Hong Kong Institute of Certified Public Accountants
香港會計師公會

MEMBERS' HANDBOOK

Update No. 73

(Issued November 2009)

This Update contains:

- HKFRS 9 *Financial Instruments*

Document Reference and Title	*Instructions*	*Explanations*
VOLUME II		
Contents of Volume II	Discard the existing page ii and replace with the new page ii.	Revised contents page
HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)		
HKFRS 9 *Financial Instruments*	Insert these pages after HKFRS 8 *Operating Segments*.	New Standard

Note:

1. This issuance of HKFRS 9 *Financial Instruments* represents the completion of the first part of a three-part project to replace HKAS 39 *Financial Instruments: Recognition and Measurement.* Proposals addressing the second part, the impairment methodology for financial assets were published for public comment at the beginning of November, while proposals on the third part, on hedge accounting, continue to be developed.

2. HKFRS 9 uses a single approach to determine whether a financial asset is measured at amortised cost or fair value, replacing the many different rules in HKAS 39. The approach in HKFRS 9 is based on how an entity manages its financial instruments (its business model) and the contractual cash flow characteristics of the financial assets.

3. The effective date of HKFRS 9 is for annual periods beginning on or after 1 January 2013, with early adoption permitted.

		Issue/(Review date)
HKAS 29	Financial Reporting in Hyperinflationary Economies	3/04(10/08)
HKAS 31	Interests in Joint Ventures	12/04(10/08)
HKAS 32	Financial Instruments: Presentation	11/04(10/09)
HKAS 33	Earnings per Share	3/04(3/08)
HKAS 34	Interim Financial Reporting	10/04(10/08)
HKAS 36	Impairment of Assets	8/04(5/09)
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets	11/04(3/08)
HKAS 38	Intangible Assets	8/04(5/09)
HKAS 39	Financial Instruments: Recognition and Measurement	1/06(5/09)
HKAS 40	Investment Property	11/05(10/08)
HKAS 41	Agriculture	12/04(10/08)
	HONG KONG FINANCIAL REPORTING STANDARDS (HKFRS)	
HKFRS 1	First-time Adoption of Hong Kong Financial Reporting Standards	5/06(12/08)
HKFRS 1 Revised	First-time Adoption of Hong Kong Financial Reporting Standards	12/08(8/09)
HKFRS 2	Share-based Payment	4/04(7/09)
HKFRS 3	Business Combinations	11/05(3/08)
HKFRS 3 Revised	Business Combinations	3/08
HKFRS 4	Insurance Contracts	3/06(3/09)
HKFRS 5	Non-current Assets Held for Sale and Discontinued Operations	8/04(5/09)
HKFRS 6	Exploration for and Evaluation of Mineral Resources	2/05(12/08)
HKFRS 7	Financial Instruments: Disclosures	9/05(3/09)
HKFRS 8	Operating Segments	3/07(11/09)
HKFRS 9	Financial Instruments	11/09
IMPROVEMENTS TO HKFRSs	Improvements to HKFRSs	10/08
IMPROVEMENTS TO HKFRSs 2009	Improvements to HKFRSs 2009	5/09

HKFRS 9
Issued November 2009

Effective for annual periods
beginning on or after 1 January 2013

Hong Kong Financial Reporting Standard 9

Financial Instruments

Hong Kong Institute of
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Hong Kong Financial Reporting Standard 9 *Financial Instruments* (HKFRS 9) is set out in paragraphs 1.1–8.2.13 and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the HKFRS. HKFRS 9 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for issuing the HKFRS

IN1 The objective of Hong Kong Institute of Certified Public Accountants (HKICPA) issuing HKFRS 9 is to maintain international convergence with the International Accounting Standards Board (IASB) further to its issuance of IFRS 9. HKAS 39 *Financial Instruments: Recognition and Measurement* sets out the requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items.

IN2 Many users of financial statements and other interested parties have expressed that the requirements in HKAS 39 are difficult to understand, apply and interpret. They have urged the development of a new standard for financial reporting for financial instruments that is principle-based and less complex. Although HKAS 39 has been amended several times to clarify requirements, add guidance and eliminate internal inconsistencies, it has not previously undertaken a fundamental reconsideration of reporting for financial instruments.

IN3 Since 2005, the IASB and the US Financial Accounting Standards Board (FASB) have had a long-term objective to improve and simplify the reporting for financial instruments. This work resulted in the publication of a discussion paper, *Reducing Complexity in Reporting Financial Instruments*, in March 2008. Focusing on the measurement of financial instruments and hedge accounting, the paper identified several possible approaches for improving and simplifying the accounting for financial instruments. The responses to the paper indicated support for a significant change in the requirements for reporting financial instruments. In November 2008 the IASB added this project to its active agenda, and in December 2008 the FASB also added the project to its agenda.

IN4 In April 2009, in response to the input received on its work responding to the financial crisis, and following the conclusions of the G20 leaders and the recommendations of international bodies such as the Financial Stability Board, the IASB announced an accelerated timetable for replacing IAS 39. As a result, in July 2009 the IASB published an exposure draft *Financial Instruments: Classification and Measurement*, followed by IFRS 9 *Financial Instruments* in November 2009.

IN5 In developing IFRS 9 the IASB considered input obtained in response to its discussion paper, the report from the Financial Crisis Advisory Group published in July 2009, the responses to the exposure draft and other discussions with interested parties, including three public round tables held to discuss the proposals in that exposure draft. The IASB staff also obtained additional feedback from users of financial statements and others through an extensive outreach programme.

Approach to replacing HKAS 39

IN6 It is intended that HKFRS 9 will ultimately replace HKAS 39 in its entirety. However, in response to requests from interested parties that the accounting for financial instruments should be improved quickly, the project to replace HKAS 39 is divided into three main phases. As each phase is completed, as well as its separate project on the derecognition of financial instruments, the relevant portions of HKAS 39 will be deleted and chapters in HKFRS 9 will be created to replace the requirements in HKAS 39. The replacement of HKAS 39 in its entirety is aimed to be completed by the end of 2010.

IN7 Proposals for the classification and measurement of financial liabilities were included in the exposure draft that preceded HKFRS 9. In that exposure draft attention was also drawn to the discussion paper *Credit Risk in Liability Measurement* published in June 2009. In their responses to the exposure draft and discussion paper, many expressed concern about recognising changes in an entity’s own credit risk in the remeasurement of liabilities. During its redeliberations on the classification and measurement of financial liabilities, the requirements for financial liabilities was decided not to be finalised before considering those issues further and analysing possible approaches to address the concerns raised by respondents.

IN8 Accordingly, in November 2009 the HKICPA issued the chapters of HKFRS 9 relating to the classification and measurement of financial assets. HKFRS 9 addressed those matters first because they form the foundation of a standard on reporting financial instruments. Moreover, many of the concerns expressed during the financial crisis arose from the classification and measurement requirements for financial assets in HKAS 39.

IN9 The HKICPA sees this first instalment on classification and measurement of financial assets as a stepping stone to future improvements in the financial reporting of financial instruments and is committed to completing its work on classification and measurement of financial instruments expeditiously.

Main features of the HKFRS

IN10 Chapters 4 and 5 of HKFRS 9 specify how an entity should classify and measure financial assets, including some hybrid contracts. They require all financial assets to be:

(a) classified on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset.

(b) initially measured at fair value plus, in the case of a financial asset not at fair value through profit or loss, particular transaction costs.

(c) subsequently measured at amortised cost or fair value.

IN11 These requirements improve and simplify the approach for classification and measurement of financial assets compared with the requirements of HKAS 39. They apply a consistent approach to classifying financial assets and replace the numerous categories of financial assets in HKAS 39, each of which had its own classification criteria. They also result in one impairment method, replacing the numerous impairment methods in HKAS 39 that arise from the different classification categories.

Next steps

IN12 HKFRS 9 is the first part of Phase 1 of the project to replace HKAS 39. The main phases are:

(a) Phase 1: Classification and measurement. The exposure draft *Financial Instruments: Classification and Measurement*, published in July 2009, contained proposals for both assets and liabilities within the scope of HKAS 39. Requirements for financial liabilities will be included in HKFRS 9 in due course.

(b) Phase 2: Impairment methodology. The request for Information on the feasibility of an expected loss model for the impairment of financial assets was published on 25 June 2009. This formed the basis of an exposure draft, *Financial Instruments: Amortised Cost and Impairment*, published in November 2009 with a comment deadline of 30 June 2010. An expert advisory panel will be set up by the IASB to address the operational issues arising from an expected cash flow approach.

(c) Phase 3: Hedge accounting. The project for considering how to improve and simplify the hedge accounting requirements of HKAS 39 has started and the proposals are expected to be published shortly.

IN13 In addition to those three phases, an exposure draft *Derecognition* (proposed amendments to HKAS 39 and HKFRS 7) was published in March 2009. Redeliberations are under way and the project is expected to be completed in the second half of 2010.

IN14 As stated above, HKAS 39 is aimed to be replaced by HKFRS 9 in its entirety by the end of 2010.

IN15 The IASB and the FASB are committed to achieving by the end of 2010 a comprehensive and improved solution that provides comparability internationally in the accounting for financial instruments. However, those efforts have been complicated by the differing project timetables established to respond to the respective stakeholder groups. The IASB and FASB have developed strategies and plans to achieve a comprehensive and improved solution that provides comparability internationally. As part of those plans, they reached agreement at their joint meeting in October 2009 on a set of core principles designed to achieve comparability and transparency in reporting, consistency in accounting for credit impairments, and reduced complexity of financial instrument accounting. The HKICPA will be monitoring these developments closely.

Hong Kong Financial Reporting Standard 9
Financial Instruments

Chapter 1 Objective

1.1 The objective of this HKFRS is to establish principles for the financial reporting of *financial assets* that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of the entity's future cash flows.

Chapter 2 Scope

2.1 An entity shall apply this HKFRS to all assets within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement*.

Chapter 3 Recognition and derecognition

3.1 Initial recognition of financial assets

3.1.1 An entity shall recognise a financial asset in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument (see paragraphs AG34 and AG35 of HKAS 39). When an entity first recognises a financial asset, it shall classify it in accordance with paragraphs 4.1-4.5 and measure it in accordance with paragraph 5.1.1.

3.1.2 A *regular way purchase or sale* of a financial asset shall be recognised and derecognised in accordance with paragraphs 38 and AG53–AG56 of HKAS 39.

Chapter 4 Classification

4.1 Unless paragraph 4.5 applies, an entity shall classify financial assets as subsequently measured at either *amortised cost* or *fair value* on the basis of both:

(a) the entity's business model for managing the financial assets; and

(b) the contractual cash flow characteristics of the financial asset.

4.2 A financial asset shall be measured at amortised cost if both of the following conditions are met:

(a) the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows.

(b) 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.

Paragraphs B4.1–B4.26 provide guidance on how to apply these conditions.

4.3 For the purpose of this HKFRS, interest is consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time.

4.4 A financial asset shall be measured at fair value unless it is measured at amortised cost in accordance with paragraph 4.2.

Option to designate a financial asset at fair value through profit or loss

4.5 **Notwithstanding paragraphs 4.1-4.4, an entity may, at initial recognition, designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases (see paragraphs AG4D–AG4G of HKAS 39).**

Embedded derivatives

4.6 An embedded *derivative* is a component of a hybrid contract that also includes a non-derivative host—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. A derivative that is attached to a *financial instrument* but is contractually transferable independently of that instrument, or has a different counterparty, is not an embedded derivative, but a separate financial instrument.

4.7 **If a hybrid contract contains a host that is within the scope of this HKFRS, an entity shall apply the requirements in paragraphs 4.1-4.5 to the entire hybrid contract.**

4.8 **If a hybrid contract contains a host that is not within the scope of this HKFRS, an entity shall apply the requirements in paragraphs 11–13 and AG27–AG33B of HKAS 39 to determine whether it must separate the embedded derivative from the host. If the embedded derivative must be separated from the host, the entity shall:**

(a) classify the derivative in accordance with either paragraphs 4.1-4.4 for derivative assets or paragraph 9 of HKAS 39 for all other derivatives; and

(b) account for the host in accordance with other HKFRSs.

Reclassification

4.9 **When, and only when, an entity changes its business model for managing financial assets it shall reclassify all affected financial assets in accordance with paragraphs 4.1–4.4.**

Chapter 5 Measurement

5.1 Initial measurement of financial assets

5.1.1 **At initial recognition, an entity shall measure a financial asset at its fair value (see paragraphs 48, 48A and AG69–AG82 of HKAS 39) plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset.**

5.2 Subsequent measurement of financial assets

5.2.1 **After initial recognition, an entity shall measure a financial asset in accordance with paragraphs 4.1-4.5 at fair value (see paragraphs 48, 48A and AG69–AG82 of HKAS 39) or amortised cost.**

5.2.2 **An entity shall apply the impairment requirements in paragraphs 58–65 and AG84–AG93 of HKAS 39 to financial assets measured at amortised cost.**

5.2.3 **An entity shall apply the hedge accounting requirements in paragraphs 89–102 of HKAS 39 to a financial asset that is designated as a *hedged item* (see paragraphs 78–84 and AG98–AG101 of HKAS 39).**

5.3 Reclassification

5.3.1 **If an entity reclassifies financial assets in accordance with paragraph 4.9, it shall apply the reclassification prospectively from the *reclassification date*. The entity shall not restate any previously recognised gains, losses or interest.**

5.3.2 **If, in accordance with paragraph 4.9, an entity reclassifies a financial asset so that it is measured at fair value, its fair value is determined at the reclassification date. Any gain or loss arising from a difference between the previous carrying amount and fair value is recognised in profit or loss.**

5.3.3 **If, in accordance with paragraph 4.9, an entity reclassifies a financial asset so that it is measured at amortised cost, its fair value at the reclassification date becomes its new carrying amount.**

5.4 Gains and losses

5.4.1 **A gain or loss on a financial asset that is measured at fair value and is not part of a hedging relationship (see paragraphs 89–102 of HKAS 39) shall be recognised in profit or loss unless the financial asset is an investment in an *equity instrument* and the entity has elected to present gains and losses on that investment in other comprehensive income in accordance with paragraph 5.4.4.**

5.4.2 **A gain or loss on a financial asset that is measured at amortised cost and is not part of a hedging relationship (see paragraphs 89–102 of HKAS 39) shall be recognised in profit or loss when the financial asset is derecognised, impaired or reclassified in accordance with paragraph 5.3.2, and through the amortisation process.**

5.4.3 **A gain or loss on financial assets that are**

(a) hedged items (see paragraphs 78-84 and AG98-AG101 of HKAS 39) shall be recognised in accordance with paragraphs 89-102 of HKAS 39.

(b) accounted for using settlement date accounting shall be recognised in accordance with paragraph 57 of HKAS 39.

Investments in equity instruments

5.4.4 **At initial recognition, an entity may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument within the scope of this HKFRS that is not *held for trading*.**

5.4.5 If an entity makes the election in paragraph 5.4.4, it shall recognise in profit or loss dividends from that investment when the entity's right to receive payment of the dividend is established in accordance with HKAS 18 *Revenue*.

Chapter 6 Hedge accounting – not used

Chapter 7 Disclosures – not used

Chapter 8 Effective date and transition

8.1 Effective date

8.1.1 An entity shall apply this HKFRS for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies this HKFRS in its financial statements for a period beginning before 1 January 2013, it shall disclose that fact and at the same time apply the amendments in Appendix C.

8.2 Transition

8.2.1 An entity shall apply this HKFRS retrospectively, in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs 8.2.4–8.2.13. This HKFRS shall not be applied to financial assets that have already been derecognised at the date of initial application.

8.2.2 For the purposes of the transition provisions in paragraphs 8.2.3–8.2.13, the date of initial application is the date when an entity first applies the requirements of this HKFRS. The date of initial application may be:

(a) any date between the issue of this HKFRS and 31 December 2010, for entities initially applying this HKFRS before 1 January 2011; or

(b) the beginning of the first reporting period in which the entity adopts this HKFRS, for entities initially applying this HKFRS on or after 1 January 2011.

8.2.3 If the date of initial application is not at the beginning of a reporting period, the entity shall disclose that fact and the reasons for using that date of initial application.

8.2.4 At the date of initial application, an entity shall assess whether a financial asset meets the condition in paragraph 4.2(a) on the basis of the facts and circumstances that exist at the date of initial application. The resulting classification shall be applied retrospectively irrespective of the entity's business model in prior reporting periods.

8.2.5 If an entity measures a hybrid contract at fair value in accordance with paragraph 4.4 or paragraph 4.5 but the fair value of the hybrid contract had not been determined in comparative reporting periods, the fair value of the hybrid contract in the comparative reporting periods shall be the sum of the fair values of the components (ie the non-derivative host and the embedded derivative) at the end of each comparative reporting period.

8.2.6 At the date of initial application, an entity shall recognise any difference between the fair value of the entire hybrid contract at the date of initial application and the sum of the fair values of the components of the hybrid contract at the date of initial application:

(a) in the opening retained earnings of the reporting period of initial application if the entity initially applies this HKFRS at the beginning of a reporting period; or

(b) in profit or loss if the entity initially applies this HKFRS during a reporting period.

8.2.7 At the date of initial application, an entity may designate:

(a) a financial asset as measured at fair value through profit or loss in accordance with paragraph 4.5; or

(b) an investment in an equity instrument as at fair value through other comprehensive income in accordance with paragraph 5.4.4.

Such designation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

8.2.8 At the date of initial application, an entity:

(a) shall revoke its previous designation of a financial asset as measured at fair value through profit or loss if that financial asset does not meet the condition in paragraph 4.5.

(b) may revoke its previous designation of a financial asset as measured at fair value through profit or loss if that financial asset meets the condition in paragraph 4.5.

Such revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

8.2.9 At the date of initial application, an entity shall apply paragraph 103M of HKAS 39 to determine when it:

(a) may designate a *financial liability* as measured at fair value through profit or loss; and

(b) shall or may revoke its previous designation of a financial liability as measured at fair value through profit or loss.

Such revocation shall be made on the basis of the facts and circumstances that exist at the date of initial application. That classification shall be applied retrospectively.

8.2.10 If it is impracticable (as defined in HKAS 8) for an entity to apply retrospectively the *effective interest method* or the impairment requirements in paragraphs 58–65 and AG84–AG93 of HKAS 39, the entity shall treat the fair value of the financial asset at the end of each comparative period as its amortised cost. In those circumstances, the fair value of the financial asset at the date of initial application shall be treated as the new amortised cost of that financial asset at the date of initial application of this HKFRS.

8.2.11 If an entity previously accounted for an investment in an unquoted equity instrument (or a derivative that is linked to and must be settled by delivery of such an unquoted equity instrument) at cost in accordance with HKAS 39, it shall measure that instrument at fair value at the date of initial application. Any difference between the previous carrying amount and fair value shall be recognised in the opening retained earnings of the reporting period that includes the date of initial application.

8.2.12 Notwithstanding the requirement in paragraph 8.2.1, an entity that adopts this HKFRS for reporting periods beginning before 1 January 2012 need not restate prior periods. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application in the opening retained earnings (or other component of equity, as appropriate) of the reporting period that includes the date of initial application.

8.2.13 If an entity prepares interim financial reports in accordance with HKAS 34 *Interim Financial Reporting* the entity need not apply the requirements in this HKFRS to interim periods prior to the date of initial application if it is impracticable (as defined in HKAS 8).

Appendix A
Defined terms

This appendix is an integral part of the HKFRS.

reclassification date	The first day of the first reporting period following the change in business model that results in an entity reclassifying financial assets.

The following terms are defined in paragraph 11 of HKAS 32 or paragraph 9 of HKAS 39 and are used in this HKFRS with the meanings specified in HKAS 32 or HKAS 39:

(a) amortised cost of a financial asset or financial liability

(b) derivative

(c) effective interest method

(d) equity instrument

(e) fair value

(f) financial asset

(g) financial instrument

(h) financial liability

(i) hedged item

(j) hedging instrument

(k) held for trading

(l) regular way purchase or sale

(m) transaction costs.

Appendix B
Application guidance

This appendix is an integral part of the HKFRS.

Classification

The entity's business model for managing financial assets

B4.1 Paragraph 4.1(a) requires an entity to classify financial assets as subsequently measured at amortised cost or fair value on the basis of the entity's business model for managing the financial assets. An entity assesses whether its financial assets meet this condition on the basis of the objective of the business model as determined by the entity's key management personnel (as defined in HKAS 24 *Related Party Disclosures*).

B4.2 The entity's business model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined on a higher level of aggregation. However, a single entity may have more than one business model for managing its financial instruments. Therefore, classification need not be determined at the reporting entity level. For example, an entity may hold a portfolio of investments that it manages in order to collect contractual cash flows and another portfolio of investments that it manages in order to trade to realise fair value changes.

B4.3 Although the objective of an entity's business model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. Thus an entity's business model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur. For example, the entity may sell a financial asset if:

(a) the financial asset no longer meets the entity's investment policy (eg the credit rating of the asset declines below that required by the entity's investment policy);

(b) an insurer adjusts its investment portfolio to reflect a change in expected duration (ie the expected timing of payouts); or

(c) an entity needs to fund capital expenditures.

However, if more than an infrequent number of sales are made out of a portfolio, the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows.

B4.4 The following are examples of when the objective of an entity's business model may be to hold financial assets to collect the contractual cash flows. This list of examples is not exhaustive.

Example	**Analysis**
Example 1 An entity holds investments to collect their contractual cash flows but would sell an investment in particular circumstances.	Although an entity may consider, among other information, the financial assets' fair values from a liquidity perspective (ie the cash amount that would be realised if the entity needs to sell assets), the entity's objective is to hold the financial assets and collect the contractual cash flows. Some sales would not contradict that objective.
Example 2 An entity's business model is to purchase portfolios of financial assets, such as loans. Those portfolios may or may not include financial assets with incurred credit losses. If payment on the loans is not made on a timely basis, the entity attempts to extract the contractual cash flows through various means—for example, by making contact with the debtor by mail, telephone or other methods. In some cases, the entity enters into interest rate swaps to change the interest rate on particular financial assets in a portfolio from a floating interest rate to a fixed interest rate.	The objective of the entity's business model is to hold the financial assets and collect the contractual cash flows. The entity does not purchase the portfolio to make a profit by selling them. The same analysis would apply even if the entity does not expect to receive all of the contractual cash flows (eg some of the financial assets have incurred credit losses). Moreover, the fact that the entity has entered into derivatives to modify the cash flows of the portfolio does not in itself change the entity's business model. If the portfolio is not managed on a fair value basis, the objective of the business model could be to hold the assets to collect the contractual cash flows.
Example 3 An entity has a business model with the objective of originating loans to customers and subsequently to sell those loans to a securitisation vehicle. The securitisation vehicle issues instruments to investors. The originating entity controls the securitisation vehicle and thus consolidates it. The securitisation vehicle collects the contractual cash flows from the loans and passes them on to its investors. It is assumed for the purposes of this example that the loans continue to be recognised in the consolidated statement of financial position because they are not derecognised by the securitisation vehicle.	The consolidated group originated the loans with the objective of holding them to collect the contractual cash flows. However, the originating entity has an objective of realising cash flows on the loan portfolio by selling the loans to the securitisation vehicle, so for the purposes of its separate financial statements it would not be considered to be managing this portfolio in order to collect the contractual cash flows.

B4.5 One business model in which the objective is not to hold instruments to collect the contractual cash flows is if an entity manages the performance of a portfolio of financial assets with the objective of realising cash flows through the sale of the assets. For example, if an entity actively manages a portfolio of assets in order to realise fair value changes arising from changes in credit spreads and yield curves, its business model is not to hold those assets to collect the contractual cash flows. The entity's objective results in active buying and selling and the entity is managing the instruments to realise fair value gains rather than to collect the contractual cash flows.

B4.6 A portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis (as described in paragraph 9(b)(ii) of HKAS 39) is not held to collect contractual cash flows. Also, a portfolio of financial assets that meets the definition of held for trading is not held to collect contractual cash flows. Such portfolios of instruments must be measured at fair value through profit or loss.

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding

B4.7 Paragraph 4.1 requires an entity (unless paragraph 4.5 applies) to classify a financial asset as subsequently measured at amortised cost or fair value on the basis of the contractual cash flow characteristics of the financial asset that is in a group of financial assets managed for the collection of the contractual cash flows.

B4.8 An entity shall assess whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding for the currency in which the financial asset is denominated (see also paragraph B5.13).

B4.9 Leverage is a contractual cash flow characteristic of some financial assets. Leverage increases the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest. Stand-alone option, forward and swap contracts are examples of financial assets that include leverage. Thus such contracts do not meet the condition in paragraph 4.2(b) and cannot be subsequently measured at amortised cost.

B4.10 Contractual provisions that permit the issuer (ie the debtor) to prepay a debt instrument (eg a loan or a bond) or permit the holder (ie the creditor) to put a debt instrument back to the issuer before maturity result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding only if:

(a) the provision is not contingent on future events, other than to protect:

   (i) the holder against the credit deterioration of the issuer (eg defaults, credit downgrades or loan covenant violations), or a change in control of the issuer; or

   (ii) the holder or issuer against changes in relevant taxation or law; and

(b) the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the early termination of the contract.

B4.11 Contractual provisions that permit the issuer or holder to extend the contractual term of a debt instrument (ie an extension option) result in contractual cash flows that are solely payments of principal and interest on the principal amount outstanding only if:

(a) the provision is not contingent on future events, other than to protect:

(i) the holder against the credit deterioration of the issuer (eg defaults, credit downgrades or loan covenant violations), or a change in control of the issuer; or

(ii) the holder or issuer against changes in relevant taxation or law; and

(b) the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest on the principal amount outstanding.

B4.12 A contractual term that changes the timing or amount of payments of principal or interest does not result in contractual cash flows that are solely principal and interest on the principal amount outstanding unless it:

(a) is a variable interest rate that is consideration for the time value of money and the credit risk (which may be determined at initial recognition only, and so may be fixed) associated with the principal amount outstanding; and

(b) if the contractual term is a prepayment option, meets the conditions in paragraph B4.10; or

(c) if the contractual term is an extension option, meets the conditions in paragraph B4.11.

