Explanatory Statement

Accounting Standard AASB 9
Financial Instruments

December 2009

Australian Government
Australian Accounting Standards Board

EXPLANATORY STATEMENT

Reasons for Issuing AASB 9

The IASB issued IFRS 9 *Financial Instruments* in November 2009, setting out requirements for the classification and measurement of financial assets. The AASB issued AASB 9 *Financial Instruments*, that incorporates IFRS 9 *Financial Instruments*, in December 2009. At the same time, the AASB issued AASB 2009-11 *Amendments to Australian Accounting Standards arising from AASB 9*, which makes consequential amendments to other Australian Accounting Standards that arose as a result of the IASB's Financial Instruments project. These Standards enable Australian reporting entities, where appropriate, to continue to be compliant with IFRSs in relation to the classification and measurement of financial assets.

The requirements in AASB 9 form part of the first phase of the International Accounting Standards Board's project to replace IAS 39 *Financial Instruments: Recognition and Measurement*, which is incorporated in AASB 139 *Financial Instruments: Recognition and Measurement*.

The IASB will address the classification and measurement of financial liabilities, as well as impairment of financial assets and hedging, as part of other phases of the IASB's project to replace IAS 39. The AASB will similarly address these matters.

Main Features of AASB 9

AASB 9 includes requirements for the classification and measurement of financial assets resulting from Phase 1 of the IASB's project to replace IAS 39 and the AASB's shadow project to replace AASB 139. These requirements improve and simplify the approach for classification and measurement of financial assets compared with the requirements of AASB 139. The IASB plans to complete its work on financial liabilities during 2010 and issue requirements for financial liabilities that the AASB will consider for incorporation into AASB 9 in due course.

The main differences between AASB 9 and AASB 139 are described below.

(a) Financial assets are classified based on (i) the objective of the entity's business model for managing the financial assets; and (ii) the characteristics of the contractual cash flows. This replaces the numerous categories of financial assets in AASB 139, each of which had its own classification criteria. Application guidance has been included in AASB 9 on how to apply the conditions necessary for amortised cost measurement.

(b) AASB 9 allows an irrevocable election on initial recognition to present gains and losses on investments in equity instruments that are not held for trading in other comprehensive income. Dividends in respect of these investments that are a return on investment shall be recognised in profit or loss and there is no impairment or recycling on disposal of the instrument.

(c) Financial assets can be designated and measured at fair value through profit or loss at initial recognition if doing so eliminates or significantly reduces a measurement or recognition inconsistency that would arise from measuring assets or liabilities, or recognising the gains and losses on them, on different bases.

(d) Hybrid contracts with financial asset hosts are classified and measured in their entirety in accordance with the classification criteria. Embedded derivative assets that are separated from a financial liability or non-financial host in accordance with AASB 139 are to be accounted for in accordance with AASB 9.

(e) Investments in unquoted equity instruments (and contracts on those investments that must be settled by delivery of the unquoted equity instrument) must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value.

(f) Investments in contractually linked instruments that create concentrations of credit risk (tranches) are classified and measured using a 'look through' approach. Such an approach looks to the underlying assets generating cash flows and assesses the cash flows against the classification criteria (noted in (a) above) to determine whether the investment is measured at fair value or amortised cost.

(g) Financial assets are reclassified when there is a relevant change in the entity's business model.

Application Date

This Standard applies to annual reporting periods beginning on or after 1 January 2013. This Standard may be applied to annual reporting periods ending on or after 31 December 2009 that begin before 1 January 2013. When an entity applies this Standard to an annual reporting period beginning before 1 January 2013 it shall disclose that fact and at the same time apply the amendments in AASB 2009-11 *Amendments to Australian Accounting Standards arising from AASB 9*.

Consequential Amendments

Consequential amendments to other Australian Accounting Standards are included in AASB 2009-11.

Consultation Prior to Issuing this Standard

The AASB issued Exposure Draft ED 184 *Financial Instruments: Classification and Measurement* in July 2009. ED 184 reproduced the proposals included in the IASB's Exposure Draft ED/2009/7 *Financial Instruments: Classification and Measurement* without amendment.

The AASB invited comments from Australian constituents on the proposals regarding the classification and measurement of financial instruments, as well as the consequential amendments to other Australian Accounting Standards that would result from the issuance of a Standard incorporating the proposals. The AASB received nine written submissions from Australian constituents. Submissions received were generally supportive of the proposals. However, a number of constituents expressed concerns regarding the proposal to recognise dividends in other comprehensive income when an entity elected to present fair value changes for an investment in an equity instrument in other comprehensive income and the proposal to remove the cost exemption for investments in equity instruments where the fair value could not be measured reliably.

In its submission to the IASB, the AASB noted the concerns expressed by constituents. The IASB addressed the concerns by allowing the dividends that are 'returns on investment', for investments in equity instruments that are not held for trading, to be recognised in profit or loss. The IASB also clarified that in certain circumstances, cost may be representative of fair value.

A Regulation Impact Statement has also been prepared in connection with the issue of this Standard.