Straight away

IFRS bulletin from PwC

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IASB updates IFRS 9 for financial liabilities

What is the issue?

The IASB has updated IFRS 9, 'Financial instruments' to include guidance on financial liabilities and derecognition of financial instruments. The accounting and presentation for financial liabilities and for derecognising financial instruments has been relocated from IAS 39, 'Financial instruments: Recognition and measurement', without change, except for financial liabilities that are designated at fair value through profit or loss. The new standard is applicable for accounting periods beginning on or after 1 January 2013.

Key provisions

Items unchanged

The requirements in IAS 39 regarding the classification and measurement of financial liabilities have been retained, including the related application and implementation guidance. This means that there continue to be two measurement categories for financial liabilities: fair value through profit or loss (FVTPL) and amortised cost. The criteria for designating a financial liability at FVTPL also remain unchanged.

Entities are still required to separate derivatives embedded in financial liabilities where they are not closely related to the host contract. The separated embedded derivative continues to be measured at FVTPL, and the residual debt host continues to be measured at amortised cost. The existing application guidance relating to embedded derivatives has also been included in IFRS 9; it will also continue to apply to derivatives embedded in non-financial items – for example, foreign currency derivatives embedded in purchase and sales contracts.

The requirements in IAS 39 for determining when financial instruments are derecognised from the balance sheet have also been relocated to IFRS 9 without change.

New measurement guidance

Under the new standard, entities with financial liabilities designated at FVTPL recognise changes in the fair value due to changes in the liability's credit risk directly in other comprehensive income (OCI). There is no subsequent recycling of the amounts in OCI to profit or loss, but accumulated gains or losses may be transferred within equity.

However, if presenting the change in fair value attributable to the credit risk of the liability in OCI would create an accounting mismatch in profit or loss, all fair value movements are recognised in profit or loss. An entity is required to determine whether an accounting mismatch is created when the financial liability is first recognised, and this determination is not reassessed. The mismatch must arise due to an economic relationship between the financial liability and a financial asset that results in the liability's credit risk being offset by a change in the fair value of the asset. Financial liabilities that are required to be measured at FVTPL (as distinct from those that the entity has designated at FVTPL), including financial guarantees and loan commitments measured at FVTPL, will continue to have all fair value movement recognised in profit or loss. Derivatives such as foreign currency forwards and interest rate swaps, or a bank's own liabilities that it holds in its trading portfolio, continue to have all fair value movements recognised in profit or loss.

Credit risk

The standard does not change the definition of 'credit risk' in IFRS 7, 'Financial instruments: Disclosures', but clarifies the meaning of credit risk with guidance that addresses how embedded derivatives, unit-linking features and collateral may impact the determination of a liability's credit risk.

IFRS 9 retains the flexibility that existed in IFRS 7 to determine the amount of fair value change that relates to changes in the credit risk of the liability using a default method or by an alternative method that the entity believes more faithfully represents the credit risk of the liability.

Effective date and transition

The effective date and transition requirements are consistent with IFRS 9 issued in November 2009 for the classification and measurement of financial assets. That is, IFRS 9 is mandatory for annual periods beginning on or after 1 January 2013. Entities may choose to adopt early, but it is not possible for entities to adopt the part for financial liabilities without adopting the requirements for financial assets. However, entities still have the ability before 1 January 2013 to adopt the requirements for financial assets in IFRS 9 without adopting the requirements for financial liabilities.

Consistent with the transition guidance for the classification and measurement of financial assets, entities that early adopt prior to 1 January 2012 are not required to restate comparatives.

Entities may not make or revoke designations at FVTPL for financial liabilities or financial assets on initial application of this new part of IFRS 9. However, the transition rules in IFRS 9 for the classification and measurement of financial assets allow entities to make or revoke designations at FVTPL for financial assets and certain financial liabilities on initial application.

Am I affected?

The new standard impacts entities that have designated financial liabilities at fair value through profit or loss. For example, it impacts financial institutions that have designated liabilities at FVTPL to eliminate an accounting mismatch, or to avoid separating an embedded derivative.

What do I need to do?

Management of entities that currently designate (or in future may wish to designate) financial liabilities at fair value through profit or loss should familiarise themselves with the updated requirements of IFRS 9. Management should also consider carefully the planned timing of their adoption of IFRS 9. However, management should bear in mind that the financial instruments project is still evolving and subsequent updates are expected for the impairment and hedging phases. In addition, responses to the IASB's recent request for views on the effective date and transition requirements for the new standards, resulting from their work to improve convergence with US GAAP, may impact the IASB's decision on the timing of IFRS 9 application.