B4.13 The following examples illustrate contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

Instrument	Analysis
Instrument A Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected.	The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest on the principal amount outstanding to an unleveraged inflation index resets the time value of money to a current level. In other words, the interest rate on the instrument reflects 'real' interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding. However, if the interest payments were indexed to another variable such as the debtor's performance (eg the debtor's net income) or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the interest payments are not consideration for the time value of money and for credit risk associated with the principal amount outstanding. There is variability in the contractual interest payments that is inconsistent with market interest rates.

Instrument	Analysis
Instrument B Instrument B is a variable interest rate instrument with a stated maturity date that permits the borrower to choose the market interest rate on an ongoing basis. For example, at each interest rate reset date, the borrower can choose to pay three-month LIBOR for a three-month term or one-month LIBOR for a one-month term.	The contractual cash flows are solely payments of principal and interest on the principal amount outstanding as long as the interest paid over the life of the instrument reflects consideration for the time value of money and for the credit risk associated with the instrument. The fact that the LIBOR interest rate is reset during the life of the instrument does not in itself disqualify the instrument. However, if the borrower is able to choose to receive one-month LIBOR for three months and that one-month LIBOR is not reset each month, the contractual cash flows are not payments of principal and interest. The same analysis would apply if the borrower is able to choose between the lender's published one-month variable interest rate and the lender's published three-month variable interest rate. However, if the instrument has a contractual interest rate that is based on a term that exceeds the instrument's remaining life, its contractual cash flows are not payments of principal and interest on the principal amount outstanding. For example, a constant maturity bond with a five-year term that pays a variable rate that is reset periodically but always reflects a five-year maturity does not result in contractual cash flows that are payments of principal and interest on the principal amount outstanding. That is because the interest payable in each period is disconnected from the term of the instrument (except at origination).

Instrument	Analysis
Instrument C Instrument C is a bond with a stated maturity date and pays a variable market interest rate. That variable interest rate is capped.	The contractual cash flows of both: (a) an instrument that has a fixed interest rate and (b) an instrument that has a variable interest rate are payments of principal and interest on the principal amount outstanding as long as the interest reflects consideration for the time value of money and for the credit risk associated with the instrument during the term of the instrument. Therefore, an instrument that is a combination of (a) and (b) (eg a bond with an interest rate cap) can have cash flows that are solely payments of principal and interest on the principal amount outstanding. Such a feature may reduce cash flow variability by setting a limit on a variable interest rate (eg an interest rate cap or floor) or increase the cash flow variability because a fixed rate becomes variable.
Instrument D Instrument D is a full recourse loan and is secured by collateral.	The fact that a full recourse loan is collateralised does not in itself affect the analysis of whether the contractual cash flows are solely payments of principal and interest on the principal amount outstanding.

B4.14 The following examples illustrate contractual cash flows that are not payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

Instrument	Analysis
Instrument E Instrument E is a bond that is convertible into equity instruments of the issuer.	The holder would analyse the convertible bond in its entirety. The contractual cash flows are not payments of principal and interest on the principal amount outstanding because the interest rate does not reflect only consideration for the time value of money and the credit risk. The return is also linked to the value of the equity of the issuer.
Instrument F Instrument F is a loan that pays an inverse floating interest rate (ie the interest rate has an inverse relationship to market interest rates).	The contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. The interest amounts are not consideration for the time value of money on the principal amount outstanding.

Instrument	Analysis
Instrument G Instrument G is a perpetual instrument but the issuer may call the instrument at any point and pay the holder the par amount plus accrued interest due. Instrument G pays a market interest rate but payment of interest cannot be made unless the issuer is able to remain solvent immediately afterwards. Deferred interest does not accrue additional interest.	The contractual cash flows are not payments of principal and interest on the principal amount outstanding. That is because the issuer may be required to defer interest payments and additional interest does not accrue on those deferred interest amounts. As a result, interest amounts are not consideration for the time value of money on the principal amount outstanding. If interest accrued on the deferred amounts, the contractual cash flows could be payments of principal and interest on the principal amount outstanding. The fact that Instrument G is perpetual does not in itself mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding. In effect, a perpetual instrument has continuous (multiple) extension options. Such options may result in contractual cash flows that are payments of principal and interest on the principal amount outstanding if interest payments are mandatory and must be paid in perpetuity. Also, the fact that Instrument G is callable does not mean that the contractual cash flows are not payments of principal and interest on the principal amount outstanding unless it is callable at an amount that does not substantially reflect payment of outstanding principal and interest on that principal. Even if the callable amount includes an amount that compensates the holder for the early termination of the instrument, the contractual cash flows could be payments of principal and interest on the principal amount outstanding.

B4.15 In some cases a financial asset may have contractual cash flows that are described as principal and interest but those cash flows do not represent the payment of principal and interest on the principal amount outstanding as described in paragraphs 4.2(b) and 4.3 of this HKFRS.

B4.16 This may be the case if the financial asset represents an investment in particular assets or cash flows and hence the contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. For example, the contractual cash flows may include payment for factors other than consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time. As a result, the instrument would not satisfy the condition in paragraph 4.2(b). This could be the case when a creditor's claim is limited to specified assets of the debtor or the cash flows from specified assets (for example, a 'non-recourse' financial asset).

B4.17 However, the fact that a financial asset is non-recourse does not in itself necessarily preclude the financial asset from meeting the condition in paragraph 4.2(b). In such situations, the creditor is required to assess ('look through to') the particular underlying assets or cash flows to determine whether the contractual cash flows of the financial asset being classified are payments of principal and interest on the principal amount outstanding. If the terms of the financial asset give rise to any other cash flows or limit the cash flows in a manner inconsistent with payments representing principal and interest, the financial asset does not meet the condition in paragraph 4.2(b). Whether the underlying assets are financial assets or non-financial assets does not in itself affect this assessment.

B4.18 If a contractual cash flow characteristic is not genuine, it does not affect the classification of a financial asset. A cash flow characteristic is not genuine if it affects the instrument's contractual cash flows only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur.

B4.19 In almost every lending transaction the creditor's instrument is ranked relative to the instruments of the debtor's other creditors. An instrument that is subordinated to other instruments may have contractual cash flows that are payments of principal and interest on the principal amount outstanding if the debtor's non-payment is a breach of contract and the holder has a contractual right to unpaid amounts of principal and interest on the principal amount outstanding even in the event of the debtor's bankruptcy. For example, a trade receivable that ranks its creditor as a general creditor would qualify as having payments of principal and interest on the principal amount outstanding. This is the case even if the debtor issued loans that are collateralised, which in the event of bankruptcy would give that loan holder priority over the claims of the general creditor in respect of the collateral but does not affect the contractual right of the general creditor to unpaid principal and other amounts due.

Contractually linked instruments

B4.20 In some types of transactions, an entity may prioritise payments to the holders of financial assets using multiple contractually linked instruments that create concentrations of credit risk (tranches). Each tranche has a subordination ranking that specifies the order in which any cash flows generated by the issuer are allocated to the tranche. In such situations, the holders of a tranche have the right to payments of principal and interest on the principal amount outstanding only if the issuer generates sufficient cash flows to satisfy higher-ranking tranches.

B4.21 In such transactions, a tranche has cash flow characteristics that are payments of principal and interest on the principal amount outstanding only if:

(a) the contractual terms of the tranche being assessed for classification (without looking through to the underlying pool of financial instruments) give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding (eg the interest rate on the tranche is not linked to a commodity index);

(b) the underlying pool of financial instruments has the cash flow characteristics set out in paragraphs B4.23 and B4.24; and

(c) the exposure to credit risk in the underlying pool of financial instruments inherent in the tranche is equal to or lower than the exposure to credit risk of the underlying pool of financial instruments (for example, this condition would be met if the underlying pool of instruments were to lose 50 per cent as a result of credit losses and under all circumstances the tranche would lose 50 per cent or less).

B4.22 An entity must look through until it can identify the underlying pool of instruments that are creating (rather than passing through) the cash flows. This is the underlying pool of financial instruments.

B4.23 The underlying pool must contain one or more instruments that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

B4.24 The underlying pool of instruments may also include instruments that:

(a) reduce the cash flow variability of the instruments in paragraph B4.23 and, when combined with the instruments in paragraph B4.23, result in cash flows that are solely payments of principal and interest on the principal amount outstanding (eg an interest rate cap or floor or a contract that reduces the credit risk on some or all of the instruments in paragraph B4.23); or

(b) align the cash flows of the tranches with the cash flows of the pool of underlying instruments in paragraph B4.23 to address differences in and only in:

(i) whether the interest rate is fixed or floating;

(ii) the currency in which the cash flows are denominated, including inflation in that currency; or

(iii) the timing of the cash flows.

B4.25 If any instrument in the pool does not meet the conditions in either paragraph B4.23 or paragraph B4.24, the condition in paragraph B4.21(b) is not met.

B4.26 If the holder cannot assess the conditions in paragraph B4.21 at initial recognition, the tranche must be measured at fair value. If the underlying pool of instruments can change after initial recognition in such a way that the pool may not meet the conditions in paragraphs B4.23 and B4.24, the tranche does not meet the conditions in paragraph B4.21 and must be measured at fair value.

Measurement

Initial measurement of financial assets

B5.1 The fair value of a financial asset at initial recognition is normally the transaction price (ie the fair value of the consideration given, see also paragraph AG76 of HKAS 39). However, if part of the consideration given is for something other than the financial instrument, the fair value of the financial instrument is estimated using a valuation technique (see paragraphs AG74–AG79 of HKAS 39). For example, the fair value of a long-term loan or receivable that carries no interest can be estimated as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.

B5.2 If an entity originates a loan that bears an off-market interest rate (eg 5 per cent when the market rate for similar loans is 8 per cent), and receives an upfront fee as compensation, the entity recognises the loan at its fair value, ie net of the fee it receives.

Subsequent measurement of financial assets

B5.3 If a financial instrument that was previously recognised as a financial asset is measured at fair value and its fair value decreases below zero, it is a financial liability measured in accordance with HKAS 39. However, hybrid contracts with financial asset hosts are always measured in accordance with HKFRS 9.

B5.4 The following example illustrates the accounting for transaction costs on the initial and subsequent measurement of a financial asset measured at fair value with changes through other comprehensive income in accordance with paragraph 5.4.4. An entity acquires an asset for CU100[1] plus a purchase commission of CU2. Initially, the entity recognises the asset at CU102. The reporting period ends one day later, when the quoted market price of the asset is CU100. If the asset were sold, a commission of CU3 would be paid. On that date, the entity measures the asset at CU100 (without regard to the possible commission on sale) and recognises a loss of CU2 in other comprehensive income.

Investments in unquoted equity instruments (and contracts on those investments that must be settled by delivery of the unquoted equity instruments)

B5.5 All investments in equity instruments and contracts on those instruments must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value. That may be the case if insufficient more recent information is available to determine fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

B5.6 Indicators that cost might not be representative of fair value include:

(a) a significant change in the performance of the investee compared with budgets, plans or milestones.

(b) changes in expectation that the investee's technical product milestones will be achieved.

(c) a significant change in the market for the investee's equity or its products or potential products.

(d) a significant change in the global economy or the economic environment in which the investee operates.

(e) a significant change in the performance of comparable entities, or in the valuations implied by the overall market.

(f) internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.

(g) 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.

B5.7 The list in paragraph B5.6 is not exhaustive. An entity shall use all information about the performance and operations of the investee that becomes available after the date of initial recognition. To the extent that any such relevant factors exist, they may indicate that cost might not be representative of fair value. In such cases, the entity must estimate fair value.

B5.8 Cost is never the best estimate of fair value for investments in quoted equity instruments (or contracts on quoted equity instruments).

[1] In this HKFRS monetary amounts are denominated in 'currency units (CU)'.

Reclassification

B5.9 Paragraph 4.9 requires an entity to reclassify financial assets if the objective of the entity's business model for managing those financial assets changes. Such changes are expected to be very infrequent. Such changes must be determined by the entity's senior management as a result of external or internal changes and must be significant to the entity's operations and demonstrable to external parties. Examples of a change in business model include the following:

(a) An entity has a portfolio of commercial loans that it holds to sell in the short term. The entity acquires a company that manages commercial loans and has a business model that holds the loans in order to collect the contractual cash flows. The portfolio of commercial loans is no longer for sale, and the portfolio is now managed together with the acquired commercial loans and all are held to collect the contractual cash flows.

(b) A financial services firm decides to shut down its retail mortgage business. That business no longer accepts new business and the financial services firm is actively marketing its mortgage loan portfolio for sale.

B5.10 A change in the objective of the entity's business model must be effected before the reclassification date. For example, if a financial services firm decides on 15 February to shut down its retail mortgage business and hence must reclassify all affected financial assets on 1 April (ie the first day of the entity's next reporting period), the entity must not accept new retail mortgage business or otherwise engage in activities consistent with its former business model after 15 February.

B5.11 The following are not changes in business model:

(a) a change in intention related to particular financial assets (even in circumstances of significant changes in market conditions).

(b) a temporary disappearance of a particular market for financial assets.

(c) a transfer of financial assets between parts of the entity with different business models.

Gains and losses

B5.12 Paragraph 5.4.4 permits an entity to make an irrevocable election to present in other comprehensive income changes in the fair value of an investment in an equity instrument that is not held for trading. This election is made on an instrument-by-instrument (ie share-by-share) basis. Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss. However, the entity may transfer the cumulative gain or loss within equity. Dividends on such investments are recognised in profit or loss in accordance with HKAS 18 *Revenue* unless the dividend clearly represents a recovery of part of the cost of the investment.

B5.13 An entity applies HKAS 21 *The Effects of Changes in Foreign Exchange Rates* to financial assets that are monetary items in accordance with HKAS 21 and denominated in a foreign currency. HKAS 21 requires any foreign exchange gains and losses on monetary assets to be recognised in profit or loss. An exception is a monetary item that is designated as a *hedging instrument* in either a cash flow hedge (see paragraphs 95–101 of HKAS 39) or a hedge of a net investment (see paragraph 102 of HKAS 39).

B5.14 Paragraph 5.4.4 permits an entity to make an irrevocable election to present in other comprehensive income changes in the fair value of an investment in an equity instrument that is not held for trading. Such an investment is not a monetary item. Accordingly, the gain or loss that is presented in other comprehensive income in accordance with paragraph 5.4.4 includes any related foreign exchange component.

B5.15 If there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component of those financial instruments are presented in profit or loss.

Transition

Financial assets held for trading

B8.1 At the date of initial application of this HKFRS, an entity must determine whether the objective of the entity's business model for managing any of its financial assets meets the condition in paragraph 4.2(a) or if a financial asset is eligible for the election in paragraph 5.4.4. For that purpose, an entity shall determine whether financial assets meet the definition of held for trading as if the entity had acquired the assets at the date of initial application.

Appendix D

Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared as at November 2009 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKFRS 9. The International Financial Reporting Standard comparable with HKFRS 9 is IFRS 9 *Financial Instruments.*

There are no major textual differences between HKFRS 9 and IFRS 9.

HKFRS 9 BC
Issued November 2009

Effective for annual periods
beginning on or after 1 January 2013

Basis for Conclusions on
Hong Kong Financial Reporting Standard 9

Financial Instruments

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Basis for Conclusions
HKFRS 9 *Financial Instruments*

HKFRS 9 is based on IFRS 9 *Financial Instruments.* In approving HKFRS 9, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IFRS 9. Accordingly, there are no significant differences between HKFRS 9 and IFRS 9. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IFRS 9 referred to below generally correspond with those in HKFRS 9.

paragraphs

BASIS FOR CONCLUSIONS ON IFRS 9 *FINANCIAL INSTRUMENTS*

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DISSENTING OPINIONS

APPENDIX
Amendments to the Basis for Conclusions on other HKFRSs

Basis for Conclusions on IFRS 9 *Financial Instruments*

This Basis for Conclusions accompanies, but is not part of, IFRS 9.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in developing IFRS 9 *Financial Instruments*. Individual Board members gave greater weight to some factors than to others.

BC2 The Board has long acknowledged the need to improve the requirements for financial reporting of financial instruments to make it easier for users of financial statements to understand financial reporting information. To meet the heightened urgency of that need in the light of the financial crisis, the Board proposes to replace IAS 39 *Financial Instruments: Recognition and Measurement* by the end of 2010. To make progress as quickly as possible the Board has divided the project into several phases. In adopting this approach, the Board acknowledged the difficulties that might be created by differences in timing between this project and others, in particular phase II of the project on insurance contracts. (Paragraphs BC91(b), BC93 and BC113–BC117 discuss issues relating to insurance contracts.)

BC3 IFRS 9 is a new standard dealing with the accounting for financial instruments. In developing IFRS 9, the Board considered the responses to its exposure draft *Financial Instruments: Classification and Measurement*, published in July 2009. As a result, in November 2009 the Board finalised the first part of IFRS 9, dealing with classification and measurement of financial assets. In the Board's view, requirements on classification and measurement are the foundation for any financial reporting standard, and requirements on associated matters (for example, on impairment and hedge accounting) have to reflect those requirements. In addition, the Board noted that many of the application issues that have arisen in the financial crisis are related to the classification and measurement of financial assets in accordance with IAS 39.

BC4 The Board sees this first phase of the project to replace IAS 39 as a stepping stone to future improvements in the financial reporting of financial instruments and is committed to completing its project on financial instruments expeditiously. The Board is also committed to the convergence of IFRSs and US GAAP requirements for financial instruments. There are many detailed differences between them, making it impossible to achieve convergence on the basis of existing requirements. The Board will consider publishing for comment any proposals that the US Financial Accounting Standards Board (FASB) may publish, to the extent that they are different from IFRSs or proposed IFRSs.

Scope

BC5 The Board has not yet considered the scope of IFRS 9. The scope of IAS 39 and its interaction with other IFRSs have resulted in some application and interpretation issues. However, the Board believes that it should address the issue of scope comprehensively rather than only in the context of classification and measurement. The scope of IAS 39 has not been raised as a matter of concern during the financial crisis and, hence, the Board believes that the scope of IFRS 9 should be based on that of IAS 39 until it considers the scope more generally in a later phase of the project to replace IAS 39.

BC6 The exposure draft contained proposals for all items within the scope of IAS 39. However, some respondents to the exposure draft said that the Board should restrict its proposals on classification and measurement to financial assets and retain the existing requirements for financial liabilities (including the requirements for embedded derivatives and the fair value option) until the Board has more fully considered and debated the issues relating to financial liabilities. Those respondents pointed out that the Board accelerated its project on financial instruments because of the global financial crisis, which placed more emphasis on issues in the accounting for financial assets than for financial liabilities. They suggested that the Board should consider issues that arise from its projects on own credit risk and other related projects more fully before finalising the requirements for classification and measurement of financial liabilities.

BC7 The Board noted those concerns and decided that IFRS 9 should at this stage apply only to assets within the scope of IAS 39. Thus, financial liabilities, including derivative liabilities, remain within the scope of IAS 39. Accordingly, this Basis for Conclusions discusses the responses to the exposure draft as they apply to the classification and measurement of financial assets. Taking this course will enable the Board to obtain further feedback on the accounting for financial liabilities, including how best to address accounting for changes in own credit risk.

Classification

BC8 In IFRS 9 the Board aimed to improve the ability of users to understand the financial reporting of financial assets by:

(a) reducing the number of classification categories and providing a clearer rationale for measuring financial assets in a particular way that replaces the numerous categories in IAS 39, each of which has specific rules dictating how an asset can or must be classified;

(b) applying a single impairment method to all financial assets not measured at fair value, which replaces the many different impairment methods that are associated with the numerous classification categories in IAS 39; and

(c) aligning the measurement attribute of financial assets to the way the entity manages its financial assets (‘business model’) and their contractual cash flow characteristics, thus providing relevant and useful information to users for their assessment of the amounts, timing and uncertainty of the entity’s future cash flows.

BC9 The Board believes that IFRS 9 both improves the ability of users to understand and use the financial reporting of financial assets and eliminates much of the complexity in IAS 39. The Board disagrees with the assertion made by a dissenting Board member that IFRS 9 does not meet the objective of reducing the number of classification categories for financial assets and eliminating the specific rules associated with those categories. Unlike IAS 39, IFRS 9 provides a clear rationale for measuring a financial asset at either amortised cost or fair value, and hence improves the ability of users to understand the financial reporting of financial assets. IFRS 9 aligns the measurement attribute of financial assets to the way the entity manages its financial assets (‘business model’) and their contractual cash flow characteristics. In so doing, IFRS 9 significantly reduces complexity by eliminating the numerous rules associated with each classification category in IAS 39. Consistently with all other financial assets, hybrid contracts with financial asset hosts are classified and measured in their entirety, thereby eliminating the complex and rule-based requirements in IAS 39 for embedded derivatives. Furthermore, IFRS 9 requires a single impairment method, which replaces the different impairment methods associated with the many classification categories in IAS 39. The Board believes that these changes will improve the ability of users to understand the financial reporting of financial assets and to better assess the amounts, timing and uncertainty of future cash flows.

Measurement categories

BC10 Some users of financial statements support a single measurement method—fair value—for all financial assets. They view fair value as more relevant than other measurements in helping them to assess the effect of current economic events on an entity. They assert that having one measurement attribute for all financial assets promotes consistency in valuation, presentation and disclosure and improves the usefulness of financial statements.

BC11 However, many users and others, including many preparers and auditors of financial statements and regulators, do not support the recognition in the statement of comprehensive income of changes in fair value for financial assets that are not held for trading or are not managed on a fair value basis. Some users say that they often value an entity on the basis of its business model and that in some circumstances cost-based information provides relevant information that can be used to predict likely actual cash flows.

BC12 Some, including some of those who generally support the broad application of fair value for financial assets, raise concerns about the use of fair value when fair value cannot be determined within a narrow range. Those views were consistent with the general concerns raised during the financial crisis. Many also believe that other issues, including financial statement presentation, need to be addressed before a comprehensive fair value measurement requirement would be feasible.

BC13 In response to those views, the Board decided that measuring all financial assets at fair value is not the most appropriate approach to improving the financial reporting for financial instruments. Accordingly, the exposure draft proposed that entities should classify financial assets into two primary measurement categories: amortised cost and fair value (the 'mixed attribute approach'). The Board noted that both of those measurement methods can provide useful information to users of financial statements for particular types of financial assets in particular circumstances.

BC14 Almost all respondents to the exposure draft supported the mixed attribute approach, stating that amortised cost provides relevant and useful information about particular financial assets in particular circumstances because it provides information about the entity's likely actual cash flows. Some respondents said that fair value does not provide such information because it assumes that the financial asset is sold or transferred on the measurement date.

BC15 Accordingly, IFRS 9 requires some financial assets to be measured at amortised cost if particular conditions are met.

Fair value information in the statements of financial position and financial performance

BC16 Some respondents to the exposure draft proposed that fair value information should be presented in the statement of financial position for financial assets measured at amortised cost. Some of those supporting such presentation said that the information provided would be more reliable and timely if it were required to be presented in the statement of financial position rather than in the notes.

BC17 The Board also considered whether the total gains and losses for the period related to fair value measurements in Level 3 of the fair value measurement hierarchy (paragraph 27A of IFRS 7 *Financial Instruments: Disclosures* describes the levels in the fair value hierarchy) should be presented separately in the statement of comprehensive income. Those supporting such presentation said that its prominence would draw attention to how much of the total fair value gain or loss for the period was attributable to fair value measurements that are subject to more measurement uncertainty.

BC18 The Board decided that it would reconsider both issues at a future date. The Board noted that the Level 3 gains or losses for the period are required to be disclosed in the notes to the financial statements in accordance with IFRS 7. The Board also noted that neither proposal had been exposed for public comment and further consultation was required. The Board decided that these two issues should form part of convergence discussions with the FASB.

Approach to classification

BC19 The exposure draft proposed that an entity should classify its financial assets into two primary measurement categories on the basis of the financial assets' characteristics and the entity's business model for managing them. Thus, a financial asset would be measured at amortised cost if two conditions were met:

(a) the financial asset has only basic loan features; and

(b) the financial asset is managed on a contractual yield basis.

A financial asset that did not meet both conditions would be measured at fair value.

BC20 Most respondents supported classification based on the contractual terms of the financial asset and how an entity manages groups of financial assets. Although they agreed with the principles proposed in the exposure draft, some did not agree with the way the approach was described and said that more application guidance was needed, in particular to address the following issues:

(a) the order in which the two conditions are considered;

(b) how the 'managed on a contractual yield basis' condition should be applied; and

(c) how the 'basic loan features' condition should be applied.

BC21 Most respondents agreed that the two conditions for determining how financial assets are measured were necessary. However, many questioned the order in which the two conditions should be considered. The Board agreed with those comment letters that stated that it would be more efficient for an entity to consider the business model condition first. Therefore, the Board clarified that entities would consider the business model first. However, the Board noted that the contractual cash flow characteristics of any financial asset within a business model that has the objective of collecting contractual cash flows must also be assessed to ensure that amortised cost provides relevant information to users.

The entity's business model

BC22 The Board concluded that an entity's business model affects the predictive quality of contractual cash flows—ie whether the likely actual cash flows will result primarily from the collection of contractual cash flows. Accordingly, the exposure draft proposed that a financial asset should be measured at amortised cost only if it is 'managed on a contractual yield basis'. This condition was intended to ensure that the measurement of a financial asset provides information that is useful to users of financial statements in predicting likely actual cash flows.

BC23 Almost all respondents to the exposure draft agreed that classification and measurement should reflect how an entity manages its financial assets. However, most expressed concern that the term 'managed on a contractual yield basis' would not adequately describe that principle and that more guidance was needed.

BC24 In August 2009 the FASB posted on its website a description of its tentative approach to classification and measurement of financial instruments. That approach also considers the entity's business model. Under that approach, financial instruments would be measured at fair value through profit or loss unless:

> ... an entity's business strategy is to hold debt instruments with principal amounts for collection or payment(s) of contractual cash flows rather than to sell or settle the financial instruments with a third party ...

The FASB also provided explanatory text:

> ... an entity's business strategy for a financial instrument would be evaluated based on how the entity manages its financial instruments rather than based on the entity's intent for an individual financial instrument. The entity also would demonstrate that it holds a high proportion of similar instruments for long periods of time relative to their contractual terms.

