

Financial reporting guide

Accounting for financial instruments

This publication provides a summary of the key changes to the accounting treatment of financial instruments under AASB 9 *Financial Instruments*.

Principal requirements of the standard

AASB 9 applies to annual reporting periods beginning on or after 1 January 2018. The standard differs from its predecessor, AASB 139 *Financial Instruments: Recognition and Measurement*, in a number of important respects, including the following.

Simplified classification of financial assets

Under AASB 139 there are a number of different classes of financial assets, including 'fair value through profit or loss', 'available for sale', 'held to maturity' and 'loans and receivables'. Under AASB 9, all of these categories will be reduced down to three main categories – fair value through profit or loss (FVtPL), fair value through other comprehensive income (FVtOCI) and amortised cost.

In contrast to the approach under AASB 139, the measurement category to be applied to a particular financial asset under AASB 9 (FVtPL, FVtOCI or amortised cost) is subject to whether the financial asset yields cash flows that are solely payments of interest and principal and the business model applicable to the asset.

In addition, AASB 9 permits an entity to irrevocably designate on initial recognition:

- an equity instrument that is not held for trading at FVtOCI; and
- a debt instrument at FVtPL provided that such a designation eliminates, or significantly reduces, an accounting mismatch.

Accounting for financial liabilities

AASB 9 retains the main measurement categories from AASB 139 with respect to financial liabilities (i.e., FVtPL and amortised cost). In addition, AASB 9 requires that an entity that designates a financial liability at FVtPL to present:

- the portion of the change in the fair value attributable to changes in the credit risk of the liability in OCI, except when it would create an 'accounting mismatch'; and
- the balance of any change in the fair value of the financial liability in profit or loss.

New model for hedge accounting

AASB 9 introduces a new model for hedge accounting that permits greater flexibility in the ability to hedge risk, particularly with respect to non-financial items.

The AASB 9 hedge accounting model is less rules based than the AASB 139 model and therefore potentially more capable of aligning with an entity's broader risk management activities. For instance, the '80-125%' effectiveness range has been replaced by an objectives-based test that emphasises the economic relationship between the hedged item and the hedging instrument. As a result, under the new hedge accounting model in AASB 9 more hedging instruments and hedged items will potentially qualify for hedge accounting as compared to the arrangements under AASB 139.



New model for impairment of financial assets

AASB 9 replaces the current 'incurred loss' model with an 'expected loss' model. The new 'expected loss' impairment model in AASB 9 will require entities to recognise an allowance for expected credit losses using the following three-stage impairment model ('**general approach**')

- **Stage 1** – for credit exposures for which there has not been a significant increase in credit risk since initial recognition of the instrument, entities are required to recognise an allowance for expected credit losses from possible default events within 12 months after the reporting date;
- **Stage 2** - for credit exposures for which there has been a significant increase in credit risk since initial recognition of the instrument, entities are required to recognise an allowance for expected credit losses from possible default events over the expected life of the instrument; and
- **Stage 3** – for credit exposures that are assessed as being 'credit-impaired', in addition to recognising an allowance for expected credit losses from possible default events over the expected life of the instrument, entities are required to calculate interest revenue on the net (rather than gross) carrying amount of the instrument.

AASB 9 also provides a '**simplified approach**' that requires loss allowances to be based on the lifetime expected credit losses at each reporting date. The simplified approach:

- is required to be applied to trade receivables and contract assets that result from contracts with customers and that do not contain a significant financing component; and
- can be applied, if an entity chooses to do so, to trade receivables and contract assets that result from contracts with customers and that do contain a significant financing component, as well as to lease receivables.

Further information and assistance

Contact Pitcher Partners for further information and assistance on accounting for financial instruments.



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