained.

IFRS 7 *Financial Instruments: Disclosures* contains new disclosure requirements for entities applying the new hedge accounting model which is extensive yet meaningful.

The following table summarizes the more significant changes in hedge accounting:

Area of Change	IAS 39	IFRS 9
Hedging Instruments	<ul style="list-style-type: none"> Only derivatives can be designated as hedging instruments and non-derivative financial assets/liabilities used as a hedge of foreign currency risk. 	<ul style="list-style-type: none"> Allows entities to designate non-derivative financial assets/liabilities that are accounted for at FVTPL as hedging instruments.
Hedged Items	<ul style="list-style-type: none"> Is more restrictive with respect to which items can be designated as hedged items. For example, IAS 39 only allows components of financial items to be hedged items (e.g. the prime-rate component of a floating-rate bond). Components of non-financial instruments could not be designated as hedged items except for foreign currency risks. Derivatives cannot be classified as hedged items. Limited instances where hedge accounting can be applied to groups of items. 	<ul style="list-style-type: none"> Allows the following instruments to be classified as hedged items which would not have qualified under IAS 39: <ul style="list-style-type: none"> Exposures that combine a derivative and an eligible hedged item (i.e., an aggregated exposure) if the exposure is managed as one exposure. Financial instruments in the FVOCI category. Components of certain financial and non-financial items. An example of a non-financial hedged item is a contract price that is based on a commodity price plus a fixed percentage where an entity might hedge the commodity price component which is a non-financial hedged item. More groups of items.
Hedge Effectiveness Testing	<ul style="list-style-type: none"> Requires that hedge effectiveness be calculated using a numerical range of 80-125%. 	<ul style="list-style-type: none"> Outlines more principle-based criteria for determining hedge effectiveness with no specific numerical thresholds. Focuses on the economic relationship between the hedged item and the hedging instrument, the effect of credit risk on that economic relationship, and the hedge ratio of the hedging relationship.
Rebalancing	<ul style="list-style-type: none"> Requires terminating the current hedge relationship and starting a new relationship. 	<ul style="list-style-type: none"> If the quantity of the hedged item or hedging instrument changes for risk management purposes, the current hedge relationship continues. However, the hedge ratio for hedge accounting purposes must change to align with the new hedge ratio for risk management purposes.
Discontinuance	<ul style="list-style-type: none"> Entities can discontinue hedge accounting at any time. 	<ul style="list-style-type: none"> Can only discontinue hedge accounting when the qualifying criteria are no longer met.

Area of Change	IAS 39	IFRS 9
Accounting for Time Value of Options, Forward Element of Forward Contract and Foreign Currency Basis Spread	<ul style="list-style-type: none"> May cause volatility in profit or loss because to achieve effectiveness only the spot element of a forward contract or intrinsic value of options are designated as the hedging instrument. Furthermore, the foreign exchange spread is treated as part of hedge ineffectiveness which can also cause volatility in profit or loss. 	<ul style="list-style-type: none"> Entities have an option to amortize over the term, like a transaction cost.
Management of Credit Risk Through Credit Derivatives	<ul style="list-style-type: none"> No specific provisions. 	<ul style="list-style-type: none"> Can designate a financial instrument with credit risk exposure as measured at FVTPL if certain criteria are met and entity uses a credit derivative to manage the credit risk.

Transition

IFRS 9 is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

From February 2015, entities newly applying IFRS 9 will need to apply the version published in July 2014. This means that entities will need to apply the classification and measurement, impairment and hedge accounting requirements (i.e., can no longer apply only portions of the standard).

The “own credit risk” requirements (refer to *Changes in Fair Value Attributable to a Change in an Entity’s Own Credit Risk* section above) may be applied in isolation without adopting any of the other requirements of IFRS 9. Entities electing to do so are required to disclose that fact and provide on an ongoing basis the related disclosures in IFRS 7 for financial liabilities designated at FVTPL.

Further Resources

External Resources

- IFRS 9 can be found in Part I of the CPA Canada Handbook.
- 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](#) providing an overview of the standard.

Other MNP Technical Guidance

- IFRS 9 *Financial Instruments* Snapshot
- 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* (coming soon)
- An Overview of the Transition Requirements of IFRS 9 *Financial Instruments* (coming soon)



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