BC25 The Board had intended 'managed on a contractual yield basis' to describe a similar condition. However, it decided not to use the FASB's proposed guidance because the additional guidance included would still necessitate significant judgement. In addition, the Board noted that the FASB's proposed approach might be viewed as very similar to the notion of 'held to maturity' in IAS 39, which could result in 'bright line' guidance on how to apply it. Most respondents believed the Board should avoid such bright lines and that an entity should be required to exercise judgement.

BC26 Therefore, in response to the concerns noted in paragraph BC23, the Board clarified the condition by requiring an entity to measure a financial asset at amortised cost only if the objective of the entity's business model is to hold the financial asset to collect the contractual cash flows. The Board also clarified in the application guidance that:

(a) it is expected that an entity may sell some financial assets that it holds with an objective of collecting the contractual cash flows. Very few business models entail holding all instruments until maturity. However, frequent buying and selling of financial assets is not consistent with a business model of holding financial assets to collect contractual cash flows.

(b) an entity needs to use judgement to determine at what level this condition should be applied. That determination is made on the basis of how an entity manages its business. It is not made at the level of an individual financial asset.

BC27 The Board noted that an entity's business model does not relate to a choice (ie it is not a voluntary designation) but rather it is a matter of fact that can be observed by the way an entity is managed and information is provided to its management.

BC28 For example, if an investment bank uses a trading business model, it could not easily become a savings bank that uses an 'originate and hold' business model. Therefore, a business model is very different from 'management intentions' which can relate to a single instrument. The Board concluded that sales or transfers of financial instruments before maturity would not be inconsistent with a business model with an objective of collecting contractual cash flows, as long as such transactions were consistent with that business model, rather than with a business model that has the objective of realising changes in fair values.

Contractual cash flow characteristics

BC29 The exposure draft proposed that only financial instruments with basic loan features could be measured at amortised cost. It specified that a financial instrument has basic loan features if its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. For the purposes of this condition, interest is consideration for the time value of money and the credit risk associated with the principal amount outstanding during a particular period of time, which may include a premium for liquidity risk.

BC30 The objective of the effective interest method for financial instruments measured at amortised cost is to allocate interest revenue or expense to the relevant period. Cash flows that are interest always have a close relation to the amount advanced to the debtor (the 'funded' amount) because interest is consideration for the time value of money and the credit risk associated with the issuer of the instrument and with the instrument itself. The Board noted that the effective interest method is not an appropriate method to allocate cash flows that are not principal or interest on the principal amount outstanding. The Board concluded that if a financial asset contains contractual cash flows that are not principal or interest on the principal amount outstanding then a valuation overlay to contractual cash flows (fair value) is required to ensure that the reported financial information provides useful information.

BC31 Most respondents to the exposure draft agreed with the principle that classification should reflect the contractual terms of the financial asset. However, many objected to the label ‘basic loan features’ and requested more guidance to apply the principle to particular financial assets. Respondents were also concerned that the exposure draft did not discuss ‘immaterial’ or ‘insignificant’ features that they believed ought not to affect classification.

BC32 The Board decided to clarify how contractual cash flow characteristics should affect classification and improve the examples that illustrate how the condition should be applied. It decided not to add application guidance clarifying that the notion of materiality applies to this condition, because that notion applies to every item in the financial statements. However, it did add application guidance that a contractual cash flow characteristic does not affect the classification of a financial asset if it is ‘not genuine’.

Application of the two classification conditions to particular financial assets

Investments in contractually linked instruments (tranches)

BC33 A structured investment vehicle may issue different tranches to create a ‘waterfall’ structure that prioritises the payments by the issuer to the holders of the different tranches. In typical waterfall structures, multiple contractually linked instruments effect concentrations of credit risk in which payments to holders are prioritised. Such structures specify the order in which any losses that the issuer incurs are allocated to the tranches. The exposure draft concluded that tranches providing credit protection (albeit on a contingent basis) to other tranches are leveraged because they expose themselves to higher credit risk by writing credit protection to other tranches. Hence their cash flows do not represent solely payments of principal and interest on the principal amount outstanding. Thus, only the most senior tranche could have basic loan features and might qualify for measurement at amortised cost, because only the most senior tranche would receive credit protection in all situations.

BC34 The exposure draft proposed that the classification principle should be based on whether a tranche could provide credit protection to any other tranches in *any* possible scenario. In the Board’s view, a contract that contains credit concentration features that create ongoing subordination (not only in a liquidation scenario) would include contractual cash flows that represent a premium for providing credit protection to other tranches. Only the most senior tranche does not receive such a premium.

BC35 In proposing this approach, the Board concluded that subordination in itself should not preclude amortised cost measurement. The ranking of an entity’s instruments is a common form of subordination that affects almost all lending transactions. Commercial law (including bankruptcy law) typically sets out a basic ranking for creditors. This is required because not all creditors’ claims are contractual (eg claims regarding damages for unlawful behaviour and for tax liabilities or social insurance contributions). Although it is often difficult to determine exactly the degree of leverage resulting from this subordination, the Board believes that it is reasonable to assume that commercial law does not intend to create leveraged credit exposure for general creditors such as trade creditors. Thus, the Board believes that the credit risk associated with general creditors does not preclude the contractual cash flows representing the payments of principal and interest on the principal amount outstanding. Consequently, the credit risk associated with any secured or senior liabilities ranking above general creditors should also not preclude the contractual cash flows from representing payments of principal and interest on the principal amount outstanding.

BC36 Almost all respondents disagreed with the approach in the exposure draft for investments in contractually linked instruments for the following reasons:

(a) It focused on form and legal structure rather than the economic characteristics of the financial instruments.

(b) It would create structuring opportunities because of the focus on the existence of a waterfall structure, without consideration of the characteristics of the underlying instruments.

(c) It would be an exception to the overall classification model, driven by anti-abuse considerations.

BC37 In particular, respondents argued that the proposals in the exposure draft would conclude that some tranches provide credit protection and therefore were ineligible for measurement at amortised cost, even though that tranche might have a lower credit risk than the underlying pool of instruments that would themselves be eligible for measurement at amortised cost.

BC38 The Board did not agree that the proposals in the exposure draft were an exception to the overall classification model. In the Board's view, those proposals were consistent with many respondents' view that any financial instrument that creates contractual subordination should be subject to the proposed classification criteria and no specific guidance should be required to apply the classification approach to these instruments. However, it noted that, for contractually linked instruments that effect concentrations of credit risk, many respondents did not agree that the contractual cash flow characteristics determined by the terms and conditions of the financial asset in isolation best reflected the economic characteristics of that financial asset.

BC39 Respondents proposed other approaches in which an investor 'looks through' to the underlying pool of instruments of a waterfall structure and measures the instruments at fair value if looking through is not possible. They made the following points:

(a) *Practicability:* The securitisation transactions intended to be addressed were generally over-the-counter transactions in which the parties involved had sufficient information about the assets to perform an analysis of the underlying pool of instruments.

(b) *Complexity:* Complex accounting judgement was appropriate to reflect the complex economic characteristics of the instrument. In particular, in order to obtain an understanding of the effects of the contractual terms and conditions, an investor would have to understand the underlying pool of instruments. Also, requiring fair value measurement if it were not practicable to look through to the underlying pool of instruments would allow an entity to avoid such complexity.

(c) *Mechanics:* Amortised cost measurement should be available only if all of the instruments in the underlying pool of instruments had contractual cash flows that represented payments of principal and interest on the principal amount outstanding. Some also suggested that instruments that change the cash flow variability of the underlying pool of instruments in a way that is consistent with representing solely payments of principal and interest on the principal amount outstanding, or aligned currency/interest rates with the issued notes, should not preclude amortised cost measurement.

(d) *Relative exposure to credit risk:* Many favoured use of a probability-weighted approach to assess whether an instrument has a lower or higher exposure to credit risk than the average credit risk of the underlying pool of instruments.

BC40 The Board was persuaded that classification based solely on the contractual features of the financial asset being assessed for classification would not capture the economic characteristics of the instruments when a concentrated credit risk arises through contractual linkage. Therefore, the Board decided that, unless it is impracticable, an entity should 'look through' to assess the underlying cash flow characteristics of the financial assets and to assess the exposure to credit risk of those financial assets relative to the underlying pool of instruments.

BC41 The Board concluded that the nature of contractually linked instruments that effect concentrations of credit risk justifies this approach because the variability of cash flows from the underlying pool of instruments is a reference point, and tranching only reallocates credit risk. Thus, if the contractual cash flows of the assets in the underlying pool represent payments of principal and interest on the principal amount outstanding, any tranche that is exposed to the same or lower credit risk (as evidenced by the cash flow variability of the tranche relative to the overall cash flow variability of the underlying instrument pool) would also be deemed to represent payments of principal and interest on the principal amount outstanding. The Board also took the view that such an approach would address many of the concerns raised in the comment letters with regard to structuring opportunities and the focus on the contractual form of the financial asset, rather than its underlying economic characteristics. The Board also noted that in order to understand and make the judgement about whether particular types of financial assets have the required cash flow characteristics, an entity would have to understand the characteristics of the underlying issuer to ensure that the instrument's cash flows are solely payments of principal and interest on the principal amount outstanding.

BC42 To apply this approach, the Board decided that an entity should:

(a) determine whether the contractual terms of the issued instrument (the financial asset being classified) give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding. The Board concluded that the issued instrument must have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

(b) look through to the underlying pool of instruments until it can identify the instruments that are creating (rather than simply passing through) the cash flows.

(c) determine whether one or more of the instruments in the underlying pool has contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. The Board concluded the underlying pool must contain one or more instruments that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

(d) assess whether any other instruments in the underlying pool only:

(i) reduce the cash flow variability of the underlying pool of instruments in a way that is consistent with representing solely payments of principal and interest on the principal amount outstanding, or

(ii) align the cash flows of the issued financial assets with the underlying pool of financial instruments.

The Board concluded that the existence of such instruments does not preclude the cash flows from representing solely payments of principal and interest on the principal amount outstanding. The Board determined that the existence of other instruments in the pool would, however, preclude the cash flows representing solely payments of principal and interest on the principal amount outstanding. For example, an underlying pool that contains government bonds and an instrument that swaps government credit risk for (riskier) corporate credit risk would not have cash flows that represent solely principal and interest on the principal amount outstanding.

(e) measure at fair value any issued instrument in which any of the financial instruments in the underlying pool:

(i) have cash flows that do not represent solely payments of principal and interest on the principal amount outstanding; or

(ii) could change so that cash flows may not represent solely payments of principal and interest on the principal amount outstanding at any point in the future.

(f) measure at fair value any issued instrument whose exposure to credit risk in the underlying pool of financial instruments is greater than the exposure to credit risk of the underlying pool of financial instruments. The Board decided that if the range of expected losses on the issued instrument is greater than the weighted average range of expected losses on the underlying pool of financial instruments, then the issued instrument should be measured at fair value.

BC43 The Board also decided that if it were not practicable to look through to the underlying pool of financial instruments, entities should measure the issued instrument at fair value.

Financial assets acquired at a discount that reflects incurred credit losses

BC44 The exposure draft proposed that if a financial asset is acquired at a discount that reflects incurred credit losses, it cannot be measured at amortised cost because:

(a) the entity does not hold such financial assets to collect the cash flows arising from those assets' contractual terms; and

(b) an investor acquiring a financial asset at such a discount believes that the actual losses will be less than the losses that are reflected in the purchase price. Thus, that asset creates exposure to significant variability in actual cash flows and such variability is not interest.

BC45 Almost all respondents disagreed with the Board's conclusion that these assets cannot be held to collect the contractual cash flows. They regarded that conclusion as an exception to a classification approach based on the entity's business model for managing the financial assets. In particular, they noted that entities could acquire and subsequently manage such assets as part of an otherwise performing asset portfolio for which the objective of the entity's business model is to hold the assets to collect contractual cash flows.

BC46 Respondents also noted that an entity's expectations about actual future cash flows are not the same as the contractual cash flows of the financial asset. Those expectations are irrelevant to an assessment of the financial asset's contractual cash flow characteristics.

BC47 The Board agreed that the general classification approach in IFRS 9 should apply to financial assets acquired at a discount that reflects incurred credit losses. Thus, when such assets meet the conditions in paragraph 4.2, they are measured at amortised cost.

Alternative approaches to classification

BC48 In its deliberations leading to the exposure draft, the Board discussed alternative approaches to classification and measurement. In particular, it considered an approach in which financial assets that have basic loan features, are managed on a contractual yield basis and meet the definition of loans and receivables in IAS 39 would be measured at amortised cost. All other financial assets would be measured at fair value. The fair value changes for each period for those financial assets with basic loan features that are managed on a contractual yield basis would be disaggregated and presented as follows:

(a) changes in recognised value determined on an amortised cost basis (including impairments determined using the incurred loss impairment requirements in IAS 39) would be presented in profit or loss; and

(b) any difference between the amortised cost measure in (a) and the fair value change for the period would be presented in other comprehensive income.

BC49 The Board also considered variants in which all financial assets and financial liabilities would be measured at fair value. One variant would be to present both the amounts in paragraph BC48(a) and (b) in profit or loss, but separately. Another variant would be to measure all financial instruments (including financial assets that meet the two conditions specified in the exposure draft and meet the definition of loans and receivables in IAS 39) at fair value in the statement of financial position. All financial instruments (including financial liabilities) with basic loan features that are managed on a contractual yield basis would be disaggregated and presented as described in paragraph BC48(a) and (b).

BC50 Respondents noted that the alternative approach described in paragraph BC48 and both variants described in paragraph BC49 would result in more financial assets and financial liabilities being measured at fair value. Respondents also noted that the alternative approach would apply only to financial assets. Lastly, almost all respondents noted that splitting gains and losses between profit or loss and other comprehensive income would increase complexity and reduce understandability. The Board concluded that those approaches would not result in more useful information than the approach in IFRS 9 and did not consider them further.

BC51 The Board also considered and rejected the following approaches to classification:

(a) *Classification based on the definition of held for trading:* A few respondents suggested that all financial assets and financial liabilities that are not 'held for trading' should be eligible for measurement at amortised cost. However, in the Board's view, the notion of 'held for trading' is too narrow and cannot appropriately reflect all situations in which amortised cost does not provide useful information.

(b) *Three-category approach:* Some respondents suggested retaining a three-category approach, ie including a third category similar to the available-for-sale category in IAS 39. However, in the Board's view, such an approach would neither significantly improve nor reduce the complexity of the reporting for financial instruments.

(c) *Classification based only on the business model:* A small number of respondents thought the contractual terms of the instrument condition was unnecessary and that classification should depend solely on the entity's business model for managing financial instruments. However, in the Board's view, determining classification solely on the basis of how an entity manages its financial instruments would result in misleading information that is not useful to a user in understanding the risks associated with complex or risky instruments. The Board concluded, as had almost all respondents, that the contractual cash flow characteristics condition is required to ensure that amortised cost is used only when it provides information that is useful in predicting the entity's future cash flows.

(d) *Amortised cost as the default option:* The Board considered developing conditions that specified when a financial asset must be measured at fair value, with the requirement that all other financial instruments would be measured at amortised cost. The Board rejected that approach because it believes that new conditions would have to be developed in the future to address innovative financial products. In addition, the Board noted that such an approach would not be practical because an entity can apply amortised cost only to some types of financial instruments.

(e) *Originated loan approach:* In developing an approach to distinguish between financial assets measured at fair value and amortised cost the Board considered a model in which only loans originated by the entity would qualify for amortised cost measurement. The Board acknowledged that for originated instruments the entity potentially has better information about the future contractual cash flows and credit risk than for purchased loans. However, the Board decided not to pursue that approach, mainly because some entities manage originated and purchased loans in the same portfolio. Distinguishing between originated and purchased loans, which would be done mainly for accounting purposes, would involve systems changes. In addition, the Board noted that 'originated loans' might easily be created by placing purchased loans into an investment vehicle. The Board also noted that the definition of loans and receivables in IAS 39 had created application problems in practice.

Tainting

BC52 The Board considered whether it should prohibit an entity from classifying a financial asset as measured at amortised cost if the entity had previously sold or reclassified financial assets rather than holding them to collect the contractual cash flows. A restriction of this kind is often called 'tainting'. However, the Board believes that classification based on the entity's business model for managing financial assets and the contractual cash flow characteristics of those financial assets provides a clear rationale for measurement. A tainting provision would increase the complexity of application, be unduly prohibitive in the context of that approach and could give rise to classification inconsistent with the classification approach. However, the Board amended IAS 1 *Presentation of Financial Statements* to require an entity to present separately in the statement of comprehensive income all gains and losses arising from the derecognition of financial assets measured at amortised cost. The Board also amended IFRS 7 to require an entity to disclose an analysis of those gains and losses, including the reasons for derecognising those financial assets. Those requirements enable users of financial statements to understand the effects of derecognising before maturity instruments measured at amortised cost and also provides transparency in situations where an entity has measured financial assets at amortised cost on the basis of having an objective of managing those assets in order to collect the contractual cash flows but regularly sells them.

Embedded derivatives

BC53 An embedded derivative is a derivative component of a hybrid (combined) contract that also includes a non-derivative host, with the effect that some of the cash flows of the combined contract vary like the cash flows of a stand-alone derivative contract. IAS 39 requires an entity to assess all contracts to determine whether they contain one or more embedded derivatives that are required to be separated from the host and accounted for as stand-alone derivatives.

BC54 Many respondents to the discussion paper *Reducing Complexity in Reporting Financial Instruments* commented that the requirements and guidance in IAS 39 are complex, rule-based and internally inconsistent. Respondents, and others, also noted the many application problems that arise from requirements to assess all non-derivative contracts for embedded derivatives and, if required, to account for and measure those embedded derivatives separately as stand-alone derivatives.

BC55 The Board discussed three approaches for accounting for embedded derivatives:

(a) to maintain the requirements in IAS 39;

(b) to use 'closely related' (used in IAS 39 to determine whether an embedded derivative is required to be separated from the host) to determine the classification for the contract in its entirety; and

(c) to use the same classification approach for all financial assets (including hybrid contracts).

BC56 The Board rejected the first two approaches. The Board noted that both would rely on the assessment of whether an embedded derivative is 'closely related' to the host. The 'closely related' assessment in IAS 39 is based on a list of examples that are inconsistent and unclear. That assessment is also a significant source of complexity. Both approaches would result in hybrid contracts being classified using conditions different from those that would be applied to all non-hybrid financial instruments. Consequently, some hybrid contracts whose contractual cash flows do not solely represent payments of principal and interest on the principal amount outstanding might be measured at amortised cost. Similarly, some hybrid contracts whose contractual cash flows do meet the conditions for measurement at amortised cost might be measured at fair value. The Board also believes that neither approach would make it easier for users of financial statements to understand the information that financial statements present about financial instruments.

BC57 Therefore, the exposure draft proposed that entities should use the same classification approach for all financial instruments, including hybrid contracts with hosts within the scope of the proposed IFRS ('financial hosts'). The Board concluded that a single classification approach for all financial instruments and hybrid contracts with financial hosts was the only approach that responded adequately to the criticisms described above. The Board noted that using a single classification approach improves comparability by ensuring consistency in classification, and hence makes it easier for users to understand the information that financial statements present about financial instruments.

BC58 In the responses to the exposure draft, some respondents, mainly preparers, stated their preference for keeping or modifying the bifurcation model that was in IAS 39. They noted that:

(a) eliminating the requirement to account for embedded derivatives as stand-alone derivatives would lead to increased volatility in profit or loss and result in accounting that did not reflect the underlying economics and risk management or business model considerations in a transaction. For example, the components of some hybrid financial instruments may be managed separately.

(b) structuring opportunities would be created, for example if an entity entered into two transactions that have the same economic effect as entering into a single hybrid contract.

BC59 However, the Board confirmed the proposals in the exposure draft for the following reasons:

(a) The elimination of the embedded derivatives guidance for hybrid contracts with financial hosts reduces the complexity in financial reporting of financial assets by eliminating another classification approach and improves the reporting for financial instruments. Many constituents agreed with this conclusion.

(b) In the Board's view, the underlying rationale for separate accounting for embedded derivatives is not to reflect risk management activities, but to avoid entities circumventing the recognition and measurement requirements for derivatives. Accordingly it is an exception to the definition of the unit of account (the contract) motivated by a wish to avoid abuse. It would reduce complexity to eliminate an anti-abuse exception.

(c) The Board noted the concerns about structuring opportunities referred to in paragraph BC58(b). However, two contracts represent two units of account. Reconsideration of the unit of account forms part of a far broader issue for financial reporting that is outside the scope of the Board's considerations in IFRS 9. In addition, embedded derivative features often do not have contractual cash flows that represent payments of principal and interest on the principal amount outstanding and thus the entire hybrid contract would not be eligible to be measured at amortised cost. However, the Board noted that this would provide more relevant information because the embedded derivative feature affects the cash flows ultimately arising from the hybrid contract. Thus, applying the classification approach to the hybrid contract in its entirety would depict more faithfully the amount, timing and uncertainty of future cash flows.

(d) In the Board's view, accounting for the hybrid contract as one unit of account is consistent with the project's objective—to improve the usefulness for users in their assessment of the timing, amount and uncertainty of future cash flows of financial instruments and to reduce the complexity in reporting financial instruments.

Because the Board decided that the scope of IFRS 9 at this stage should be assets within the scope of IAS 39, this decision applies only to hybrid contracts with financial asset hosts.

BC60 The Board decided not to consider at this time changes to the requirements in IAS 39 for embedded derivatives in hybrid contracts with non-financial hosts. The Board acknowledged that those requirements are also complex and have resulted in some application problems, including the question of whether particular types of non-financial contracts are within the scope of IAS 39. The Board accepted the importance of ensuring that any proposals for hybrid contracts with non-financial hosts should also address which non-financial contracts should be within the scope of IFRS 9. The Board also noted the importance for many non-financial entities of hedge accounting for non-financial items, and the relationship to both scope and embedded derivative requirements. Therefore, the Board concluded that the requirements for hybrid contracts with non-financial hosts should be addressed in a later phase of the project to replace IAS 39.

Option to designate a financial asset at fair value

BC61 IAS 39 allows entities an option to designate on initial recognition any financial asset or financial liability as measured at fair value through profit or loss if one (or more) of the following three conditions is met:

(a) Doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities on different bases or recognising the gains and losses on them on different bases.

(b) A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel.

(c) The financial asset or financial liability contains one or more embedded derivatives (and particular other conditions described in paragraph 11A of IAS 39 are met) and the entity elects to account for the hybrid (combined) contract in its entirety.

BC62 However, in contrast to IAS 39, IFRS 9 requires:

(a) any financial asset that is not managed within a business model that has the objective of collecting contractual cash flows to be measured at fair value; and

(b) hybrid contracts with financial asset hosts to be classified in their entirety, hence eliminating the requirement to identify and account for embedded derivatives separately.

Accordingly, the Board concluded that the conditions described in paragraph BC61(b) and (c) are unnecessary for financial assets.

BC63 The Board retained the eligibility condition described in paragraph BC61(a) because it mitigates some anomalies that result from the different measurement attributes used for financial instruments. In particular, it eliminates the need for fair value hedge accounting of fair value exposures when there are natural offsets. It also avoids problems arising from a mixed measurement model when some financial assets are measured at amortised cost and related financial liabilities are measured at fair value. A separate phase of the project is considering hedge accounting, and the fair value option will be better considered in that context. The Board also noted that particular industry sectors believe it is important to be able to mitigate such anomalies until other IASB projects are completed (eg insurance contracts). The Board decided to defer consideration of changes to the eligibility condition set out in paragraph BC61(a) as part of the future exposure draft on hedge accounting.

BC64 Almost all the respondents to the exposure draft supported the proposal to retain the fair value option if such designation eliminates or significantly reduces an accounting mismatch. Although some respondents would prefer an unrestricted fair value option, they acknowledged that an unrestricted fair value option has been opposed by many in the past and it is not appropriate to pursue it now.

Reclassification between fair value and amortised cost categories

BC65 The exposure draft proposed to prohibit reclassification of financial assets between the amortised cost and fair value categories. The Board's rationale for that proposal was as follows:

(a) Requiring (or permitting) reclassifications would not make it easier for users of financial statements to understand the information that financial statements provide about financial instruments.

(b) Requiring (or permitting) reclassifications would increase complexity because detailed guidance would be required to specify when reclassifications would be required (or permitted) and the subsequent accounting for reclassified financial instruments.

(c) Reclassification should not be necessary because classification is based on the entity's business model and that business model is not expected to change.

BC66 In their responses, some users questioned the usefulness of reclassified information, noting concerns about the consistency and rigour with which any requirements would be applied. Some were also concerned that opportunistic reclassifications would be possible.

BC67 However, almost all respondents (including most users) argued that prohibiting reclassification is inconsistent with a classification approach based on how an entity manages its financial assets. They noted that in an approach based on an entity's business model for managing financial assets, reclassifications would provide useful, relevant and comparable information to users because it would ensure that financial statements faithfully represent how those financial assets are managed at the reporting date. In particular, most users stated that, conceptually, reclassifications should not be prohibited when the classification no longer reflects how the instruments would be classified if the items were newly acquired. If reclassification were prohibited, the reported information would not reflect the amounts, timing and uncertainty of future cash flows.

BC68 The Board was persuaded by these arguments and decided that reclassification should not be prohibited. The Board noted that prohibiting reclassification decreases comparability for like instruments managed in the same way.

BC69 Some respondents contended that reclassifications should be permitted, rather than required, but did not explain their justification. However, the Board noted that permitting reclassification would decrease comparability, both between different entities and for instruments held by a single entity, and would enable an entity to manage its profit or loss by selecting the timing of when future gains or losses are recognised. Therefore, the Board decided that reclassification should be required when the entity's business model for managing those financial assets changes.

BC70 The Board noted that, as highlighted by many respondents, such changes in business model would be very infrequent, significant and demonstrable and determined by the entity's senior management as a result of external or internal change.

BC71 The Board considered arguments that reclassification should also be permitted or required when contractual cash flow characteristics of a financial asset vary (or may vary) over that asset's life based on its original contractual terms. However, the Board noted that, unlike a change in business model, the contractual terms of a financial asset are known at initial recognition. An entity classifies the financial asset at initial recognition on the basis of the contractual terms over the life of the instrument. Therefore the Board decided that reclassification on the basis of a financial asset's contractual cash flows should not be permitted.

BC72 The Board considered how reclassifications should be accounted for. Almost all respondents said that reclassifications should be accounted for prospectively and should be accompanied by robust disclosures. The Board reasoned that if classification and reclassification are based on the business model within which they are managed, classification should always reflect the business model within which the financial asset was managed at the reporting date. To apply the reclassification retrospectively would not reflect how the financial assets were managed at the prior reporting dates.

BC73 The Board also considered the date at which reclassifications could take effect. Some respondents stated that reclassifications should be reflected in the entity's financial statements as soon as the entity's business model for the relevant instruments changes. To do otherwise would be contradictory to the objective of reclassification—ie to reflect how the instruments are managed. However, the Board decided that reclassifications should take effect from the beginning of the following reporting period. In the Board's view, entities should be prevented from choosing a reclassification date to achieve an accounting result. The Board also noted that a change in an entity's business model is a significant and demonstrable event; therefore, an entity will most likely disclose such an event in its financial statements in the reporting period in which the change in business model takes place.

BC74 The Board also considered and rejected the following approaches:

(a) *Disclosure approach:* Quantitative and qualitative disclosure (instead of reclassification) could be used to address when the classification no longer reflects how the financial assets would be classified if they were newly acquired. However, in the Board's view, disclosure is not an adequate substitute for recognition.

(b) *One-way reclassification:* Reclassification would be required only to fair value measurement, ie reclassification to amortised cost measurement would be prohibited. Proponents of this approach indicated that such an approach might minimise abuse of the reclassification requirements and result in more instruments being measured at fair value. However, in the Board's view, there is no conceptual reason to require reclassification in one direction but not the other.

Measurement

Exception in IAS 39 from fair value measurement for some unquoted equity instruments (and some derivatives linked to those instruments)

BC75 The Board believes that measurement at amortised cost is not applicable to equity investments because such financial assets have no contractual cash flows and hence there are no contractual cash flows to amortise. IAS 39 contains an exception from fair value measurement for investments in equity instruments (and some derivatives linked to those investments) that do not have a quoted price in an active market and whose fair value cannot be reliably measured. Those equity investments are required to be measured at cost less impairment, if any. Impairment losses are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset.

BC76 The exposure draft proposed that all investments in equity instruments (and derivatives linked to those investments) should be measured at fair value for the following reasons:

(a) For investments in equity instruments and derivatives, fair value provides the most relevant information. Cost provides little, if any, information with predictive value about the timing, amount and uncertainty of the future cash flows arising from the instrument. In many cases, fair value will differ significantly from historical cost (this is particularly true for derivatives measured at cost under the exception).

(b) To ensure that a financial asset accounted for under the cost exception is not carried above its recoverable amount, IAS 39 requires an entity to monitor instruments measured at cost for any impairment. Calculating any impairment loss is similar to determining fair value (ie the estimated future cash flows are discounted using the current market rate of return for a similar financial asset and compared with the carrying amount).

(c) Removing the exception would reduce complexity because the classification model for financial assets would not have a third measurement attribute and would not require an additional impairment methodology. Although there might be an increase in the complexity of determining fair values on a recurring basis that complexity would be offset (at least partially) by the fact that all equity instruments and derivatives have one common measurement attribute; thus the impairment requirements would be eliminated.

BC77 Many respondents agreed that cost does not provide useful information about future cash flows arising from equity instruments and that conceptually such equity instruments should be measured using a current measurement attribute such as fair value. Some of those respondents generally agreed with the removal of the exception, but suggested that disclosures would have to include information about the uncertainties surrounding measurement.

BC78 However, many respondents (mainly preparers from non-financial entities and some auditors) disagreed with the proposal to eliminate the current cost exception on the grounds of the reliability and usefulness of fair value measurement and the cost and difficulty involved in determining fair value on a recurring basis. They generally preferred to keep a cost exception, similar to that in IAS 39. Some noted that the proposals would not reduce complexity, because they would increase complexity in measurement. Furthermore, a few believed that cost could provide useful information if the financial asset is held for the long term.

BC79 The Board considered those arguments as follows:

(a) *Reliability and usefulness of fair value measurement*

Respondents noted that IAS 39 included a cost exception because of the lack of reliability of fair value measurement for particular equity instruments and contended that this rationale is still valid. They believe that, given the lack of available reliable information, any fair value measurement would require significant management judgement or might be impossible. They also believe that comparability would be impaired by the requirement to measure such equity instruments at fair value. However, those respondents had considered the question of reliability of fair value for the instruments concerned in isolation. In the Board's view, the usefulness of information must be assessed against all four of the qualitative characteristics in the *Framework*: reliability, understandability, relevance and comparability. Thus, cost is a reliable (and objective) amount, but has little, if any, relevance. In the Board's view measuring all equity instruments at fair value, including those that are currently measured using the cost exception in IAS 39, meets the criteria in the *Framework* for information to be reliable if appropriate measurement techniques and inputs are employed. The Board noted that its project on fair value measurement will provide guidance on how to meet that objective.

(b) *Cost and difficulty involved in determining fair value on a recurring basis*

Many respondents, particularly in emerging economies, said that they faced difficulty in obtaining information that might be relied on to use in valuation. Others said that they would inevitably rely heavily on external experts at significant cost. Many questioned whether the requirement to determine fair value on a recurring basis would involve significant costs and efforts that are not offset by the incremental benefit to usefulness from fair value. The Board considered the costs of requiring such equity investments to be measured at fair value from the perspectives of valuation methodology and expertise, as well as the ability to obtain the information required for a fair value measurement. The Board noted that valuation methods for equity investments are well-developed and are often far less complex than those required for other financial instruments that are required to be measured at fair value, including many complex derivative products. Although some expressed concern that smaller entities applying IFRSs might not have internal systems or expertise to determine easily the fair value of equity investments held, the Board noted that basic shareholder rights generally enable an entity to obtain the necessary information to perform a valuation. The Board acknowledged that there are circumstances in which the cost of determining fair value could outweigh the benefits from fair value measurement. In particular, the Board noted that, in some jurisdictions, entities hold high numbers of unquoted equity instruments that are currently accounted for under the cost exception and the value of a single investment is considered low. However, the Board concluded that if the volume of the investments individually or aggregated is material the incremental benefit of fair value generally outweighs the additional cost because of the impact of the investments on the financial performance and position of the entity.

BC80 The Board noted that there are some circumstances in which cost might be representative of fair value and decided to provide additional application guidance on those circumstances to alleviate some of the concerns expressed. However, the Board also noted that those circumstances would never apply to equity investments held by particular entities such as financial institutions and investment funds.

BC81 The Board considered whether a simplified approach to measurement should be provided for equity instruments when fair value measurement was impracticable. The Board also discussed possible simplified measurement approaches, including management’s best estimate of the price it would accept to sell or buy the instrument, or changes in the share of net assets. However, the Board concluded that a simplified measurement approach would add complexity to the classification approach and reduce the usefulness of information to users of financial statements. Those disadvantages would not be offset by the benefit of reduced cost to preparers of financial statements.

Gains and losses

Investments in equity instruments

BC82 IFRS 9 permits an entity to make an irrevocable election to present in other comprehensive income changes in the value of any investment in equity instruments that is not held for trading. The term ‘equity instrument’ is defined in IAS 32 *Financial Instruments: Presentation*. The Board noted that in particular circumstances a puttable instrument (or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation) is classified as equity. However, the Board noted that such instruments do not meet the definition of an equity instrument.

BC83 In the Board's view, fair value provides the most useful information about investments in equity instruments to users of financial statements. However, the Board noted arguments that presenting fair value gains and losses in profit or loss for some equity investments may not be indicative of the performance of the entity, particularly if the entity holds those equity instruments for non-contractual benefits, rather than primarily for increases in the value of the investment. An example could be a requirement to hold such an investment if an entity sells its products in a particular country.

BC84 The Board also noted that, in their valuation of an entity, users of financial statements often differentiate between fair value changes arising from equity investments held for purposes other than generating investment returns and equity investments held for trading. Thus, the Board believes that separate presentation in other comprehensive income of gains and losses for some investments could provide useful information to users of financial statements because it would allow them to identify easily, and value accordingly, the associated fair value changes.

BC85 Almost all respondents to the exposure draft supported recognition of fair value gains and losses in other comprehensive income for particular equity investments. They agreed that an entity should make an irrevocable election to identify those equity instruments. However, some users did not support these proposals in the exposure draft.

BC86 The concerns expressed in the comment letters were as follows:

(a) *Dividends:* The exposure draft proposed that dividends on equity instruments measured at fair value with changes recognised in other comprehensive income would also be recognised in other comprehensive income. Nearly all respondents objected to that proposal. They argued that dividends are a form of income that should be presented in profit or loss in accordance with IAS 18 *Revenue* and noted that those equity investments are sometimes funded with debt instruments whose interest expense is recognised in profit or loss. As a result, presenting dividends in other comprehensive income would create a 'mismatch'. Some listed investment funds stated that without recognising dividend income in profit or loss their financial statements would become meaningless to their investors. The Board agreed with those arguments. The Board noted that structuring opportunities may remain because dividends could represent a return of investment, rather than a return on investment. Therefore, the Board decided that dividends that clearly represent a recovery of part of the cost of the investment are not recognised in profit or loss. However, in the Board's view, those structuring opportunities would be limited because an entity with the ability to control or significantly influence the dividend policy of the investment would not account for those investments in accordance with IFRS 9. Furthermore, the Board decided to require disclosures that would allow a user to compare easily the dividends recognised in profit or loss and the other fair value changes.

(b) *Recycling:* Many respondents, including many users, did not support the proposal to prohibit subsequent transfer ('recycling') of fair value changes to profit or loss (on derecognition of the investments in an equity instrument). Those respondents supported an approach that maintains a distinction between realised and unrealised gains and losses and said that an entity's performance should include all realised gains and losses. However, the Board concluded that a gain or loss on those investments should be recognised once only; therefore, recognising a gain or loss in other comprehensive income and subsequently transferring it to profit or loss is inappropriate. In addition, the Board noted that recycling of gains and losses to profit or loss would create something similar to the available-for-sale category in IAS 39 and would create the requirement to assess the equity instrument for impairment, which had created application problems. That would not significantly improve or reduce the complexity of the financial reporting for financial assets. Accordingly, the Board decided to prohibit recycling of gains and losses into profit or loss when an equity instrument is derecognised.

(c) *Scope of exception:* Some respondents asked the Board to identify a principle that defined the equity instruments to which the exception should apply. However, they did not specify what that principle should be. The Board previously considered developing a principle to identify other equity investments whose fair value changes should be presented in profit or loss (or other comprehensive income), including a distinction based on whether the equity instruments represented a 'strategic investment'. However, the Board decided that it would be difficult, and perhaps impossible, to develop a clear and robust principle that would identify investments that are different enough to justify a different presentation requirement. The Board considered whether a list of indicators could be used to support the principle, but decided that such a list would inevitably be rule-based and could not be comprehensive enough to address all possible situations and factors. Moreover, the Board noted that such an approach would create complexity in application without necessarily increasing the usefulness of information to users of financial statements.

(d) *Irrevocability of the exception:* A small number of respondents believed that an entity should be able to reclassify equity instruments into and out of the fair value through other comprehensive income category if an entity starts or ceases to hold the investments for trading purposes. However, the Board decided that the option must be irrevocable to provide discipline to its application. The Board also noted that the option to designate a financial asset as measured at fair value is also irrevocable.

BC87 An entity may transfer the cumulative gain or loss within equity. In the light of jurisdiction-specific restrictions on components of equity, the Board decided not to provide specific requirements related to that transfer.

BC88 IFRS 9 amends IFRS 7 to require additional disclosures about investments in equity instruments that are measured at fair value through other comprehensive income. The Board believes those disclosures will provide useful information to users of financial statements about instruments presented in that manner and the effect of that presentation.

BC89 The Board noted that permitting an option for entities to present some gains and losses in other comprehensive income is an exception to the overall classification and measurement approach and adds complexity. However, the Board believes that the requirement that the election is irrevocable, together with the additional disclosures required, addresses many of those concerns.

Effective date

BC90 The Board recognises that many countries require time for translation and for introducing the mandatory requirements into law. In addition, entities require time to implement new standards. The Board usually sets an effective date of between six and eighteen months after issuing an IFRS. However, the Board has adopted a phased approach to publishing IFRS 9, so this is not possible.

BC91 In the response to the exposure draft, respondents urged that:

(a) it would be helpful to preparers if the Board were to permit all phases of the project to replace IAS 39 to be adopted at the same time.

(b) it would be helpful to entities that issue insurance contracts if the effective date of IFRS 9 were aligned to the forthcoming IFRS on accounting for insurance contracts. Most of an insurer's assets are financial assets and most of its liabilities are insurance liabilities or financial liabilities. Thus, if an insurer applies IFRS 9 before it applies any new IFRS on insurance, it might face two rounds of major change in a short period. This would be disruptive for both users and preparers.

(c) because a number of countries will adopt IFRSs in the next few years, it would be helpful to entities in those countries if the Board did not require them to make two changes in a short period of time.

BC92 With these factors in mind, the Board decided it should require entities to apply the requirements of IFRS 9 for annual periods beginning on or after 1 January 2013. The Board intends that this date will allow entities to adopt at the same time the guidance from all phases of the project to replace IAS 39.

BC93 The Board will consider delaying the effective date of IFRS 9 if the impairment phase of the project to replace IAS 39 makes such a delay necessary, or if the new IFRS on insurance contracts has a mandatory effective date later than 2013, to avoid an insurer having to face two rounds of changes in a short period.

BC94 The Board decided to permit earlier application of IFRS 9 to allow an entity to apply the new requirements on classification and measurement of financial assets. This enables entities to use IFRS 9 in their 2009 annual financial statements and meets one of the objectives of the phased approach, ie to have improved classification and measurement requirements for financial assets in place for 2009 year-ends.

BC95 The effect of transition will be significant for some entities. As a result, there will be less comparability between entities that apply IFRS 9 and those that do not. Accordingly, IFRS 9 includes additional disclosures about the transition to IFRS 9.

Transition

BC96 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that retrospective application results in the most useful information to users because the information presented for all periods is comparable. Therefore, the exposure draft proposed retrospective application subject to some transition relief in particular circumstances. The Board considered the difficulties and associated costs of full retrospective application of the proposals in the exposure draft.

BC97 Most respondents agreed, in principle, with requiring retrospective application, but many questioned the practicability of the approach. In particular, many noted that the extensive exceptions to retrospective application that would be required to make such transition practicable significantly reduced (and possibly eliminated) any benefit that users might obtain from requiring comparative information to be restated.

BC98 The Board considered whether to require prospective application, but noted that such an approach does not provide comparable information for users of financial statements. In addition, the Board noted that any transition approach (such as prospective application) that requires resetting the effective interest rate for financial assets measured at amortised cost reduces the usefulness of information about interest income.

BC99 The Board decided to require retrospective application but provide transition relief to address particular difficulties that might arise from retrospective application. The Board also noted that IAS 8 sets out transition requirements that apply if retrospective application is impracticable and prohibits the use of hindsight when applying a new accounting policy to a prior period.

Transition relief

Impracticability exceptions

BC100 The Board acknowledged that it may be impracticable for an entity to apply the effective interest method or impairment requirements in IAS 39 retrospectively in some situations. The process would be cumbersome, in particular for an entity with a large number of financial assets that were previously measured at fair value but are measured at amortised cost in accordance with the approach in IFRS 9. Several loss events and reversals might have occurred between the date when the asset was initially recognised and the date of initial application of the IFRS. IFRS 9 requires that if applying the impairment requirements is impracticable or requires the use of hindsight, an entity should use previously determined fair value information to determine whether a financial asset was impaired in comparative periods. IFRS 9 also requires that the fair value at the date of initial application of the new requirements should be treated as the new amortised cost carrying amount of that financial asset in that case. The Board rejected proposals that entities should be permitted, but not required, to treat the fair value at the date of initial application as amortised cost because it would impair comparability and require significant guidance about when such an option should be permitted.

BC101 The Board noted that an entity would not have determined the fair value of an investment in an unquoted equity instrument (or a derivative on such an investment) that was previously accounted for in accordance with paragraphs 46(c) and 66 of IAS 39. Moreover, an entity will not have the necessary information to determine fair value retrospectively without using hindsight. Accordingly, IFRS 9 requires such instruments to be measured at fair value at the date of initial application.

Hybrid contracts

BC102 An entity may not have previously determined the fair value of a hybrid contract in its entirety. Moreover, an entity will not have the necessary information to determine fair value retrospectively without using hindsight. However, an entity would have been required to measure both the embedded derivative and host separately at fair value to apply the disclosure requirements in IFRS 7. Therefore, in comparative periods, IFRS 9 requires the sum of the fair value of the embedded derivative and the host to be used as an approximation of the fair value of the entire hybrid contract.

BC103 The proposals in the exposure draft would have resulted in fair value measurement for many hybrid contracts for which the embedded derivative was accounted for separately in accordance with IAS 39. Some respondents asked for such treatment under IAS 39 to be ‘grandfathered’. The Board noted that many such requests had been related to the proposed treatment of hybrid contracts with financial liability hosts, which are not included in the IFRS. Therefore the Board decided not to permit an option to grandfather hybrid contracts with financial hosts that were bifurcated in accordance with IAS 39 as an accounting policy choice because it would impair comparability, and because some such contracts may still have a significant remaining maturity.

Assessment of the objective of the entity’s business model for managing financial assets

BC104 IFRS 9 requires an entity to assess whether the objective of an entity’s business model is to manage financial assets to collect the contractual cash flows on the basis of circumstances at the date of initial application. The Board believes it would be difficult, and perhaps impossible, to assess that condition on the basis of circumstances when the instrument first satisfied the recognition criterion in IAS 39.

Assessment of qualifying criteria for fair value option

BC105 The Board decided that the assessment of whether a financial asset or financial liability meets the eligibility criterion for designation under the fair value option should be based on the circumstances at the date of initial application. IFRS 9 changes the classification of some financial assets, including eliminating two of the three eligibility criteria in IAS 39 for the fair value option for financial assets. Therefore, the Board believes that an entity should reconsider at transition its original assessment of whether to designate a financial asset or financial liability as at fair value through profit or loss.

Comparative information

BC106 As noted above, many respondents were concerned that the inevitable exceptions to full retrospective application would result in restated information that is incomplete. They proposed an approach similar to that used on first-time adoption of IFRSs and when entities adopted IAS 39 in 2005, in which the requirement to provide comparative information was waived. Some respondents believe that such an approach would address the concerns that, although IAS 1 requires only one year of comparative information, the legal and regulatory frameworks in many jurisdictions require further comparative periods to be presented. In those situations, the restatement of comparatives would be virtually impossible for an entity wishing to adopt IFRS 9 early.

BC107 In the Board's view, waiving the requirement to restate comparatives strikes a balance between the conceptually preferable method of full retrospective application (as stated in IAS 8) and the practicability of adopting the new classification model within a short time frame. Accordingly, the Board decided that it would permit, but not require, restatement of comparative periods by entities that implement IFRS 9 for reporting periods beginning before 1 January 2012. However, those considerations would be less applicable for entities that adopted outside a short time frame. Therefore, restated comparative information is required if an entity adopts IFRS 9 for reporting periods beginning after 1 January 2012.

Date of initial application

BC108 The exposure draft stated that the date of initial application would be the date when an entity first applies the requirements in the IFRS. Many respondents questioned whether the date of initial application could be an arbitrary date between the date of issue of the IFRS (or even earlier) and the mandatory effective date, resulting in a loss of comparability over a long period of time. The Board agreed that a free choice would impair comparability, but noted it intended that entities should be able to apply the IFRS in 2009 or 2010 financial statements. Accordingly, the IFRS requires the date of initial application to be the beginning of a reporting period, but provides relief from this requirement for entities applying the IFRS for reporting periods beginning on or before 1 January 2011.

Hedge accounting

BC109 The Board decided not to carry forward the specific transition provisions on hedge accounting proposed in the exposure draft because they are not necessary.

Transitional disclosures

BC110 The exposure draft proposed disclosures for entities that apply the new IFRS 9 early. However, many noted that such disclosures would be useful for all entities applying IFRS 9 for the first time, and not only early adopters. The Board noted that the information necessary to make those disclosures would be readily available to the entity to make the necessary journal entries on transition and to account for the financial assets in the future. Accordingly, IFRS 9 requires all entities to supply additional disclosures on transition.

BC111 The Board rejected a proposal in the comment letters that entities should apply disclosures similar to those based on IFRS 1 *First-Time Adoption of International Financial Reporting Standards* explaining the transition to the new IFRS. The Board noted that the disclosures in IFRS 1 relate to first-time adoption and not to changes in accounting policies. Disclosures about changes in an accounting policy are required by IAS 8.

Transition for future phases

BC112 The Board does not intend to require entities that apply IFRS 9 early also to apply early any future requirements arising from the project to improve IAS 39. However, to reduce the number of versions of IFRSs that can be applied, the Board intends that any future additions to IFRS 9 can be applied only if the entity also applies requirements published before them.

Transitional insurance issues

BC113 The Board noted that insurers may face particular problems if they apply IFRS 9 before they apply the phase II standard on insurance contracts ('the new IFRS 4'). To avoid accounting mismatches in profit or loss, many insurers classify many of their financial assets as available for sale. If those insurers apply IFRS 9 before the new IFRS 4, they might decide to classify many of their financial assets at amortised cost (assuming they meet the relevant conditions in IFRS 9). When those insurers later apply the new IFRS 4, they may wish to reclassify those assets from amortised cost to fair value through profit or loss, but that may not generally be possible in accordance with IFRS 9. Thus, those insurers might have either to classify those assets at fair value through profit or loss during the intervening period or to continue to classify them at amortised cost when they apply the new IFRS 4. Either choice might lead to an accounting mismatch.

BC114 The Board considered whether it could reduce such mismatches by maintaining the available for sale category for insurers until they can apply the new IFRS 4. However, if the Board did so, it would have to create detailed and arbitrary descriptions of the entities and instruments to which that approach would apply. The Board concluded that permitting the continuation of that category would not provide more useful information for users.

BC115 The Board will consider in developing the new IFRS 4 whether to provide an option for insurers to reclassify some or all financial assets when they first apply the new IFRS 4. This would be similar to the option in paragraph 45 of IFRS 4 *Insurance Contracts* and paragraph D4 of IFRS 1. The Board included such an option in IFRS 4 for reasons that may be equally valid for phase II.

Shadow accounting for participating contracts

BC116 Some insurers expressed concerns that an accounting mismatch will arise if the assets backing participating insurance liabilities include equity investments and the insurer elects to present gains and losses on those investments in other comprehensive income. That accounting mismatch would arise because paragraph 30 of IFRS 4 does not give explicit authority to apply 'shadow accounting' in such cases.

BC117 The Board acknowledges that this accounting mismatch is undesirable. However, for the following reasons, the Board did not amend paragraph 30 of IFRS 4:

(a) This accounting mismatch will arise only if an insurer elects to present gains and losses on equity investments in other comprehensive income.

(b) As described in paragraph BC84, in creating the option to present gains and losses on equity investments in other comprehensive income, the Board's intention was to provide a presentation alternative for some equity investments in which presenting fair value gains and losses in profit or loss may not be indicative of the performance of the entity, particularly if the entity holds those equity instruments for non-contractual benefits, rather than primarily to generate increases in the value of the investment. The Board did not intend to provide an alternative for investments in any other circumstances, including if an entity intends to hold an equity investment over a long time frame. In the Board's view, if an insurer holds investments with the primary objective of realising a profit from increases in their value, for the benefit of either the insurer itself or its policyholders, the most transparent place to present those value changes is in profit or loss.

Summary of main changes from the exposure draft

BC118 The main changes from the exposure draft are:

(a) At this stage, IFRS 9 deals with the classification and measurement of financial assets only, rather than financial assets and financial liabilities as proposed in the exposure draft.

(b) IFRS 9 requires entities to classify financial assets on the basis of the objective of the entity's business model for managing the financial assets and the characteristics of the contractual cash flows. It points out that the entity's business model should be considered first, and that the contractual cash flow characteristics should be considered only for financial assets that are eligible to be measured at amortised cost because of the business model. It states that both classification conditions are essential to ensure that amortised cost provides useful information.

(c) Additional application guidance has been added on how to apply the conditions necessary for amortised cost measurement.

(d) IFRS 9 requires a 'look through' approach for investments in contractually linked instruments that effect concentrations of credit risk. The exposure draft had proposed that only the most senior tranche could have cash flows that represented payments of principal and interest on the principal amount outstanding.

(e) IFRS 9 requires (unless the fair value option is elected) financial assets purchased in the secondary market to be recognised at amortised cost if the instruments are managed within a business model that has an objective of collecting contractual cash flows and the financial asset has only contractual cash flows representing principal and interest on the principal amount outstanding even if such assets are acquired at a discount that reflect incurred credit losses.

(f) IFRS 9 requires that when an entity elects to present gains and losses on equity instruments measured at fair value in other comprehensive income, dividends are to be recognised in profit or loss. The exposure draft had proposed that those dividends would be recognised in other comprehensive income.

(g) IFRS 9 requires reclassifications between amortised cost and fair value classifications when the entity's business model changes. The exposure draft had proposed prohibiting reclassification.

(h) For entities that adopt IFRS 9 for reporting periods before 1 January 2012 IFRS 9 provides transition relief from restating comparative information.

(i) IFRS 9 requires additional disclosures for all entities when they first apply the IFRS.

Cost-benefit considerations

BC119 The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. To attain this objective, the Board endeavours to ensure that an IFRS will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. Although the costs to implement a new IFRS might not be borne evenly, users of financial statements benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

BC120 The evaluation of costs and benefits is necessarily subjective. In making its judgement, the Board considered the following:

(a) the costs incurred by preparers of financial statements;

(b) the costs incurred by users of financial statements when information is not available;

(c) the comparative advantage that preparers have in developing information, compared with the costs that users would incur to develop surrogate information;

(d) the benefit of better economic decision-making as result of improved financial reporting; and

(e) the costs of transition for users, preparers and others.

BC121 The objective of IFRS 9 is to present information that is useful to users for their assessment of the amounts, timing and uncertainty of future cash flows of financial assets. However, the Board also considered the cost of implementing IFRS 9 and applying it on a continuous basis. During the development of IFRS 9 the Board conducted an extensive outreach programme to consult users, preparers, auditors, regulators and others. Those activities helped the Board evaluate the relative costs and benefits of IFRS 9.

BC122 IFRS 9 should improve the ability of users to understand the financial reporting for financial assets by:

(a) reducing the number of classification categories. All financial assets will be subsequently measured at either amortised cost or fair value. Hybrid contracts with financial asset hosts will be classified and measured in their entirety thereby eliminating the complex and rule-based requirements in IAS 39.

(b) having a single impairment methodology that is applied to all financial assets that are not measured at fair value. Many constituents criticised the multitude of impairment methodologies in IAS 39.

(c) providing a clear rationale for why financial assets are measured in a particular way, which aligns the measurement attribute to the way that an entity manages its financial assets and their contractual cash flow characteristics.

BC123 There are costs involved in the adoption and ongoing application of IFRS 9. Those costs will depend on an entity's volume and complexity of financial instruments as well the industry and jurisdiction in which the entity operates. However, those costs should be minimised because IFRS 9 is less complex and rule-based than the equivalent requirements in IAS 39. Consequently, the Board believes that the benefits of IFRS 9 outweigh the costs.

Dissenting opinions

Dissenting opinion of James J Leisenring

DO1 Mr Leisenring supports efforts to reduce the complexity of accounting for financial instruments. In that regard, he supports requiring all financial instruments to be measured at fair value, with that measurement being recognised in profit or loss. He finds no compelling reason related to improving financial reporting to reject that approach. It is an approach that maximises comparability and minimises complexity.

DO2 It maximises comparability because all financial instruments would be measured at one attribute within an entity and across entities. No measurement or presentation would change to reflect either arbitrary distinctions or management behaviour or intentions. IFRS 9 emphasises management intentions and behaviour, which substantially undermines comparability.

DO3 Complexity of accounting would be drastically reduced if all financial instruments were measured at fair value. The approach favoured by Mr Leisenring provides at least the following simplifications:

(a) no impairment model is necessary.

(b) criteria for when a given instrument must or can be measured with a given attribute are unnecessary.

(c) there is no need to bifurcate embedded derivatives or to identify financial derivatives.

(d) it eliminates the need for fair value hedge accounting for financial instruments.

(e) it eliminates the disparity in the measurement of derivatives within and outside the scope of IAS 39.

(f) it minimises the incentives for structuring transactions to achieve a particular accounting outcome.

(g) no fair value option would be needed to eliminate accounting mismatches.

(h) it provides a superior foundation for developing a comprehensive standard for the derecognition of financial instruments that is not present in a mixed attribute model.

DO4 Mr Leisenring accepts that measuring more instruments at fair value increases measurement complexity, but this increase is minimal compared with the reductions in complexity that would be otherwise achieved. There is no disagreement that derivatives must be measured at fair value. Those instruments raise the most difficult measurement issues, as cash instruments have many fewer problems. Indeed, some suggestions for an impairment model would measure at fair value the credit loss component of cash instruments. If that were to be the conclusion on impairment (an expected loss approach), it would minimise the incremental fair value measurement complexity of recording at fair value instruments now at amortised cost.

DO5 Mr Leisenring recognises that measuring all instruments at fair value through profit or loss raises presentation issues about disaggregation of fair value changes. However, he does not believe that these issues are insurmountable.

DO6 Investors have often told both the IASB and the FASB that fair value of financial instruments recognised in profit or loss provides the most useful information for their purposes. There is a worldwide demand for an improved and common solution to the accounting for financial instruments. Investors are disappointed that the Board will not take this opportunity to make, with other standard-setters, truly substantive changes rather than these minimal changes that perpetuate all the legitimate concerns that have been expressed about the mixed attribute model.

DO7 IFRS 9 does to some extent reduce complexity but that reduction is minimal. Certain measurement classifications are eliminated but others have been added. Mr Leisenring does not think that, on balance, this is an improvement over IAS 39.

DO8 Fundamental to IFRS 9 is the distinction between financial instruments measured at amortised cost and those at fair value. Mr Leisenring is concerned that neither of the two conditions necessary for that determination is operational. Paragraph BC56 criticises IAS 39 because the embedded derivative requirement of that standard is based on a list of examples. However, the basic classification model of IFRS 9 is based on lists of examples in paragraphs B4.4, B4.13 and B4.14. The examples are helpful but are far from exhaustive of the issues that will be problematic in applying the two criteria for classification at amortised cost.

DO9 Mr Leisenring also thinks that the two criteria are inconsistently applied. When the objective of the entity's business model is to hold the assets to collect the contracted cash flows of an instrument there is no requirement that the entity must actually do so. The cash flow characteristics of the instrument are also ignored when the guidance is applied to investments in contractually linked instruments (tranches). In those circumstances the contractual cash flows of the instrument are ignored and one is required to look through to the composition of assets and liabilities of the issuing entity. This 'look through' requirement is also potentially complex and in Mr Leisenring's opinion is likely to be not very operational. Mr Leisenring also objects to eliminating the requirement to bifurcate derivatives embedded in cash instruments. This objection is primarily because of concern that the two criteria to qualify for amortised cost will not be operational. The pressure on those two conditions will be enormous because there will be an incentive to embed derivatives in a cash instrument in anticipation that the instrument might qualify for amortised cost. Derivatives should be at fair value whether embedded or standing alone and a bifurcation requirement would achieve that accounting. If Mr Leisenring were confident that the criteria for amortised cost could be applied as intended he would not be as concerned because instruments with embedded derivatives would be at fair value in their entirety.

DO10 Mr Leisenring is concerned that, in the current crisis, instruments that have provided some of the most significant losses when measured at fair value would be eligible for amortised cost. That conclusion is not responsive to the present environment. The approach also allows actively traded debt instruments, including treasury securities, to be at amortised cost. These results are unacceptable and reduce the usefulness of reported information for investors.

DO11 The Board is required by its *Framework* to be neutral in its decision-making and to strive to produce neutral information to maximise the usefulness of financial information. IFRS 9 fails in that regard because it produces information based on free choice, management intention and management behaviour. Reporting that will result from this approach will not produce neutral information and diminishes the usefulness of financial reporting.

DO12 The Board is insistent in paragraph BC27 that accounting based on a business model is not free choice but never explains why selection of a business model is not a management choice. The existence of a trading account, a fair value option and the objective of a business model are all free choices.

DO13 The classification of selected equity instruments at fair value with the result of the remeasurement reported outside profit or loss is also a free choice. The Board concludes that reporting fair value changes in profit or loss may not reflect the operating performance of an entity. Mr Leisenring could accept accounting for changes in fair value of some instruments outside profit or loss in other comprehensive income. That accounting, however, should not be a free choice and why that presentation is superior in defined circumstances should be developed. In addition, when these securities are sold any realised gains and losses are not 'recycled' to profit or loss. That conclusion is inconsistent with the Board's conclusion that dividends received on these instruments should be reported in profit or loss. Such dividends would represent a return on investment or a form of 'recycling' of changes in the value of the instruments.

DO14 Mr Leisenring believes that a business model is rarely relevant in writing accounting standards. Identical transactions, rights and obligations should be accounted for in the same way if comparability of financial information is to be achieved. The result of applying IFRS 9 ignores any concern for comparability of financial information.

DO15 The credit crisis has provided confirmation that a drastic change in accounting for financial instruments is desirable. However, many have said that while they agree that the approach suggested by Mr Leisenring would be superior, and a significant improvement, the world is not ready to embrace such change. It is unclear to Mr Leisenring what factors need to be present for the optimal solution to be acceptable. He has concluded that it is hard to envisage circumstances that would make the case any more compelling for fundamental change and improvement than the present circumstances. Therefore, IFRS 9 will inevitably preserve a mixed attribute model and the resulting complexity for a significant period of time.

DO16 An objective of replacing IAS 39 was to provide a basis for convergence with accounting standards issued by the FASB. Mr Leisenring is concerned that IFRS 9 does not provide such a basis. As a consequence, allowing early adoption of the IFRS is undesirable. For convergence to be achieved significant changes in the IFRS are inevitable. Early adoption of the IFRS will therefore necessitate another costly accounting change when convergence is achieved. Permitting early adoption of this IFRS is also undesirable as it permits a lack of comparability in accounting for many years due to the deferred required effective date.

DO17 Mr Leisenring would accept that if, for reasons other than the desire to provide useful information to investors, his approach is politically unattainable, an alternative could be developed that would be operational. That approach would require all financial assets and financial liabilities to be recorded at fair value through profit or loss except originated loans retained by the originator, trade receivables and accounts payable. If certain derivatives were embedded in an instrument to be accounted for at amortised cost the derivative would be either bifurcated and accounted for at fair value or the entire instrument would be measured at fair value. Either approach would be acceptable.

Dissenting opinion of Patricia McConnell

DO18 Ms McConnell believes that fair value is the most relevant and useful measurement attribute for financial assets. However, she acknowledges that many investors prefer not to measure all financial assets at fair value. Those investors believe that both amortised cost and fair value can provide useful information for particular kinds of financial assets in particular circumstances. Therefore, in order to meet the objective of developing high quality, global accounting standards that serve the interests of all investors, Ms McConnell believes that no single measurement attribute should have primacy over another. Thus any new IFRS setting classification and measurement principles for financial assets should require disclosure of sufficient information in the primary financial statements to permit determination of profit or loss and financial position using both amortised cost and fair value. For example, when a measurement attribute other than fair value is used for financial assets, information about fair value should be displayed prominently in the statement of financial position. The Board did not adopt such disclosure in IFRS 9, as discussed in paragraphs BC16–BC18 of the Board's Basis for Conclusions.

DO19 As stated in paragraph BC8, an objective of the Board in developing IFRS 9 was to reduce the number of classification categories for financial instruments. However, Ms McConnell believes that IFRS 9 has not accomplished that objective. IFRS 9 would permit or require the following categories: (1) amortised cost, (2) a fair value option through profit or loss for financial assets that qualify for amortised cost but for which amortised cost would create an accounting mismatch, (3) fair value through profit or loss for debt instruments that fail to qualify for amortised cost, (4) fair value though profit or loss for trading securities, (5) fair value through profit or loss for equity securities not held for trading and (6) fair value through other comprehensive income for equity investments not held for trading. Ms McConnell does not view those six categories as a significant improvement over the six categories in IAS 39; like the categories in IAS 39, they will hinder investors' understanding of an already complex area of financial reporting.

DO20 IFRS 9 sets out two criteria for measuring financial assets at amortised cost: (1) the way the entity manages its financial assets ('business model') and (2) the contractual cash flow characteristics of its financial assets. On the surface, this appears to be an improvement over IAS 39's criterion that was based on management's intention to trade, hold available for sale, hold to maturity, or hold for the foreseeable future. However, Ms McConnell finds it difficult to see how IFRS 9's criterion based on the objective of the entity's business model differs significantly from management's intention. In her opinion selection of a business model is a management choice, as is the decision to have a trading account, use the fair value option for debt instruments or the fair value option for equity instruments with gains and losses reported in other comprehensive income. In paragraphs BC27 and BC28 the Board argues that selection of a measurement method based on an entity's business model is not a free choice. Ms McConnell does not find the arguments persuasive.

DO21 IFRS 9 permits an entity to make an irrevocable election to present in other comprehensive income changes in the value of any investment in equity instruments that is not held for trading. Ms McConnell could accept accounting for changes in fair value of some instruments outside profit or loss in other comprehensive income. However, that treatment should not be a free choice; criteria for that presentation should be developed. In addition, the Board decided that when those securities are sold any realised gains and losses are not 'reclassified' to profit or loss. That conclusion is inconsistent with the Board's decision to report dividends received on these investments in profit or loss. Such dividends represent a return on investment or a form of 'reclassifying' changes in the value of the instruments.

DO22 In addition, Ms McConnell believes the 'look through' guidance for contractually linked investments (tranches) is an exception to one of the criteria necessary for applying amortised cost, namely the contractual cash flow characteristics of the instrument. In those circumstances the contractual cash flows of the instrument are ignored. Instead an entity is required to 'look through' to the underlying pool of instruments and access their cash flow characteristics and credit risk relative to a direct investment in the underlying instruments. Ms McConnell believes that this provision adds complexity to the IFRS and reduces the usefulness of the reporting for financial assets. Moreover, since an entity is required to 'look through' only upon initial recognition of the financial asset, subsequent changes in the relative exposure to credit risk over the life of a structured investment vehicle would be ignored. Consequently, Ms McConnell believes it is possible that highly volatile investments, such as those owning sub-prime residential mortgage loans, would be reported at amortised cost.

Appendix
Amendments to the Basis for Conclusions on other HKFRSs

This appendix contains amendments to the Basis for Conclusions on other HKFRSs that are necessary in order to ensure consistency with HKFRS 9 and the related amendments to other HKFRSs. Amended paragraphs are shown with new text underlined and deleted text struck through.

HKFRS 1 *First-time Adoption of International Financial Reporting Standards*

HKFRS 1 (as revised in August 2009)

BCA1 The Basis for Conclusions on IFRS 1 is amended as described below.

In paragraph BC58A a footnote is added to the reference to 'IAS 39' as follows:

> * In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.

In paragraphs BC63A, BC89 and BC89A the first reference to 'IAS 39' is footnoted as follows:

> * In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. This paragraph refers to matters relevant when IFRS 1 was issued.

In paragraph BC65 the reference to IAS 39 and in paragraph BC66 the first reference to 'IAS 39' are footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, amended the requirements in IAS 39 to identify and separately account for derivatives embedded in a financial host within the scope of IFRS 9. The requirements in IAS 39 continue to apply for derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9. This Basis for Conclusions has not been updated for changes in requirements since IFRIC 9 *Reassessment of Embedded Derivatives* was issued in March 2006.

In paragraph BC74 the reference to 'IAS 39' is footnoted as follows:

> * In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. Paragraphs BC74(b) and (c) and BC81–BC83A discuss matters relevant when IFRS 1 was issued.

The heading 'Available-for-sale financial assets' above paragraph BC81 is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets. Paragraphs BC81–BC83A discuss matters relevant when IFRS 1 was issued.

HKFRS 2 *Share-based Payment*

BCA2 In the Basis for Conclusions on IFRS 2 the heading above paragraph BC25 is footnoted as follows:

> * In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

HKFRS 3 *Business Combinations*

BCA3 The Basis for Conclusions on IFRS 3 is amended as described below.

In paragraph BC185, the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' and in paragraphs BC256 and BC437(c), the references to 'IAS 39' are footnoted as follows:

> * In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. This paragraph discusses matters relevant when IFRS 3 was issued.

In paragraph BC244 the reference to 'IAS 39' is footnoted as follows:

> * In November 2009 the IASB relocated to IFRS 9 *Financial Instruments* the requirements on the accounting for financial guarantees and commitments to provide loans at below-market interest rates.

HKFRS 4 *Insurance Contracts*

BCA4 The Basis for Conclusions on IFRS 4 is amended as described below.

In paragraph BC11 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*', in paragraphs BC22(c) and BC146 the first reference to 'IAS 39' and in paragraphs BC28(b), BC40, BC41(b), BC55, BC73(d) and BC82 the references to 'IAS 39' are footnoted as follows:

> * In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. This paragraph discusses matters relevant when IFRS 4 was issued.

In paragraphs BC47 and BC161 the reference to 'IAS 39' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, amended the requirements in IAS 39 to identify and separately account for derivatives embedded in a financial host within the scope of IFRS 9. The requirements in IAS 39 continue to apply for derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9. This Basis for Conclusions has not been updated for changes in requirements since IFRIC 9 *Reassessment of Embedded Derivatives* was issued in March 2006.

In paragraph BC145(b) 'available for sale' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets.

The heading 'Issues related to IAS 39' above paragraph BC166 is footnoted as follows:

> * In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. Paragraphs BC166–BC194 discuss matters relevant when IFRS 4 was issued.

BCA5 In the dissenting opinions on IFRS 4 the headings above paragraphs DO7, DO9 and DO18 are footnoted as follows:

> * In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

BCA6 The Basis for Conclusions on IFRS 5 is amended as described below.

In paragraph BC8(b) the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

> * In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

In paragraph BC13 the footnote to 'IAS 39' is deleted and replaced by the following footnote:

> * In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

In paragraph BC54(b) the reference to 'IAS 39' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of held-for-trading financial assets. Paragraph BC54 discusses matters relevant when IFRS 5 was issued.

In paragraph BC58 'available for sale' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets. Paragraph BC58 discusses matters relevant when IFRS 5 was issued.

HKFRS 7 *Financial Instruments: Disclosures*

BCA7 The Basis for Conclusions on IFRS 7 is amended as described below.

In the rubric below the title a paragraph is added as follows:

In November 2009 the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 were relocated to IFRS 9 Financial Instruments*. The text of this Basis for Conclusions has been marked up to reflect those changes: new text is underlined and deleted text is struck through.*

Paragraph BC14 is amended to read as follows:

BC14 Paragraph 8 requires entities to disclose financial assets by the measurement categories in IFRS 9 *Financial Instruments* and financial liabilities by the measurement categories in IAS 39 *Financial Instruments: Recognition and Measurement*. The Board concluded that disclosures for each measurement category would assist users in understanding the extent to which accounting policies affect the amounts at which financial assets and financial liabilities are recognised.

Paragraph BC15 is amended to read as follows:

BC15 The Board also concluded that separate disclosure of the carrying amounts of financial assets and financial liabilities that are ~~classified as held for trading and those~~ designated upon initial recognition as financial assets and financial liabilities at fair value through profit or loss and those mandatorily measured at fair value is useful because such designation is at the discretion of the entity.

The heading above paragraph BC23 is amended to read as follows and paragraph BC23B is added as follows:

Reclassification (paragraphs 12 ~~and 12A~~–12D)

BC23B In November 2009 the Board revised the requirements relating to reclassification of financial assets in IFRS 9 *Financial Instruments*. Accordingly, the Board revised the disclosure requirements relating to reclassification of financial assets.

Paragraphs BC33 and BC34 are amended to read as follows:

BC33 Paragraph 20(a) requires disclosure of income statement gains and losses by the measurement categories in IAS 39 and measurement classifications in IFRS 9 (which complement the balance sheet disclosure requirement described in paragraph BC14). The Board concluded that the disclosure is needed for users to understand the financial performance of an entity's financial instruments, given the different measurement bases in IAS 39 and IFRS 9.

BC34 Some entities include interest and dividend income in gains and losses on financial assets and financial liabilities ~~held for trading~~ measured at fair value through profit or loss and others do not. To assist users in comparing income arising from financial instruments across different entities, the Board decided that an entity should disclose how the income statement amounts are determined. For example, an entity should disclose whether net gains and losses on financial assets or financial liabilities ~~held for trading~~ measured at fair value through profit or loss include interest and dividend income (see Appendix B, paragraph B5(e)).

HKAS 1 *Presentation of Financial Statements*

BCA8 The Basis for Conclusions on IAS 1 is amended as described below.

In paragraph BC38A the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' and in paragraph BC38B the reference to 'IAS 39' are footnoted as follows:

* In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39. Paragraphs 38A–38D discuss matters relevant when IAS 1 was issued.

In paragraphs BC49 and BC69 the references to 'available-for-sale' are footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets. This paragraph discusses matters relevant when IAS 1 was issued.

HKAS 17 *Leases*

BCA9 In the Basis for Conclusions on IAS 17 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' in paragraph BC21 is footnoted as follows:

* In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.

HKAS 19 *Employee Benefits*

BCA10 The Basis for Conclusions on IAS 19 is amended as described below.

In paragraph BC58 the reference to 'available for sale' is footnoted as follows:

* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets.

In paragraph BC75A the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

* In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

HKAS 27 *Consolidated and Separate Financial Statements*

BCA11 The Basis for Conclusions on IAS 27 is amended as described below.

In paragraph BC22 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

* In November 2009 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.

In paragraphs BC65–BC66C the references to IAS 39 are footnoted as follows:

BC65 Paragraph 29 of IAS 27 (as revised in 2000) permitted investments in subsidiaries to be measured in any one of three ways in a parent's separate financial statements. These were cost, the equity method or as available-for-sale financial assets in accordance with IAS 39[*]. Paragraph 12 of IAS 28 (as revised in 2000) permitted the same choices for investments in associates in separate financial statements, and paragraph 38 of IAS 31 (as revised in 2000) mentioned that IAS 31 did not indicate a preference for any particular treatment for accounting for interests in jointly controlled entities in a venturer's separate financial statements. The Board decided to require use of cost or IAS 39[‡] for all investments included in separate financial statements.

BC66 Although the equity method would provide users with some profit and loss information similar to that obtained from consolidation, the Board noted that such information is reflected in the investor's economic entity financial statements and does not need to be provided to the users of its separate financial statements. For separate statements, the focus is upon the performance of the assets as investments. The Board concluded that separate financial statements prepared using either the fair value method in accordance with IAS 39‡ or the cost method would be relevant. Using the fair value method in accordance with IAS 39‡ would provide a measure of the economic value of the investments. Using the cost method can result in relevant information, depending on the purpose of preparing the separate financial statements. For example, they may be needed only by particular parties to determine the dividend income from subsidiaries.

BC66A As part of its annual improvements project begun in 2007, the Board identified an apparent inconsistency with IFRS 5. The inconsistency relates to the accounting by a parent in its separate financial statements when investments it accounts for in accordance with IAS 39‡ are classified as held for sale in accordance with IFRS 5. Paragraph 38 requires an entity that prepares separate financial statements to account for such investments that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5. However, financial assets that an entity accounts for in accordance with IAS 39‡ are excluded from IFRS 5's measurement requirements.

BC66B Paragraph BC13 of the Basis for Conclusions on IFRS 5 explains that the Board decided that non-current assets should be excluded from the measurement scope of IFRS 5 only 'if (i) they are already carried at fair value with changes in fair value recognised in profit or loss or (ii) there would be difficulties in determining their fair value less costs to sell.' The Board acknowledged in the Basis for Conclusions on IFRS 5 that not all financial assets within the scope of IAS 39‡ are recognised at fair value with changes in fair value recognised in profit or loss, but it did not want to make any further changes to the accounting for financial assets at that time.

BC66C Therefore, the Board amended paragraph 38 by *Improvements to IFRSs* issued in May 2008 to align the accounting in separate financial statements for those investments that are accounted for in accordance with IAS 39‡ with the measurement exclusion that IFRS 5 provides for other assets that are accounted for in accordance with IAS 39 before classification as held for sale. Thus, an entity should continue to account for such investments in accordance with IAS 39 when they meet the held for sale criteria in IFRS 5.

* IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets.

† In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.

BCA12 In the dissenting opinions on the amendments issued in May 2008, the references to IAS 39 are footnoted as follows:

DO3 These Board members acknowledge that a new parent could choose to apply paragraph 38(b) of IAS 27 and account for its investment in the original parent in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.‡ However, the new parent then would be required to account for the investment in accordance with IAS 39‡ in subsequent periods and to account for all other investments in the same category in accordance with IAS 39‡.

† In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.

HKAS 28 *Investments in Associates*

BCA13 The Basis for Conclusions on IAS 28 is amended as described below.

In paragraph BC7 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

> * In November 2009 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

In paragraph BC9 the first reference to 'IAS 39' is footnoted as follows:

> * In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 eliminated the available-for-sale category and permits entities to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument that is not held for trading.

In paragraph BC22 the first reference to 'IAS 39' is footnoted as follows:

> * In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

In paragraph BC26 the reference to 'IAS 39' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets.

HKAS 31 *Investments in Joint Ventures*

BCA14 The Basis for Conclusions on IAS 31 is amended as described below.

In paragraph BC7 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

> * In November 2009 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

In paragraph BC9 the first reference to IAS 39 is footnoted as follows:

> * In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 eliminated the available-for-sale category and permits entities to make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument that is not held for trading.

In paragraph BC17 the first reference to 'IAS 39' is footnoted as follows:

> * In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

HKAS 32 *Financial Instruments: Presentation*

BCA15 The Basis for Conclusions on IAS 32 *Financial Instruments: Presentation* is amended as described below.

In paragraph BC2 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

> * In November 2009 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*.

In paragraph BC25 the reference to 'IAS 39, paragraph 43' is footnoted as follows:

> * In November 2009 the requirements of IAS 39, paragraph 43 relating to the initial measurement of financial assets were relocated to paragraph 5.1.1 of IFRS 9 *Financial Instruments*.

In paragraphs BC26, BC29 and BC53(a), the references to 'IAS 39' are footnoted as follows:

> * In November 2009 the requirements on measurement of assets within the scope of IAS 39 were moved from IAS 39 to IFRS 9 *Financial Instruments*.

HKAS 39 *Financial Instruments: Recognition and Measurement*

BCA16 The Basis for Conclusions on IAS 39 *Financial Instruments: Recognition and Measurement* is amended as described below.

The following paragraph is added to the rubric:

In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 Financial Instruments*. Accordingly, the following were deleted: paragraphs BC13 and BC14, the heading above paragraph BC25 and paragraphs BC25–BC29, paragraph BC70, the heading above paragraph BC104A and paragraphs BC104A–BC104E, the headings above paragraphs BC125, BC127 and BC129 and paragraphs BC125– BC130, the heading above paragraph BC221 and that paragraph and the heading above paragraph BC222 and that paragraph.*

The following are deleted: paragraphs BC13 and BC14, the heading above paragraph BC25 and paragraphs BC25–BC29, paragraph BC70, the heading above paragraph BC104A and paragraphs BC104A–BC104E, the headings above paragraphs BC125, BC127 and BC129 and paragraphs BC125–BC130, the heading above paragraph BC221 and that paragraph and the heading above paragraph BC222 and that paragraph.

The following footnotes are added:

At the end of paragraph BC11E	Superseded by IFRS 9 *Financial Instruments*
At the end of paragraph BC11F	IFRS 9 *Financial Instruments* applies to combined instruments in which a derivative is embedded in a host that is within the scope of IFRS 9. However, the requirements of IAS 39 continue to apply to derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9.

To the reference to 'IAS 39' in paragraph BC12	In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.
At the end of paragraph BC13	In November 2009 the IASB published IFRS 9 *Financial Instruments*, the first phase of its project to replace IAS 39. The Board aims to have replaced IAS 39 in its entirety by the end of 2010.
At the end of paragraph BC16	IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of loans and receivables.
To the heading above paragraph BC37	IFRS 9 *Financial Instruments* applies to combined instruments in which a derivative is embedded in a host that is within the scope of IFRS 9. However, the requirements of IAS 39 continue to apply to derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9.
To the heading above paragraph BC40A	IFRS 9 *Financial Instruments* applies to combined instruments in which a derivative is embedded in a host that is within the scope of IFRS 9. However, the requirements of IAS 39 continue to apply to derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9.
The second sentence in paragraph BC40B	IFRS 9 *Financial Instruments* eliminated the requirement to separate embedded derivatives from financial hosts within the scope of IFRS 9. However, this amendment is still relevant to derivatives embedded in host insurance contracts and other host contracts outside the scope of IFRS 9.
To the heading 'Recognition and derecognition' above paragraph BC41	In November 2009 the requirements for the recognition of assets within the scope of IAS 39 were relocated in IFRS 9 *Financial Instruments*.
To the heading 'Measurement' above paragraph BC70A	The relevant paragraphs relating to measurement of assets within the scope of IAS 39 have been relocated in the Basis for Conclusions on IFRS 9 *Financial Instruments*. The remaining paragraphs still apply to financial liabilities within the scope of IAS 39 and have not been amended.
To the reference to 'IAS 39' in paragraph BC72	IFRS 9 *Financial Instruments* eliminated the loans and receivables and available-for-sale categories from IAS 39.
To the heading 'Impairment of investments in equity instruments' above paragraph BC105	IFRS 9 *Financial Instruments*, issued in November 2009, amended the measurement requirements for investments in equity instruments. However, the section on impairment remains relevant for assets that are measured at amortised cost in accordance with IFRS 9.

To the reference to 'loans and receivables' in paragraph BC111	IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of loans and receivables.
The reference to 'held-to-maturity' in paragraph BC201(f)	IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the held-to-maturity category.

HKAS 40 *Investment Property*

BCA17 The Basis for Conclusions on IAS 40 *Investment Property* is amended as described below.

In paragraph BC8 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' and in paragraph BC9 the reference to 'IAS 39' are footnoted as follows:

> * In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

BCA18 The Basis for Conclusions on IAS 40 (2000) *Investment Property* is amended as described below:

In paragraph B35 the reference to 'IAS 39' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the held-to-maturity category.

In paragraph B63(a) the reference to 'IAS 39' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets.

The footnote to paragraph B67(a)(i) is amended as follows (new text underlined):

> † Paragraph 69 was replaced by paragraph 46 when the IASB revised IAS 39 in 2003. <u>In 2009 paragraph 46 of IAS 39 was replaced by paragraph 5.2.1 of IFRS 9 *Financial Instruments*.</u>

HKAS 41 *Agriculture*

BCA19 The Basis for IASC's Conclusions on IAS 41 is amended as described below.

In paragraph B48 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' and in paragraph B54 the first reference to 'IAS 39' are footnoted as follows:

> * In November 2009 the IASB amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease*

BCA20 The Basis for Conclusions on IFRIC 4 is amended as described below.

In paragraph BC14 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

> * In November 2009 the Board amended some of the requirements of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

HK(IFRIC)-Int 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*

BCA21 The Basis for Conclusions on IFRIC 5 is amended as described below.

In paragraph BC6 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' and in paragraphs BC12, BC20 and BC24 the first reference in each to 'IAS 39' are footnoted as follows:

> * In November 2009 the Board amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

In paragraph BC11 a footnote is added to the reference to 'IAS 39' as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial assets.

HK(IFRIC)-Int 9 *Reassessment of Embedded Derivatives*

BCA22 The Basis for Conclusions on IFRIC 9 is amended as described below.

In paragraph BC2 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, amended the requirements in IAS 39 to identify and separately account for derivatives embedded in a financial host within the scope of IFRS 9 *Financial Instruments*. The requirements in IAS 39 continue to apply for derivatives embedded in non-financial hosts and financial hosts outside the scope of IFRS 9.

HK(IFRIC)-Int 10 *Interim Financial Reporting and Impairment*

BCA23 The Basis for Conclusions on IFRIC 10 is amended as described below.

In paragraphs BC2 and BC9 the references to 'IAS 39' are footnoted as follows:

> * In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. Consequently, no financial assets are carried at cost.

HK(IFRIC)-Int 12 *Service Concession Arrangements*

BCA24 The Basis for Conclusions on IFRIC 12 is amended as described below.

In paragraph BC59 the reference to 'IAS 39' is footnoted as follows:

> * In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

The heading above paragraph BC60 is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, amended the requirements in IAS 39 for the classification of assets within the scope of IAS 39. This Basis for Conclusions has not been updated for changes in requirements since IFRIC 12 was issued.

HK(IFRIC)-Int 17 *Distributions of Non-cash Assets to Owners*

BCA25 The Basis for Conclusions on IFRIC 17 is amended as described below.

In paragraph BC22 the reference to 'IAS 39 *Financial Instruments: Recognition and Measurement*' is footnoted as follows:

> * In November 2009 the IASB amended the requirements of IAS 39 relating to classification and measurement of assets within the scope of IAS 39 and relocated them to IFRS 9 *Financial Instruments*. IFRS 9 applies to all assets within the scope of IAS 39.

Paragraph BC28 is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, requires all investments in equity instruments to be measured at fair value.

In paragraph BC29 the reference to paragraph AG81 is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, amended paragraphs AG80 and AG81 of IAS 39 so that they apply only to derivatives on unquoted equity instruments.

In paragraph BC32 the reference to 'IAS 39' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the requirement in IAS 39 for some assets to be measured using a historical cost basis.

In paragraph BC47(e) the reference to 'available-for-sale' is footnoted as follows:

> * IFRS 9 *Financial Instruments*, issued in November 2009, eliminated the category of available-for-sale financial asset

HKFRS 9 Appendix C
Issued November 2009

Effective for annual periods
beginning on or after 1 January 2013

Amendments to other HKFRSs and guidance
Hong Kong Financial Reporting Standard 9

Financial Instruments

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Appendix C
Amendments to other HKFRSs

Except where otherwise stated, an entity shall apply the amendments in this appendix when it applies HKFRS 9. Amended paragraphs are shown with new text underlined and deleted text struck through.

HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

HKFRS 1 (as revised in August 2009)

C1 In HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (as revised in August 2009), paragraph 29 is amended and paragraphs 29A and 39B are added as follows:

29 An entity is permitted to designate a previously recognised financial asset ~~or financial liability~~ as a financial asset ~~or financial liability at~~ measured at fair value through profit or loss ~~or a financial asset as available for sale~~ in accordance with paragraph D19A. The entity shall disclose the fair value of financial assets ~~or financial liabilities~~ so designated ~~into each category~~ at the date of designation and their classification and carrying amount in the previous financial statements.

29A An entity is permitted to designate a previously recognised financial liability as a financial liability at fair value through profit or loss in accordance with paragraph D19. The entity shall disclose the fair value of financial liabilities so designated at the date of designation and their classification and carrying amount in the previous financial statements.

39B HKFRS 9 *Financial Instruments* amended paragraphs 29, B1 and D19, added paragraphs 29A, B8, D19A–D19C, E1 and E2. An entity shall apply those amendments when it applies HKFRS 9.

C2 In Appendix B, paragraph B1 is amended, and a heading and paragraph B8 are added as follows:

B1 An entity shall apply the following exceptions:

(a) derecognition of financial assets and financial liabilities (paragraphs B2 and B3);

(b) hedge accounting (paragraphs B4–B6);~~, and~~

(c) non-controlling interests (paragraph B7)~~.~~; and

(d) classification and measurement of financial assets (paragraph B8).

Classification and measurement of financial assets

B8 An entity shall assess whether a financial asset meets the conditions in paragraph 4.2 of HKFRS 9 on the basis of the facts and circumstances that exist at the date of transition to HKFRSs.

C3 In Appendix D (Exemptions from other HKFRSs), paragraph D19 is amended and paragraphs D19A–D19C are added as follows.

D19 HKAS 39 permits a financial liability ~~asset to be designated on initial recognition as available for sale or a financial instrument~~ (provided it meets certain criteria) to be designated as a ~~financial asset or~~ financial liability at fair value through profit or loss. Despite this requirement ~~exceptions apply in the following circumstances:~~

~~(a)~~ ~~an entity is permitted to make an available-for-sale designation at the date of transition to HKFRSs.~~

~~(b)~~ an entity is permitted to designate, at the date of transition to HKFRSs, any ~~financial asset or~~ financial liability as at fair value through profit or loss provided the ~~asset or~~ liability meets the criteria in paragraph 9(b)(i), 9(b)(ii) or 11A of HKAS 39 at that date.

D19A An entity may designate a financial asset as measured at fair value through profit or loss in accordance with paragraph 4.5 of HKFRS 9 on the basis of the facts and circumstances that exist at the date of transition to HKFRSs.

D19B An entity may designate an investment in an equity instrument as at fair value through other comprehensive income in accordance with paragraph 5.4.4 of HKFRS 9 on the basis of the facts and circumstances that exist at the date of transition to HKFRSs.

D19C If it is impracticable (as defined in HKAS 8) for an entity to apply retrospectively the effective interest method or the impairment requirements in paragraphs 58–65 and AG84–AG93 of HKAS 39, the fair value of the financial asset at the date of transition to HKFRSs shall be the new amortised cost of that financial asset at the date of transition to HKFRSs.

In Appendix E (Short-term exemptions from HKFRSs), a heading and paragraphs E1 and E2 are added as follows:

Exemption from the requirement to restate comparative information for HKFRS 9

E1 In its first HKFRS financial statements, an entity that (a) adopts HKFRSs for annual periods beginning before 1 January 2012 and (b) applies HKFRS 9 shall present at least one year of comparative information. However, this comparative information need not comply with HKFRS 9 or HKFRS 7, to the extent that the disclosures required by HKFRS 7 relate to assets within the scope of HKFRS 9. For such entities, references to the 'date of transition to HKFRSs' shall mean, in the case of HKFRS 9 and HKFRS 7 only, the beginning of the first HKFRS reporting period.

E2 An entity that chooses to present comparative information that does not comply with HKFRS 9 and HKFRS 7 in its first year of transition shall:

(a) apply the recognition and measurement requirements of its previous GAAP in place of the requirements of HKAS 39 and HKFRS 9 to comparative information about assets within the scope of HKFRS 9.

(b) disclose this fact together with the basis used to prepare this information.

(c) treat any adjustment between the statement of financial position at the comparative period's reporting date (ie the statement of financial position that includes comparative information under previous GAAP) and the statement of financial position at the start of the *first HKFRS reporting period* (ie the first period that includes information that complies with HKFRS 9 and HKFRS 7) as arising from a change in accounting policy and give the disclosures required by paragraph 28(a)–(e) and (f)(i) of HKAS 8. Paragraph 28(f)(i) applies only to amounts presented in the statement of financial position at the comparative period's reporting date.

(d) apply paragraph 17(c) of HKAS 1 to provide additional disclosures when compliance with the specific requirements in HKFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

HKFRS 1 (issued 2003)

C4 In HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (issued in October 2003 and amended at October 2008), paragraphs 25A, 26 and 43A are amended and paragraph 25AA, a heading and paragraphs 34D–34G, a heading above paragraph 36D and paragraphs 36D, 36E and 47M are added.

25A HKAS 39 *Financial Instruments: Recognition and Measurement* permits a financial ~~asset~~ liability to be designated on initial recognition as ~~available for sale or a financial instrument (provided it meets certain criteria) to be designated as~~ a ~~financial asset or~~ financial liability at fair value through profit or loss provided it meets certain criteria. Despite this requirement, a first-time adopter of HKFRSs ~~exceptions apply in the following circumstances,~~

~~(a)~~ ~~any entity is permitted to make an available-for-sale designation at the date of transition to HKFRSs.~~

~~(b)~~ ~~*an entity that presents its first HKFRS financial statements for an annual period beginning on or after 1 September 2006—*such an entity~~ is permitted to designate, at the date of transition to HKFRSs, any ~~financial asset or~~ financial liability as at fair value through profit or loss provided the ~~asset or~~ liability meets the criteria in paragraph 9(b)(i), 9(b)(ii) or 11A of HKAS 39 at that date.

~~(c)~~ ~~*an entity that presents*~~ ...

~~(e)~~ ... ~~at the same time they are designated as at fair value through profit or loss.~~

25AA HKFRS 9 *Financial Instruments* permits a financial asset to be designated on initial recognition as a financial asset measured at fair value through profit or loss provided that the financial asset meets the criterion in paragraph 4.5 of HKFRS 9. Despite this requirement, a first-time adopter of HKFRSs is permitted to designate, at the date of transition to HKFRSs, any financial asset as measured at fair value through profit or loss provided the asset meets the criterion in paragraph 4.5 of HKFRS 9 at that date.

26 This HKFRS prohibits retrospective application of some aspects of other HKFRSs relating to:

(a) …

(d) assets classified as held for sale and discontinued operations (paragraphs 34A and 34B); ~~and~~

(e) some aspects of accounting for non-controlling interests (paragraph 34C)~~.~~<u>; and</u>

<u>(f) classification and measurement of financial assets (paragraphs 34D–34G).</u>

Classification and measurement of financial assets

34D An entity shall assess whether a financial asset meets the conditions in paragraph 4.2 of HKFRS 9 *Financial Instruments* on the basis of the facts and circumstances that exist at the date of transition to HKFRSs.

34E An entity may designate a financial asset as measured at fair value through profit or loss in accordance with paragraph 4.5 of HKFRS 9 on the basis of the facts and circumstances that exist at the date of transition to HKFRSs.

34F An entity may designate an investment in an equity instrument as at fair value through other comprehensive income in accordance with paragraph 5.4.4 of HKFRS 9 on the basis of the facts and circumstances that exist at the date of transition to HKFRSs.

34G If it is impracticable (as defined in HKAS 8) for an entity to apply retrospectively the effective interest method or the impairment requirements in paragraphs 58–65 and AG84–AG93 of HKAS 39, the fair value of the financial asset at the date of transition to HKFRSs shall be the new amortised cost of that financial asset at the date of transition to HKFRSs.

Exemption from the requirement to restate comparative information for HKFRS 9

36D In its first HKFRS financial statements, an entity that (a) adopts HKFRSs for annual periods beginning before 1 January 2012 and (b) applies HKFRS 9 shall present at least one year of comparative information. However, this comparative information need not comply with HKFRS 9 or HKFRS 7, to the extent that the disclosures required by HKFRS 7 relate to assets within the scope of HKFRS 9. For such entities, references to the 'date of transition to HKFRSs' shall mean, in the case of HKFRS 9 and HKFRS 7 only, the beginning of the first HKFRS reporting period.

36E An entity that chooses to present comparative information that does not comply with HKFRS 9 and HKFRS 7 in its first year of transition shall:

(a) apply the recognition and measurement requirements of its previous GAAP in place of the requirements of HKAS 39 and HKFRS 9 to comparative information about assets within the scope of HKFRS 9.

(b) disclose this fact together with the basis used to prepare this information.

(c) treat any adjustment between the statement of financial position at the comparative period's reporting date (ie the statement of financial position that includes comparative information under previous GAAP) and the statement of financial position at the start of the *first HKFRS reporting period* (ie the first period that includes information that complies with HKFRS 9 and HKFRS 7) as arising from a change in accounting policy and give the disclosures required by paragraph 28(a)–(e) and (f)(i) of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.* Paragraph 28(f)(i) applies only to amounts presented in the statement of financial position at the comparative period's reporting date.

(d) apply paragraph 17(c) of HKAS 1 to provide additional disclosures when compliance with the specific requirements in HKFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

43A An entity is permitted to designate a previously recognised financial asset ~~or financial liability as a financial asset or financial liability~~ as measured at fair value through profit or loss in accordance with paragraph 25AA or a previously recognised financial liability as a financial liability at fair value through profit or loss ~~or a financial asset as available for sale~~ in accordance with paragraph 25A. The entity shall disclose the fair value of financial assets or financial liabilities so designated ~~into each category~~ at the date of designation and their classification and carrying amount in the previous financial statements.

47M HKFRS 9, issued in November 2009, amended paragraphs 25A, 26 and 43A and added paragraphs 25AA, 34D–34G, 36D and 36E. An entity shall apply those amendments when it applies HKFRS 9.

HKFRS 3 *Business Combinations*

HKFRS 3 (2008)

C5 In HKFRS 3 *Business Combinations* (as revised in 2008), paragraphs 16, 42 and 58 are amended and paragraph 64A is added as follows:

16 In some situations, HKFRSs provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the acquirer shall make on the basis of the pertinent conditions as they exist at the acquisition date include but are not limited to:

(a) classification of particular financial assets and liabilities as measured ~~a financial asset or liability~~ at fair value ~~through profit or loss,~~ or at amortised cost ~~as a financial asset available for sale or held to maturity~~, in accordance with HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement*;

(b) designation of a derivative instrument as a hedging instrument in accordance with HKAS 39; and

(c) assessment of whether an embedded derivative should be separated from ~~the~~ a host contract outside the scope of HKFRS 9 in accordance with HKAS 39 (which is a matter of 'classification' as this HKFRS uses that term).

42 In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income ~~(for example, because the investment was classified as available for sale)~~. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

58 ...

(b) Contingent consideration classified as an asset or a liability that:

(i) is a financial instrument and is within the scope of HKFRS 9 or HKAS 39 shall be measured at fair value, with any resulting gain or loss recognised either in profit or loss or in other comprehensive income in accordance with ~~that~~ HKFRS 9 or HKAS 39 as applicable.

(ii) is not within the scope of HKFRS 9 or HKAS 39 shall be accounted for in accordance with HKAS 37 or other HKFRSs as appropriate.

64A HKFRS 9, issued in November 2009, amended paragraphs 16, 42 and 58. An entity shall apply those amendments when it applies HKFRS 9.

HKFRS 4 *Insurance Contracts*

C6 Paragraphs 3 and 45 are amended and paragraph 41C is added as follows:

3 This HKFRS does not address other aspects of accounting by insurers, such as accounting for financial assets held by insurers and financial liabilities issued by insurers (see HKAS 32 *Financial Instruments: Presentation*, HKAS 39 *Financial Instruments: Recognition and Measurement*, ~~and~~ HKFRS 7 and HKFRS 9 *Financial Instruments*), except in the transitional provisions in paragraph 45.

45 Notwithstanding paragraph 4.9 of HKFRS 9, w~~W~~hen an insurer changes its accounting policies for insurance liabilities, it is permitted, but not required, to reclassify some or all of its financial assets as measured ~~'~~at fair value ~~through profit or loss'~~. This reclassification is permitted if an insurer changes accounting policies when it first applies this HKFRS and if it makes a subsequent policy change permitted by paragraph 22. The reclassification is a change in accounting policy and HKAS 8 applies.

41C HKFRS 9, issued in November 2009, amended paragraphs 3 and 45. An entity shall apply those amendments when it applies HKFRS 9.

HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

C7 In paragraph 5(c), the reference to 'HKAS 39 *Financial Instruments: Recognition and Measurement*' is replaced with 'HKFRS 9 *Financial Instruments*'.

HKFRS 7 *Financial Instruments: Disclosures*

C8 In the rubric, the reference to 'Appendices A–D' is amended to 'Appendices A–C'. In paragraph 4 the references to 'HKAS 39' and in paragraph 5 the first reference to 'HKAS 39' are replaced with 'HKAS 39 and HKFRS 9'. A heading and paragraphs 11A, 11B, 12B–12D, 20A and 44H–44J are added, paragraphs 12 and 12A are deleted and paragraphs 2, 3, 8, 9, 20, 29 and 30 are amended as follows:

2 The principles in this HKFRS complement the principles for recognising, measuring and presenting financial assets and financial liabilities in HKAS 32 *Financial Instruments: Presentation* , ~~and~~ HKAS 39 *Financial Instruments: Recognition and Measurement* and HKFRS 9 *Financial Instruments*.

3 This HKFRS shall be applied by all entities to all types of financial instruments, except:

(a) those interests in subsidiaries, associates or joint ventures that are accounted for in accordance with HKAS 27 *Consolidated and Separate Financial Statements*, HKAS 28 Investments in Associates or HKAS 31 *Interests in Joint Ventures*. However, in some cases, HKAS 27, HKAS 28 or HKAS 31 permits an entity to account for an interest in a subsidiary, associate or joint venture using HKAS 39 and HKFRS 9; in those cases, entities shall apply the requirements of this HKFRS. Entities shall also apply this HKFRS to all derivatives linked to interests in subsidiaries, associates or joint ventures unless the derivative meets the definition of an equity instrument in HKAS 32.

8 The carrying amounts of each of the following categories, as specified ~~defined~~ in HKFRS 9 or HKAS 39, shall be disclosed either in the statement of financial position or in the notes:

(a) financial assets measured at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those mandatorily ~~classified as~~ measured at fair value ~~held for trading~~ in accordance with HKFRS 9 ~~HKAS 39;~~.

(b)–(d) [deleted]

~~(b) held-to-maturity investments;~~

~~(c) loans and receivables;~~

~~(d) available-for-sale financial assets;~~

(e) financial liabilities at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those that meet the definition of ~~classified as~~ held for trading in ~~accordance with~~ HKAS 39~~; and~~.

(f) financial assets ~~liabilities~~ measured at amortised cost.

(g) financial liabilities measured at amortised cost.

(h) financial assets measured at fair value through other comprehensive income.

9 If the entity has designated ~~a loan or receivable (or group of loans or receivables)~~ as measured at fair value ~~through profit or loss~~ a financial asset (or group of financial assets) that would otherwise be measured at amortised cost, it shall disclose:

(a) the maximum exposure to *credit risk* (see paragraph 36(a)) of the ~~loan or receivable~~ financial asset (or group of ~~loans or receivables~~ financial assets) at the end of the reporting period.

(b) the amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.

(c) the amount of change, during the period and cumulatively, in the fair value of the ~~loan or receivable~~ financial asset (or group of ~~loans or receivables~~ financial assets) that is attributable to changes in the credit risk of the financial asset determined either:

...

(d) the amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the ~~loan or receivable~~ financial asset was designated.

...

Financial assets measured at fair value through other comprehensive income

11A If an entity has designated investments in equity instruments to be measured at fair value through other comprehensive income, as permitted by paragraph 5.4.4 of HKFRS 9, it shall disclose:

(a) which investments in equity instruments have been designated to be measured at fair value through other comprehensive income.

(b) the reasons for using this presentation alternative.

(c) the fair value of each such investment at the end of the reporting period.

(d) dividends recognised during the period, showing separately those related to investments derecognised during the reporting period and those related to investments held at the end of the reporting period.

(e) any transfers of the cumulative gain or loss within equity during the period including the reason for such transfers.

11B If an entity derecognised investments in equity instruments measured at fair value through other comprehensive income during the reporting period, it shall disclose:

(a) the reasons for disposing of the investments.

(b) the fair value of the investments at the date of derecognition.

(c) the cumulative gain or loss on disposal.

12B An entity shall disclose if, in the current or previous reporting periods, it has reclassified any financial assets in accordance with paragraph 4.9 of HKFRS 9. For each such event, an entity shall disclose:

(a) the date of reclassification.

(b) a detailed explanation of the change in business model and a qualitative description of its effect on the entity's financial statements.

(c) the amount reclassified into and out of each category.

12C For each reporting period following reclassification until derecognition, an entity shall disclose for assets reclassified so that they are measured at amortised cost in accordance with paragraph 4.9 of HKFRS 9:

(a) the effective interest rate determined on the date of reclassification; and

(b) the interest income or expense recognised.

12D If an entity has reclassified financial assets so that they are measured at amortised cost since its last annual reporting date, it shall disclose:

(a) the fair value of the financial assets at the end of the reporting period; and

(b) the fair value gain or loss that would have been recognised in profit or loss during the reporting period if the financial assets had not been reclassified.

20 An entity shall disclose the following items of income, expense, gains or losses either in the statement of comprehensive income or in the notes:

(a) net gains or net losses on:

(i) financial assets ~~or financial liabilities~~ measured at fair value through profit or loss, showing separately those on financial assets ~~or financial liabilities~~ designated as such upon initial recognition, and those ~~on financial assets or financial liabilities~~ that are mandatorily measured at fair value ~~classified as held for trading~~ in accordance with HKFRS 9 ~~HKAS 39;~~.

(ii)–(iv) [deleted]

~~(ii)~~ ~~available-for-sale financial assets, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount reclassified from equity to profit or loss for the period;~~

~~(iii)~~ ~~held-to-maturity investments;~~

~~(iv)~~ ~~loans and receivables; and~~

(v) financial liabilities ~~measured at amortised cost~~ at fair value through profit or loss, showing separately those on financial liabilities designated as such upon initial recognition, and those on financial liabilities that meet the definition of held for trading in HKAS 39.

(vi) financial assets measured at amortised cost.

(vii) financial liabilities measured at amortised cost.~~;~~

(viii) financial assets measured at fair value through other comprehensive income.

(b) total interest income and total interest expense (calculated using the effective interest method) for financial assets ~~or financial liabilities~~ that are measured at amortised cost or financial liabilities not at fair value through profit or loss;

(c) fee income and expense (other than amounts included in determining the effective interest rate) arising from:

(i) financial assets ~~or financial liabilities~~ measured at amortised cost or financial liabilities that are not at fair value through profit or loss; and

(ii) trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions;

(d) ...

20A An entity shall disclose an analysis of the gain or loss recognised in the statement of comprehensive income arising from the derecognition of financial assets measured at amortised cost, showing separately gains and losses arising from derecognition of those financial assets. This disclosure shall include the reasons for derecognising those financial assets.

29 Disclosures of fair value are not required:

(a) when the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;

(b) for ~~an investment in equity instruments that do not have a quoted market price in an active market, or~~ derivatives linked to investments in equity instruments that do not have a quoted market price in an active market that are ~~such equity instruments, that is~~ measured at cost in accordance with HKAS 39 because ~~its~~ their fair value cannot be measured reliably; or

(c) for a contract containing a discretionary participation feature (as described in HKFRS 4) if the fair value of that feature cannot be measured reliably.

30 In the cases described in paragraph 29(b) and (c), an entity shall disclose information to help users of the financial statements make their own judgements about the extent of possible differences between the carrying amount of those ~~financial assets or financial liabilities~~ contracts and their fair value, including:

(a) ...

44H HKFRS 9, issued in November 2009, amended paragraphs 2–5, 8, 9, 12, 20, 29 and 30, added paragraphs 11A, 11B, 12B–12D and 20A and deleted paragraph 12A. It also amended the last paragraph of Appendix A (Defined terms) and paragraphs B1, B5, B10, B22 and B27, and deleted Appendix D (Amendments to HKFRS 7 if the Amendments to HKAS 39 Financial Instruments: Recognition and Measurement—*The Fair Value Option* have not been applied). An entity shall apply those amendments when it applies HKFRS 9.

44I When an entity first applies HKFRS 9, it shall disclose for each class of financial assets at the date of initial application:

(a) the original measurement category and carrying amount determined in accordance with HKAS 39;

(b) the new measurement category and carrying amount determined in accordance with HKFRS 9;

(c) the amount of any financial assets in the statement of financial position that were previously designated as measured at fair value through profit or loss but are no longer so designated, distinguishing between those that HKFRS 9 requires an entity to reclassify and those that an entity elects to reclassify.

An entity shall present these quantitative disclosures in tabular format unless another format is more appropriate.

44J When an entity first applies HKFRS 9, it shall disclose qualitative information to enable users to understand:

(a) how it applied the classification requirements in HKFRS 9 to those financial assets whose classification has changed as a result of applying HKFRS 9.

(b) the reasons for any designation or de-designation of financial assets or financial liabilities as measured at fair value through profit or loss.

C9 In Appendix A (Defined terms), the last paragraph is amended as follows:

The following terms are defined in paragraph 11 of HKAS 32 or paragraph 9 of HKAS 39 and are used in the HKFRS with the meaning specified in HKAS 32 and HKAS 39.

- amortised cost of a financial asset or financial liability
- ~~available-for-sale financial assets~~
- derecognition
- derivative
- effective interest method
- equity instrument
- fair value
- financial asset
- ~~financial asset or~~ financial liability at fair value through profit or loss
- ~~financial asset or financial liability held for trading~~
- financial guarantee contract
- financial instrument
- financial liability

- forecast transaction
- hedging instrument
- held for trading
- ~~held-to-maturity investments~~
- ~~loans and receivables~~
- regular way purchase or sale

C10 In Appendix B (Application guidance), paragraphs B1, B5, B10, B22 and B27 are amended as follows:

B1 Paragraph 6 requires an entity to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes described in paragraph 6 are determined by the entity and are, thus, distinct from the categories of financial instruments specified in HKAS 39 and HKFRS 9 (which determine how financial instruments are measured and where changes in fair value are recognised).

B5 Paragraph 21 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:

(a) for ~~financial assets or~~ financial liabilities designated as at fair value through profit or loss:

(i) the nature of the ~~financial assets or~~ financial liabilities the entity has designated as at fair value through profit or loss;

(ii) the criteria for so designating such ~~financial assets or~~ financial liabilities on initial recognition; and

(iii) how the entity has satisfied the conditions in paragraph 9, 11A or 12 of HKAS 39 for such designation. For instruments designated in accordance with paragraph (b)(i) of the definition of a ~~financial asset or~~ financial liability at fair value through profit or loss in HKAS 39, that disclosure includes a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with paragraph (b)(ii) of the definition of a ~~financial asset or~~ financial liability at fair value through profit or loss in HKAS 39, that disclosure includes a narrative description of how designation at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.

(aa) for financial assets designated as measured at fair value through profit or loss:

(i) the nature of the financial assets the entity has designated as measured at fair value through profit or loss;

(ii) how the entity has satisfied the criteria in paragraph 4.5 of HKFRS 9 for such designation.

(b) [deleted] ~~the criteria for designating financial assets as available for sale.~~

(c) ...

B10 Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:

(a) granting loans ~~and receivables~~ to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the related financial assets.

(b) ...

B22 *Interest rate risk* arises on interest-bearing financial instruments recognised in the statement of financial position (eg ~~loans and receivables and~~ debt instruments acquired or issued) and on some financial instruments not recognised in the statement of financial position (eg some loan commitments).

B27 In accordance with paragraph 40(a), the sensitivity of profit or loss (that arises, for example, from instruments measured ~~classified as~~ at fair value through profit or loss ~~and impairments of available-for-sale financial assets~~) is disclosed separately from the sensitivity of other comprehensive income ~~equity (~~that arises, for example, from investments in equity instruments whose changes in fair value are presented in other comprehensive income ~~classified as available for sale)~~.

C11 Appendix D (Amendments to HKFRS 7 if the Amendments to HKAS 39 Financial Instruments: Recognition and Measurement—*The Fair Value Option* have not been applied) is deleted.

HKAS 1 *Presentation of Financial Statements*

C12 In paragraph 7, the definition of 'other comprehensive income' and paragraphs 68, 82, 93 and 95 are amended and paragraph 139E is added as follows:

7 ...

Other comprehensive income **comprises items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other HKFRSs.**

The components of other comprehensive income include:

(a) ...

(d) gains and losses ~~on remeasuring available-for-sale financial assets (see HKAS 39 *Financial Instruments: Recognition and Measurement*)~~ from investments in equity instruments measured at fair value through other comprehensive income in accordance with paragraph 5.4.4 of HKFRS 9 *Financial Instruments*;

(e) the effective portion of gains and losses on hedging instruments in a cash flow hedge (see HKAS 39).

68 The operating cycle of an entity ... Current assets also include assets held primarily for the purpose of trading (examples include some financial assets that meet the definition of ~~classified as~~ held for trading in ~~accordance with~~ HKAS 39) and the current portion of non-current financial assets.

82 As a minimum, the statement of comprehensive income shall include line items that present the following amounts for the period:

(a) revenue;

(aa) gains and losses arising from the derecognition of financial assets measured at amortised cost;

(b) finance costs;

(c) share of the profit or loss of associates and joint ventures accounted for using the equity method;

(ca) if a financial asset is reclassified so that it is measured at fair value, any gain or loss arising from a difference between the previous carrying amount and its fair value at the reclassification date (as defined in HKFRS 9);

(d) ...

93 Other HKFRSs specify whether and when amounts previously recognised in other comprehensive income are reclassified to profit or loss. Such reclassifications are referred to in this Standard as reclassification adjustments. A reclassification adjustment is included with the related component of other comprehensive income in the period that the adjustment is reclassified to profit or loss. ~~For example, gains realised on the disposal of available-for-sale financial assets are included in profit or loss of the current period.~~ These amounts may have been recognised in other comprehensive income …

95 Reclassification adjustments arise, for example, on disposal of a foreign operation (see HKAS 21)~~, on derecognition of available-for-sale financial assets (see HKAS 39)~~ and when a hedged forecast transaction affects profit or loss (see paragraph 100 of HKAS 39 in relation to cash flow hedges).

139E HKFRS 9, issued in November 2009, amended the definition of 'other comprehensive income' in paragraph 7 and paragraphs 68, 82, 93 and 95. An entity shall apply those amendments when it applies HKFRS 9.

HKAS 2 *Inventories*

C13 Paragraph 2(b) is amended and paragraph 40A added as follows:

2 This Standard applies to all inventories, except:

...

(b) financial instruments (see HKAS 32 *Financial Instruments: Presentation*, ~~and~~ HKAS 39 *Financial Instruments: Recognition and Measurement* and HKFRS 9 *Financial Instruments*); and

...

40A HKFRS 9, issued in November 2009, amended paragraph 2(b). An entity shall apply that amendment when it applies HKFRS 9.

HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

C14 Paragraph 53 is amended and paragraph 54A is added as follows:

53 Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, ~~when an entity corrects a prior period error in measuring financial assets previously classified as held-to-maturity investments in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*, it does not change their basis of measurement for that period if management decided later not to hold them to maturity. In addition,~~ when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with HKAS 19 *Employee Benefits*, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were authorised for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

54A HKFRS 9 *Financial Instruments*, issued in November 2009, amended paragraph 53. An entity shall apply that amendment when it applies HKFRS 9.

HKAS 12 *Income Taxes*

C15 In the rubric the reference to 'paragraphs 1–95' is amended to 'paragraphs 1–96'. Paragraph 20 is amended and paragraph 96 is added as follows:

20 HKFRSs permit or require certain assets to be carried at fair value or to be revalued (see, for example, HKAS 16 *Property, Plant and Equipment*, HKAS 38 *Intangible Assets*, <u>HKFRS 9 *Financial Instruments*</u> ~~HKAS 39 *Financial Instruments: Recognition and Measurement*~~ and HKAS 40 *Investment Property*). In some jurisdictions, the revaluation or other restatement of an asset to fair value affects taxable profit (tax loss) for the current period. As a result, ...

96 HKFRS 9, issued in November 2009, amended paragraph 20. An entity shall apply that amendment when it applies HKFRS 9.

HKAS 18 *Revenue*

C16 In the rubric the reference to 'paragraphs 1–38' is amended to 'paragraphs 1–39'. Paragraph 6(d) and the last sentence of paragraph 11 are amended and paragraph 39 is added as follows:

6 This Standard does not deal with revenue arising from:

...

(d) changes in the fair value of financial assets and financial liabilities or their disposal (see HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement*);

11 In most cases … The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue in accordance with paragraphs 29 and 30 and in accordance with HKAS 39 and HKFRS 9.

39 HKFRS 9, issued in November 2009, amended paragraphs 6(d) and 11. An entity shall apply those amendments when it applies HKFRS 9.

HKAS 21 *The Effects of Changes in Foreign Exchange Rates*

C17 Paragraphs 3(a), 4 and 52(a) are amended and paragraph 60C is added as follows:

3 This Standard shall be applied: [footnote omitted]

(a) in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of HKAS 39 *Financial Instruments: Recognition and Measurement* **and HKFRS 9** *Financial Instruments*;

...

4 HKFRS 9 and HKAS 39 apply ~~applies~~ to many foreign currency derivatives and, accordingly, these are excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of HKFRS 9 and HKAS 39 (eg some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.

52 An entity shall disclose:

(a) the amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with HKFRS 9 and HKAS 39; and

(b) …

60C HKFRS 9, issued in November 2009, amended paragraphs 3(a), 4 and 52(a). An entity shall apply those amendments when it applies HKFRS 9.

HKAS 27 *Consolidated and Separate Financial Statements*

HKAS 27 (2008)

C18 In paragraph IN10 after the reference to 'HKAS 39 *Financial Instruments: Recognition and Measurement*' is added 'and HKFRS 9 *Financial Instruments*'. Paragraphs 35, 37, 38 and 40 are amended and paragraph 45D is added as follows:

35 If a parent loses control of a subsidiary, … For example, if a subsidiary has cumulative exchange differences relating to a foreign operation ~~available-for-sale financial assets~~ and the parent loses control of the subsidiary, the parent shall

reclassify to profit or loss the gain or loss previously recognised in other comprehensive income in relation to the foreign operation ~~those assets~~. Similarly, …

37 The fair value of any investment retained in the former subsidiary at the date when control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with HKFRS 9 *Financial Instruments* ~~HKAS 39 *Financial Instruments: Recognition and Measurement*~~ or, when appropriate, the cost on initial recognition of an investment in an associate or jointly controlled entity.

38 When an entity prepares separate financial statements, it shall account for investments in subsidiaries, jointly controlled entities and associates either:

(a) at cost, or

(b) in accordance with HKFRS 9 and HKAS 39.

The entity shall apply the same accounting for each category of investments. Investments accounted for at cost shall be accounted for in accordance with HKFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* when they are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5. The accounting for ~~measurement of~~ investments ~~accounted for~~ in accordance with HKFRS 9 and HKAS 39 is not changed in such circumstances.

40 Investments in jointly controlled entities and associates that are accounted for in accordance with HKFRS 9 and HKAS 39 in the consolidated financial statements shall be accounted for in the same way in the investor's separate financial statements.

45D HKFRS 9, issued in November 2009, amended paragraphs 35, 37, 38 and 40. An entity shall apply those amendments when it applies HKFRS 9.

HKAS 27 (2003)

C19 In HKAS 27 *Consolidated and Separate Financial Statements* (as revised in October 2005) paragraphs 31, 32, 37 and 39 are amended and paragraph 43A is added as follows:

31 An investment in an entity shall be accounted for in accordance with HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement* from the date that it ceases to be a subsidiary, provided that it does not become an associate as defined in HKAS 28 or a jointly controlled entity as described in HKAS 31.

32 The carrying amount of the investment at the date that the entity ceases to be a subsidiary shall be regarded as the cost on initial measurement of a financial asset in accordance with HKFRS 9 ~~HKAS 39~~.

37 When separate financial statements are prepared, investments in subsidiaries, jointly controlled entities and associates that are not classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 shall be accounted for either:

(a) at cost, or

(b) in accordance with HKFRS 9 and HKAS 39.

The same accounting shall be applied for each category of investments. Investments in subsidiaries, jointly controlled entities and associates that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with HKFRS 5 shall be accounted for in accordance with that HKFRS.

39 Investments in jointly controlled entities and associates that are accounted for in accordance with <u>HKFRS 9 and</u> HKAS 39 in the consolidated financial statements shall be accounted for in the same way in the investor's separate financial statements.

43A HKFRS 9, issued in November 2009, amended paragraphs 31, 32, 37 and 39. An entity shall apply those amendments when it applies HKFRS 9.

HKAS 28 *Investments in Associates*

HKAS 28 (2008)

C20 HKAS 28 *Investments in Associates* (as amended in October 2008) is amended as described below.

Paragraphs 1 and 18–19A are amended and paragraph 41D is added as follows:

1 This Standard shall be applied in accounting for investments in associates. However, it does not apply to investments in associates held by:

(a) venture capital organisations, or

(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

that <u>are measured</u> ~~upon initial recognition are designated as~~ at fair value through profit or loss ~~or are classified as held for trading and accounted for~~ in accordance with <u>HKFRS 9 *Financial Instruments* and</u> HKAS 39 *Financial Instruments: Recognition and Measurement*. <u>An entity shall measure such</u> ~~Such~~ investments ~~shall be measured~~ at fair value <u>through profit or loss</u> in accordance with <u>HKFRS 9</u> ~~HKAS 39, with changes in fair value recognised in profit or loss in the period of the change~~. An entity holding such an investment shall make the disclosures required by paragraph 37(f).

18 An investor shall discontinue the use of the equity method from the date when it ceases to have significant influence over an associate and shall account for the investment in accordance with <u>HKFRS 9 and</u> HKAS 39 from that date, provided the associate does not become a subsidiary or a joint venture as defined in HKAS 31. On the loss of significant influence, …

19 When an investment ceases to be an associate and is accounted for in accordance with <u>HKFRS 9 and</u> HKAS 39, the fair value of the investment at the date when it ceases to be an associate shall be regarded as its fair value on initial recognition as a financial asset in accordance with <u>HKFRS 9</u> ~~HKAS 39~~.

19A If an investor loses significant influence over an associate, … For example, if an associate has <u>cumulative exchange differences relating to a foreign operation</u> ~~available-for-sale financial assets~~ and the investor loses significant influence over the associate, the investor shall reclassify to profit or loss the gain or loss previously recognised in other comprehensive income in relation to the foreign operation ~~those assets~~. If …

41D HKFRS 9, issued in November 2009, amended paragraphs 1 and 18–19A. An entity shall apply those amendments when it applies HKFRS 9.

HKAS 28 (2003)

C21 HKAS 28 *Investments in Associates*, issued in December 2003 and amended at 31 December 2007, is amended as described below.

Paragraphs 1, 18 and 19 are amended and paragraph 41A is added as follows:

1 This Standard shall be applied in accounting for investments in associates. However, it does not apply to investments in associates held by:

(a) venture capital organisations, or

(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

that are measured ~~upon initial recognition are designated as~~ at fair value through profit or loss ~~or are classified as held for trading and accounted for~~ in accordance with HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement*. An entity shall measure such ~~Such~~ investments ~~shall be measured~~ at fair value through profit or loss in accordance with HKFRS 9 ~~HKAS 39, with changes in fair value recognised in profit or loss in the period of the change~~.

18 An investor shall discontinue the use of the equity method from the date that it ceases to have significant influence over an associate and shall account for the investment in accordance with HKFRS 9 and HKAS 39 from that date, provided the associate does not become a subsidiary or a joint venture as defined in HKAS 31.

19 The carrying amount of the investment at the date that it ceases to be an associate shall be regarded as its cost on initial recognition ~~measurement~~ as a financial asset in accordance with HKFRS 9 ~~HKAS 39~~.

41A HKFRS 9, issued in November 2009, amended paragraphs 1, 18 and 19. An entity shall apply those amendments when it applies HKFRS 9.

HKAS 31 *Interests in Joint Ventures*

HKAS 31 as amended in October 2008

C22 HKAS 31 *Interests in Joint Ventures* (as amended in October 2008) is amended as described below.

Paragraph IN5 is amended as follows:

IN5 The Standard does not apply to investments that would otherwise be interests of venturers in jointly controlled entities held by venture capital organisations, mutual funds, unit trusts and similar entities when those investments are ~~classified as held for trading and~~ accounted for at fair value through profit or loss in accordance with

HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement*. Those investments are measured at fair value, with changes in fair value recognised in profit or loss in the period in which they occur.

Paragraphs 1, 45–45B and 51 are amended and paragraph 58C is added as follows:

1 **This Standard shall be applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place. However, it does not apply to venturers' interests in jointly controlled entities held by:**

(a) venture capital organisations, or

(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

that are measured ~~upon initial recognition are designated as~~ at fair value through profit or loss ~~or are classified as held for trading and accounted for~~ in accordance with HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement*. An entity shall measure such ~~Such~~ investments ~~shall be measured~~ at fair value through profit or loss in accordance with HKFRS 9 ~~HKAS 39, with changes in fair value recognised in profit or loss in the period of the change~~. A venturer holding such an interest shall make the disclosures required by paragraphs 55 and 56.

45 **When an investor ceases to have joint control over an entity, it shall account for any remaining investment in accordance with HKFRS 9 and HKAS 39 from that date, provided that the former jointly controlled entity does not become a subsidiary or associate. From …**

45A **When an investment ceases to be a jointly controlled entity and is accounted for in accordance with HKFRS 9 and HKAS 39, the fair value of the investment when it ceases to be a jointly controlled entity shall be regarded as its fair value on initial recognition as a financial asset in accordance with HKFRS 9 ~~HKAS 39~~.**

45B If an investor loses joint control of an entity, … For example, if a jointly controlled entity has cumulative exchange differences relating to a foreign operation ~~available-for-sale financial assets~~ and the investor loses joint control of the entity, the investor shall reclassify to profit or loss the gain or loss previously recognised in other comprehensive income in relation to the foreign operation ~~those assets~~. If ...

51 **An investor in a joint venture that does not have joint control shall account for that investment in accordance with HKFRS 9 and HKAS 39 or, if it has significant influence in the joint venture, in accordance with HKAS 28.**

58C HKFRS 9, issued in November 2009, amended paragraphs 1, 45–45B and 51. An entity shall apply those amendments when it applies HKFRS 9.

HKAS 31 (2004)

C23 HKAS 31 *Interests in Joint Ventures*, issued in December 2004 and amended in December 2007, is amended as described below:

Paragraph IN5 is amended as follows:

IN5 The Standard does not apply to investments that would otherwise be interests of venturers in jointly controlled entities held by venture capital organisations, mutual funds, unit trusts and similar entities when those investments are ~~classified as held for trading and~~ accounted for at fair value through profit or loss in accordance with HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement*. Those investments are measured at fair value, with changes in fair value recognised in profit or loss in the period in which they occur.

Paragraphs 1 and 51 are amended and paragraph 58A is added as follows:

1 This Standard shall be applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place. However, it does not apply to venturers' interests in jointly controlled entities held by:

(a) venture capital organisations, or

(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds

that are measured ~~upon initial recognition are designated as~~ at fair value through profit or loss ~~or are classified as held for trading and accounted for~~ in accordance with HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement*. An entity shall measure such ~~Such~~ investments ~~shall be measured~~ at fair value through profit or loss in accordance with HKFRS 9 ~~HKAS 39, with changes in fair value recognised in profit or loss in the period of the change~~.

51 An investor in a joint venture that does not have joint control shall account for that investment in accordance with HKFRS 9 and HKAS 39 or, if it has significant influence in the joint venture, in accordance with HKAS 28.

58A HKFRS 9, issued in November 2009, amended paragraphs 1 and 51. An entity shall apply those amendments when it applies HKFRS 9.

HKAS 32 *Financial Instruments: Presentation*

C24 Paragraphs 3, 12 and 31 are amended and paragraph 97F is added as follows:

3 The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement*, and for disclosing information about them in HKFRS 7 *Financial Instruments: Disclosures*.

12 The following terms are defined in paragraph 9 of HKAS 39 and are used in this Standard with the meaning specified in HKAS 39.

- amortised cost of a financial asset or financial liability
- ~~available for sale financial assets~~
- derecognition
- derivative
- effective interest method
- ~~financial asset or~~ financial liability at fair value through profit or loss
- financial guarantee contract
- firm commitment
- forecast transaction
- hedge effectiveness
- hedged item
- hedging instrument
- held for trading
- ~~held to maturity investments~~
- ~~loans and receivables~~
- regular way purchase or sale
- transaction costs.

31 HKFRS 9 and HKAS 39 deal~~s~~ with the measurement of financial assets and financial liabilities respectively. Equity instruments …

97F HKFRS 9, issued in November 2009, amended paragraphs 3, 12, 31, AG2 and AG30. An entity shall apply those amendments when it applies HKFRS 9.

C25 In the Appendix (Application Guidance), paragraphs AG2 and AG30 are amended as follows:

AG2 The Standard does not deal with the recognition or measurement of financial instruments. Requirements about ~~the~~ recognition and measurement are set out in HKFRS 9 for ~~of~~ financial assets and HKAS 39 for financial liabilities.

AG30 Paragraph 28 applies only to issuers of non-derivative compound financial instruments. Paragraph 28 does not deal with compound financial instruments from the perspective of holders. HKFRS 9 deals with the classification and measurement of financial assets that are compound instruments from the holder's perspective. ~~HKAS 39 deals with the separation of embedded derivatives from the perspective of holders of compound financial instruments that contain debt and equity features.~~

HKAS 36 *Impairment of Assets*

C26 In HKAS 36, paragraphs 2(e) and 5 are amended and paragraph 140F is added as follows:

2 **...**

(e) **financial assets that are within the scope ~~of HKAS 39 *Financial Instruments: Recognition and Measurement*~~ HKFRS 9 *Financial Instruments*;**

5 This Standard does not apply to financial assets within the scope of ~~HKAS 39~~ HKFRS 9, investment property measured at fair value in accordance with HKAS 40, or biological assets related to agricultural activity measured at fair value less costs to sell in accordance with HKAS 41. However, ...

140F HKFRS 9, issued in November 2009, amended paragraphs 2(e) and 5. An entity shall apply those amendments when it applies HKFRS 9.

HKAS 39 *Financial Instruments: Recognition and Measurement*

C27 HKAS 39 *Financial Instruments: Recognition and Measurement* is amended as described below.

In the Introduction paragraphs IN1–IN26 are deleted. A new Introduction is added as follows:

The IASB has decided to replace HKAS 39 over a period of time. The first instalment, dealing with classification and measurement of financial assets, was issued as HKFRS 9 *Financial Instruments* in November 2009. As a consequence, part of HKAS 39 is being superseded and will become obsolete for annual periods beginning on or after 1 January 2013. Proposals to replace the requirements on impairment and derecognition have been published and further proposals are expected in 2009 and 2010. The remaining requirements of HKAS 39 continue in effect until superseded by future instalments of HKFRS 9.

Paragraph 1 is amended as follows:

1 The objective of this Standard is to establish principles for recognising and measuring ~~financial assets,~~ financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting information about financial instruments are in HKAS 32 *Financial Instruments: Presentation*. Requirements for disclosing information about financial instruments are in HKFRS 7 *Financial Instruments: Disclosures*. Requirements for classifying and measuring financial assets are in HKFRS 9 *Financial Instruments*.

In paragraph 9, a definition of 'held for trading' is added and the heading 'Definitions of four categories of financial instruments' and the definition of 'financial asset or financial liability at fair value through profit or loss' are amended as follows:

Definitions of ~~four~~ categories of financial instruments

...

A financial asset or financial liability is *held for trading* if:

(a) **it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;**

(b) on initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or

(c) it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

A ~~*financial asset or*~~ *financial liability at fair value through profit or loss* is a ~~financial asset or~~ financial liability that meets either of the following conditions.

(a) It ~~is classified as~~ meets the definition of held for trading. ~~A financial asset or financial liability is classified as held for trading if:~~

~~(i) it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;~~

~~(ii) on initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short term profit taking; or~~

~~(iii) it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).~~

(b) Upon initial recognition it is designated by the entity as at fair value through profit or loss. An entity may use this designation only when permitted by paragraph 11A, or when doing so results in more relevant information, because either

...

(ii) a group of ~~financial assets,~~ financial liabilities or ~~both~~ financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in HKAS 24 *Related Party Disclosures* (as revised in ~~2003~~ 2009)), for example the entity's board of directors and chief executive officer.

In HKFRS 7, paragraphs ~~9–~~10 and 11 ~~and B4~~ require the entity to provide disclosures about ~~financial assets and~~ financial liabilities it has designated as at fair value through profit or loss, including how it has satisfied these conditions (see paragraphs B4 and B5 of HKFRS 7). For instruments qualifying in accordance with (ii) above, that disclosure includes a narrative description of how designation as at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.

~~Investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured (see paragraph 46(c) and Appendix A paragraphs AG80 and AG81), shall not be designated as at fair value through profit or loss.~~

It should be noted that paragraphs 48, 48A, 49 and Appendix A paragraphs AG69–AG82, which set out requirements for determining a reliable measure of the fair value of a ~~financial asset or~~ financial liability, apply equally to all items that are measured at fair value, whether by designation or otherwise, or whose fair value is disclosed.

...

In paragraph 9 the following terms are deleted:

- held-to-maturity investments
- loans and receivables
- available-for-sale financial assets

Paragraphs 10–11A, 13 and 14 are amended as follows:

10 An embedded derivative is a component of a hybrid (combined) <u>contract</u> ~~instrument~~ that also includes a non-derivative host contract—with the effect that some of the cash flows of the combined <u>contract</u> ~~instrument~~ vary in a way similar to a stand-alone derivative. An …

11 An embedded derivative shall be separated from the host contract and accounted for as a derivative under this Standard if, and only if:

...

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; ~~and~~

(c) the hybrid (combined) <u>contract</u> ~~instrument~~ is not measured at fair value with changes in fair value recognised in profit or loss (ie a derivative that is embedded in a ~~financial asset or~~ financial liability at fair value through profit or loss is not separated)~~.~~<u>; and</u>

<u>(d) the host is outside the scope of HKFRS 9.</u>

If an embedded derivative is separated, the host contract shall be accounted for ~~under this Standard if it is a financial instrument, and~~ in accordance with <u>the</u> ~~other~~ appropriate <u>HKFRSs</u> ~~Standards if it is not a financial instrument~~. This Standard does not address whether an embedded derivative shall be presented separately in the statement of financial position.

11A Notwithstanding paragraph 11, if a contract contains one or more embedded derivatives <u>and the host is outside the scope of HKFRS 9</u>, an entity may designate the entire hybrid (combined) contract as a financial asset or financial liability at fair value through profit or loss unless:

...

13 If an entity is unable to determine reliably the fair value of an embedded derivative on the basis of its terms and conditions ~~(for example, because the embedded derivative is based on an unquoted equity instrument)~~, the fair value of the embedded derivative is the difference between the fair value of the hybrid (combined) <u>contract</u> ~~instrument~~ and the fair value of the host contract, if those can be determined under this Standard. If the entity is unable to determine the fair value

of the embedded derivative using this method, paragraph 12 applies and the hybrid (combined) contract ~~instrument~~ is designated as at fair value through profit or loss.

14 **An entity shall recognise ~~a financial asset or~~ a financial liablity in its statement of financial position when, and only when, the entity becomes a party to the contractual provisions of the instrument. ~~(See paragraph 38 with respect to regular way purchases of financial assets.)~~**

Paragraphs 26(b), 27(b), 31, 33 and 34(b) are amended as follows:

26 **On derecognition of a financial asset in its entirety, the difference between:**

(a) the carrying amount (measured at the date of derecognition) and

(b) ~~the sum of (i)~~ the consideration received (including any new asset obtained less any new liability assumed) ~~and (ii) any cumulative gain or loss that had been recognised in other comprehensive income (see paragraph 55(b))~~

shall be recognised in profit or loss.

27 **… The difference between:**

(a) the carrying amount (measured at the date of derecognition) allocated to the part derecognized and

(b) ~~the sum of (i)~~ the consideration received for the part derecognised (including any new asset obtained less any new liability assumed) ~~and (ii) any cumulative gain or loss allocated to it that had been recognised in other comprehensive income (paragraph 55(b))~~…

shall be recognised in profit or loss. ~~A cumulative gain or loss that had been recognised in other comprehensive income is allocated between the part that continues to be recognised and the part that is derecognised, based on the relative fair values of those parts.~~

31 **When an entity continues to recognise an asset to the extent of its continuing involvement, the entity also recognises an associated liability. Despite the other measurement requirements in this Standard and HKFRS 9, the transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the entity has retained. The associated liability is …**

(a) ...

33 **For the purpose of subsequent measurement, recognised changes in the fair value of the transferred asset and the associated liability are accounted for consistently with each other in accordance with paragraph 55 and HKFRS 9 paragraph 5.4.1, and shall not be offset.**

34 **…The difference between:**

(a) the carrying amount (measured at the date of derecognition) allocated to the part that is no longer recognised; and

(b) ~~the sum of (i)~~ the consideration received for the part no longer recognised ~~and (ii) any cumulative gain or loss allocated to it that had been recognised in other comprehensive income (see paragraph 55(b))~~

shall be recognised in profit or loss. ~~A cumulative gain or loss that had been recognised in other comprehensive income is allocated between the part that continues to be recognised and the part that is no longer recognised, on the basis of the relative fair values of those parts.~~

In the section titled 'Measurement' the following are deleted: the headings above paragraphs 45, 63, 66 and 67; and paragraphs 45, 46, 50B–52, 61 and 66–70. The heading above paragraphs 43 and 58 and paragraphs 43, 44, 47, 48, 50, 50A, 53–58 and 63 are amended as follows:

Initial measurement of ~~financial assets and~~ financial liabilities

43 **When a ~~financial asset or~~ financial liability is recognised initially, an entity shall measure it at its fair value <u>minus</u> ~~plus~~, in the case of a ~~financial asset or~~ financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the ~~acquisition or~~ issue of the ~~financial asset or~~ financial liability.**

44 When an entity uses settlement date accounting for an asset that is subsequently measured at ~~cost or~~ amortised cost, the asset is recognised initially at its fair value on the trade date (see Appendix A paragraphs AG53–AG56).

47 **After initial recognition, an entity shall measure all financial liabilities at amortised cost using the effective interest method, except for:**

(a) financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be measured at fair value except for a derivative liability that is linked to and must be settled by delivery of an unquoted equity instrument whose fair value cannot be reliably measured, which shall be measured at cost <u>(see Appendix A paragraphs AG80 and AG81)</u>.

…

48 **In determining the fair value of a financial asset or a financial liablity for the purpose of applying this Standard, HKAS 32<u>,</u> ~~or~~ HKFRS 7 <u>or HKFRS 9</u>, an entity shall apply paragraphs AG69–AG82 of Appendix A.**

50 **An entity~~:~~ <u>shall not reclassify a financial liability except in accordance with paragraphs 53 and 54.</u>**

(a) ~~shall not reclassify~~ ...

... ~~after initial recognition.~~

50A The following changes in circumstances are not reclassifications for the purposes of paragraph 50:

(a) a derivative that was previously a designated and effective hedging instrument in a cash flow hedge or net investment hedge no longer qualifies as such~~;~~.

(b) a derivative becomes a designated and effective hedging instrument in a cash flow hedge or net investment hedge~~;~~.

(c) [deleted]

53 If a reliable measure becomes available for a ~~financial asset or~~ financial liability for which such a measure was previously not available, and the ~~asset or~~ liability is required to be measured at fair value if a reliable measure is available (see paragraph~~s 46(c) and~~ 47(a)), the ~~asset or~~ liability shall be remeasured at fair value, and the difference between its carrying amount and fair value shall be accounted for in accordance with paragraph 55.

54 If, ~~as a result of a change in intention or ability or~~ in ~~the~~ rare circumstances ~~that~~ a reliable measure of fair value is no longer available (see paragraph~~s 46(c) and~~ 47(a)), ~~or because the 'two preceding financial years' referred to in paragraph 9 have passed, it becomes appropriate to carry a financial asset or~~ an entity shall measure the financial liability at cost ~~or amortised cost~~ rather than at fair value.~~,~~ T~~t~~he fair value ~~carrying amount~~ of the ~~financial asset or the~~ financial liability on ~~that~~ the date of reclassification becomes its new cost. ~~or amortised cost, as applicable. Any previous gain or loss on that asset that has been recognised in other comprehensive income in accordance with paragraph 55(b) shall be accounted for as follows:~~

~~(a)~~ ~~In the case of a~~ ….

~~(b)~~ … ~~in accordance with paragraph 67.~~

55 A gain or loss arising from a change in the fair value of a ~~financial asset or~~ financial liability measured at fair value through profit or loss that is not part of a hedging relationship (see paragraphs 89–102), shall be recognised in profit or loss. ~~, as follows~~

~~(a)~~ ~~A gain or loss~~ ...

~~(b)~~ ... ~~the entity's right to receive payment is established (see HKAS 18).~~

56 For ~~financial assets and~~ financial liabilities ~~carried~~ measured at amortised cost (see paragraph~~s 46 and~~ 47), a gain or loss is recognised in profit or loss when the ~~financial asset or~~ financial liability is derecognised ~~or impaired~~, and through the amortisation process. However, for ~~financial assets or~~ financial liabilities that are hedged items (see paragraphs 78–84 and Appendix A paragraphs AG98–AG101) the accounting for the gain or loss shall follow paragraphs 89–102.

57 **If an entity recognises financial assets using settlement date accounting (see paragraph 38 and Appendix A paragraphs AG53 and AG56), any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not recognised for assets ~~carried at cost or~~ measured at amortised cost (other than impairment losses). For assets ~~carried~~ measured at fair value, however, the change in fair value shall be recognised in profit or loss or in equity, as appropriate under ~~paragraph 55~~ and paragraph 5.4.1 of HKFRS 9.**

Impairment and uncollectibility of financial assets measured at amortised cost

58 **An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets measured at amortised cost is impaired. If any such evidence exists, the entity shall apply paragraph 63 ~~(for financial assets carried at amortised cost), paragraph 66 (for financial assets carried at cost) or paragraph 67 (for available for sale financial assets)~~ to determine the amount of any impairment loss.**

63 **If there is objective evidence that an impairment loss on financial assets measured ~~loans and receivables or held to maturity investments carried~~ at amortised cost has been incurred, the amount of the loss is measured as …**

Paragraph 79 is deleted and paragraphs 88(d), 89(b), 90 and 96(c) are amended as follows:

88 **A hedging relationship qualifies for hedge accounting under paragraphs 89–102 if, and only if, all of the following conditions are met.**

...

(d) **The effectiveness of the hedge can be reliably measured, ie the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured (see paragraph~~s 46 and~~ 47(a) and Appendix A paragraphs AG80 and AG81 for guidance on determining fair value).**

...

89 **If a fair value hedge meets the conditions in paragraph 88 during the period, it shall be accounted for as follows:**

...

(b) **the gain or loss on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedged item and be recognised in profit or loss. This applies if the hedged item is otherwise measured at cost. ~~Recognition of the gain or loss attributable to the hedged risk in profit or loss applies if the hedged item is an available for sale financial asset.~~**

90 If only particular risks attributable to a hedged item are hedged, recognised changes in the fair value of the hedged item unrelated to the hedged risk are recognised as set out in paragraph 55 of this Standard and paragraph 5.4.1 of HKFRS 9.

96 …

(c) if an entity's documented risk management strategy for a particular hedging relationship excludes from the assessment of hedge effectiveness a specific component of the gain or loss or related cash flows on the hedging instrument (see paragraphs 74, 75 and 88(a)), that excluded component of gain or loss is recognised in accordance with paragraph 55 of this Standard and paragraph 5.4.1 of HKFRS 9.

Paragraphs 103L and 103M are added as follows:

103L HKFRS 9, issued in November 2009, amended paragraphs 1, 9–11A, 13, 14, 26(b), 27(b), 31, 33, 34(b), 43, 44, 47, 48, 50, 50A, 53–58, 63, 88(d), 89(b), 90, 96(c), AG3, AG3A, AG4B–AG4E, AG4H, AG4I, AG8, AG50, AG53, AG56, AG64, AG76A, AG80, AG81, AG83, AG84, AG95, AG96 and AG114(a) and deleted paragraphs 45, 46, 50B–52, 61, 66–70, 79, AG16–AG26, AG30(b), AG30(f) and AG65–AG68. An entity shall apply those amendments when it applies HKFRS 9.

103M At the date of initial application of HKFRS 9, an entity:

(a) may designate a financial liability as measured at fair value through profit or loss in accordance with paragraph 9(b)(i) of HKAS 39.

(b) shall revoke its previous designation of a financial liability as measured at fair value through profit or loss if such designation was made at initial recognition in accordance with paragraph 9(b)(i) of HKAS 39 and such designation does not satisfy that condition at the date of initial application of HKFRS 9.

(c) may revoke its previous designation of a financial liability as measured at fair value through profit or loss if such designation was made at initial recognition in accordance with paragraph 9(b)(i) of HKAS 39 and such designation satisfies that condition at the date of initial application of HKFRS 9.

Such designation shall be made on the basis of the facts and circumstances that exist at the date of initial application of HKFRS 9. That classification shall be applied retrospectively.

C28 Appendix A of HKAS 39 (Application guidance) is amended as described below.

Paragraphs AG3, AG3A, AG4B–AG4E, AG4H and AG4I are amended as follows:

AG3 … If neither the equity method nor proportionate consolidation is appropriate, the entity applies this Standard and HKFRS 9 *Financial Instruments* to that strategic investment.

AG3A This Standard and HKFRS 9 apply ~~applies~~ to the financial assets and financial liabilities of insurers, other than rights and obligations that paragraph 2(e) excludes because they arise under contracts within the scope of HKFRS 4.

AG4B Paragraph 9 of this Standard and paragraph 4.5 of HKFRS 9 allows~~s~~ an entity to designate a financial asset, a financial liability, or a group of financial instruments (financial assets, financial liabilities or both) as at fair value through profit or loss provided that doing so results in more relevant information.

AG4C The decision of an entity to designate a financial asset or financial liability as at fair value through profit or loss is similar to an accounting policy choice (although, unlike an accounting policy choice, it is not required to be applied consistently to all similar transactions). When an entity has such a choice, paragraph 14(b) of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires the chosen policy to result in the financial statements providing reliable and more relevant information about the effects of transactions, other events and conditions on the entity's financial position, financial performance or cash flows. For example, in ~~In~~ the case of designation of a financial liability as at fair value through profit or loss, paragraph 9 sets out the two circumstances when the requirement for more relevant information will be met. Accordingly, to choose such designation in accordance with paragraph 9, the entity needs to demonstrate that it falls within one (or both) of these two circumstances.

AG4D Under HKAS 39 and HKFRS 9 measurement of a financial asset or financial liability and classification of recognised changes in its value are determined by the item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') when, for example, in the absence of designation as at fair value through profit or loss, a financial asset would be classified as measured at fair value in accordance with HKFRS 9 ~~available for sale (with most changes in fair value recognised in other comprehensive income)~~ and a liability the entity considers related would be measured at amortised cost (with changes in fair value not recognised). In such circumstances, an entity may conclude that its financial statements would provide more relevant information if both the asset and the liability were ~~classified~~ measured as at fair value through profit or loss.

AG4E The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through profit or loss only if it meets the principle in paragraph 9(b)(i) or paragraph 4.5 of HKFRS 9.

(a) [deleted] ~~An entity has liabilities ... the value of liabilities.~~

(b) An entity has liabilities under insurance contracts whose measurement incorporates current information (as permitted by HKFRS 4, paragraph 24), and financial assets it considers related that would otherwise be ~~classified as available for sale or~~ measured at amortised cost.

(c) ...

(d) An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, that gives rise to opposite changes in fair value that tend to offset each other and the entity does not qualify for hedge accounting because none of the instruments is a derivative. Furthermore, in the absence of hedge accounting there is a significant inconsistency in the recognition of gains and losses. For example,~~:~~

~~(i)~~ ~~the entity has financed a portfolio of fixed rate assets that would otherwise be classified as available for sale with fixed rate debentures whose changes in fair value tend to offset each other. Reporting both the assets and the debentures at fair value through profit or loss corrects the inconsistency that would otherwise arise from measuring the assets at fair value with changes recognised in other comprehensive income and the debentures at amortised cost.~~

~~(ii)~~ the entity has financed a specified group of loans by issuing traded bonds whose changes in fair value tend to offset each other. If, in addition, the entity regularly buys and sells the bonds but rarely, if ever, buys and sells the loans, reporting both the loans and the bonds at fair value through profit or loss eliminates the inconsistency in the timing of recognition of gains and losses that would otherwise result from measuring them both at amortised cost and recognising a gain or loss each time a bond is repurchased.

Paragraph 9(b)(ii): A group of ~~financial assets,~~ financial liabilities or ~~both~~ <u>financial assets and financial liabilities</u> is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy

AG4H An entity may manage and evaluate the performance of a group of ~~financial assets,~~ financial liabilities or ~~both~~ <u>financial assets and financial liabilities</u> in such a way that measuring that group at fair value through profit or loss results in more relevant information. The focus in this instance is on the way the entity manages and evaluates performance, rather than on the nature of its financial instruments.

AG4I <u>For example,</u> ~~The following examples show when this condition could be met. In all cases,~~ an entity may use this condition to designate ~~financial assets or~~ financial liabilities as at fair value through profit or loss ~~only~~ if it meets the principle in paragraph 9(b)(ii) <u>and</u>~~.~~

~~(a)~~ ~~The entity is a venture capital organisation ... HKAS 28 or HKAS 31.~~

~~(b)~~ ~~T~~<u>t</u>he entity has financial assets and financial liabilities that share one or more risks and those risks are managed and evaluated on a fair value basis in accordance with a documented policy of asset and liability management. An example could be an entity that has issued ‘structured products’ containing mulitple embedded derivatives and manages the resulting risks on a fair value basis using a mix of derivative and non-derivative financial instruments. ~~A similar ... financial instruments.~~

~~(c)~~ ~~The entity is an insurer ... subject to the insurer’s discretion.~~

AG8 If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument’s original effective interest rate or, when applicable, the revised effective interest rate calculated in accordance with paragraph 92. The adjustment is recognised in profit or loss as income or expense. ~~If a financial asset is reclassified in accordance with paragraph 50B, 50D or 50E, and the entity subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase shall be recognised as an adjustment to the effective interest rate from the date of the change in estimate rather than as an adjustment to the carrying amount of the asset at the date of the change in estimate.~~

The heading above paragraph AG14 and paragraphs AG29 and AG31–AG35 are amended as follows and the headings above paragraphs AG16 and AG26 and paragraphs AG16–AG26 and AG30(b) and (f) are deleted.

Financial ~~assets and financial~~ liabilities held for trading

AG14 …

AG29 Generally, multiple embedded derivatives in a single hybrid contract ~~instrument~~ are treated as a single compound embedded derivative. However, embedded derivatives that are classified as equity (see HKAS 32) are accounted for separately from those classified as assets or liabilities. In addition, if a~~n~~ hybrid contract ~~instrument~~ has more than one embedded derivative and those derivatives relate to different risk exposures and are readily separable and independent of each other, they are accounted for separately from each other.

AG31 An example of a hybrid contract ~~instrument~~ is a financial instrument that gives the holder a right to put the financial instrument back to the issuer in exchange for an amount of cash or other financial assets that varies on the basis of the change in an equity or commodity index that may increase or decrease (a 'puttable instrument'). Unless the issuer ...

AG32 In the case of a puttable instrument that can be put back at any time for cash equal to a proportionate share of the net asset value of an entity (such as units of an open-ended mutual fund or some unit-linked investment products), the effect of separating an embedded derivative and accounting for each component is to measure the hybrid contract ~~combined instrument~~ at the redemption amount that is payable at the end of the reporting period if the holder exercised its right to put the instrument back to the issuer.

AG33 The economic characteristics and risks of an embedded derivative are closely related to the economic characteristics and risks of the host contract in the following examples. In these examples, an entity does not account for the embedded derivative separately from the host contract.

(a) An embedded derivative in which the underlying is an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing host debt contract or insurance contract is closely related to the host contract unless the hybrid contract ~~combined instrument~~ can be settled in such a way that the holder would not recover substantially all of its recognised investment or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract.

(b) ...

AG33A When an entity becomes a party to a hybrid (combined) contract ~~instrument~~ that contains one or more embedded derivatives, paragraph 11 requires the entity to identify any such embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently. These requirements can be more complex, or result in less reliable measures, than measuring the entire instrument at fair value through profit or loss. For that reason this Standard permits the entire hybrid contract ~~instrument~~ to be designated as at fair value through profit or loss.

AG33B Such designation may be used whether paragraph 11 requires the embedded derivatives to be separated from the host contract or prohibits such separation. However, paragraph 11A would not justify designating the hybrid (combined) contract ~~instrument~~ as at fair value through profit or loss in the cases set out in paragraph 11A(a) and (b) because doing so would not reduce complexity or increase reliability.

AG34 As a consequence of the principle in paragraph 14 and paragraph 3.1.1 of HKFRS 9, an entity recognises …

AG35 The following are examples of applying the principle in paragraph 14 and paragraph 3.1.1 of HKFRS 9:

(a) ...

Paragraphs AG50, AG53 and AG56 are amended as follows:

AG50 To the extent that a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset. The transferee derecognises the cash or other consideration paid and recognises a receivable from the transferor. If the transferor has both a right and an obligation to reacquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may measure ~~account for~~ its receivable at amortised cost if it meets the criteria in paragraph 4.2 in HKFRS 9 ~~as a loan or receivable~~.

AG53 A regular way purchase or sale of financial assets is recognised using either trade date accounting or settlement date accounting as described in paragraphs AG55 and AG56. An entity shall apply the same method ~~The method used is applied~~ consistently for all purchases and sales of financial assets that are classified in the same way in accordance with HKFRS 9 ~~belong to the same category of financial assets defined in paragraph 9~~. For this purpose assets that ~~are~~ meet the definition of held for trading form a separate ~~category~~ classification from assets designated as measured at fair value through profit or loss. In addition, investments in equity instruments accounted for using the option provided in paragraph 5.4.4 of HKFRS 9 form a separate classification.

AG56 … In other words, the change in value is not recognised for assets measured ~~carried~~ at ~~cost or~~ amortised cost; it is recognised in profit or loss for assets classified as financial assets measured at fair value through profit or loss; and it is recognised in other comprehensive income for investments in equity instruments accounted for in accordance with paragraph 5.4.4 of HKFRS 9 ~~assets classified as available for sale~~.

Paragraphs AG65–AG68 are deleted. The headings above paragraph AG64 and paragraphs AG64 and AG76A are amended as follows:

Measurement (paragraphs 43–~~70~~65)

Initial measurement of ~~financial assets and~~ financial liabilities (paragraph 43)

AG64 The fair value of a financial ~~instrument~~ liability on initial recognition is normally the transaction price (ie the fair value of the consideration ~~given or~~ received, see also paragraph AG76). However, if part of the consideration given or received is for something other than the financial ~~instrument~~ liability, the fair value of the financial

~~instrument~~ liability is estimated, using a valuation technique (see paragraphs AG74–AG79). ~~For example, the fair value of a long term loan or receivable that carries no interest can be estimated as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.~~

AG76A The subsequent measurement of the financial asset or financial liability and the subsequent recognition of gains and losses shall be consistent with the requirements of this Standard or HKFRS 9 as appropriate. The application …

The heading above paragraph AG80 and paragraphs AG80 and AG81 are amended as follows:

No active market: derivatives on unquoted equity instruments

AG80 The fair value of ~~investments in equity instruments that do not have a quoted market price in an active market and~~ derivatives that are linked to and must be settled by delivery of ~~such an~~ unquoted equity instruments (see paragraph~~s 46 and~~ 47) is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that instrument or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.

AG81 There are many situations in which the variability in the range of reasonable fair value estimates of ~~investments in equity instruments that do not have a quoted market price and~~ derivatives that are linked to and must be settled by delivery of ~~such an~~ unquoted equity instruments (see paragraph~~s 46(c) and~~ 47) is likely not to be significant. Normally it is possible to estimate the fair value of such derivatives ~~a financial asset~~ that an entity has acquired from an outside party. However, if the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the instrument at fair value.

The headings above paragraph AG84 and paragraphs AG83 and AG84 are amended as follows:

AG83 An entity applies HKAS 21 to ~~financial assets and~~ financial liabilities that are monetary items in accordance with HKAS 21 and denominated in a foreign currency. Under HKAS 21, any foreign exchange gains and losses on ~~monetary assets and~~ monetary liabilities are recognised in profit or loss. An exception is a monetary item that is designated as a hedging instrument in either a cash flow hedge (see paragraphs 95–101) or a hedge of a net investment (see paragraph 102). ~~For the purpose of recognising foreign exchange gains and losses under HKAS 21, a monetary available-for-sale financial asset is treated as if it were carried at amortised cost in the foreign currency. Accordingly, for such a financial asset, exchange differences resulting from changes in amortised cost are recognised in profit or loss and other changes in carrying amount are recognised in accordance with paragraph 55(b). For available-for-sale financial assets that are not monetary items under HKAS 21 (for example, equity instruments), the gain or loss that is recognised in other comprehensive income under paragraph 55(b) includes any related foreign exchange component.~~ If there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component of those financial instruments are recognised in profit or loss.

Impairment and uncollectibility of financial assets measured at amortised cost (paragraphs 58–~~70~~65)

~~Financial assets carried at amortised cost (paragraphs 63–65)~~

AG84 Impairment of a financial asset ~~carried~~ measured at amortised cost is measured using the financial instrument's original effective interest rate because discounting at the current market rate of interest would, in effect, impose fair value measurement on financial assets that are otherwise measured at amortised cost. If the terms of a financial asset measured at amortised cost ~~loan, receivable or held-to-maturity investment~~ are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms. Cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial. If a financial asset measured at amortised cost ~~loan, receivable or held-to-maturity investment~~ has a variable interest rate, the discount rate for measuring any impairment loss under paragraph 63 is the current effective interest rate(s) determined under the contract. As a practical expedient, a creditor may measure impairment of a financial asset measured ~~carried~~ at amortised cost on the basis of an instrument's fair value using an observable market price. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

Paragraphs AG95 and AG96 are amended as follows:

AG95 A financial asset measured ~~held-to-maturity investment carried~~ at amortised cost may be designated as a hedging instrument in a hedge of foreign currency risk.

AG96 ~~An investment in an~~ A derivative that is linked to and must be settled by delivery of unquoted equity instruments that is not carried at fair value because its fair value cannot be reliably measured ~~or a derivative that is linked to and must be settled by delivery of such an unquoted equity instrument~~ (see paragraph~~s 46 and~~ 47) cannot be designated as a hedging instrument.

Paragraph AG114(a) is amended as follows:

AG114 ...

(a) As part of its risk management process the entity identifies a portfolio of items whose interest rate risk it wishes to hedge. The portfolio may comprise only assets, only liabilities or both assets and liabilities. The entity may identify two or more portfolios ~~(eg the entity may group its available-for-sale assets into a separate portfolio)~~, in which case it applies the guidance below to each portfolio separately.

In the heading above paragraph AG133, the reference to 'paragraphs 103–108B' is amended to 'paragraphs 103–108C'.

HK(IFRIC)-Int 10 *Interim Financial Reporting and Impairment*

C29 In the rubric the reference to 'paragraphs 1–10' is amended to 'paragraphs 1–11'. In the 'References' section, a reference to HKFRS 9 *Financial Instruments* is added. Paragraphs 1, 2, 7 and 8 are amended, paragraph 11 is added and paragraphs 5 and 6 are deleted as follows:

1 An entity is required to assess goodwill for impairment at the end of each reporting period~~, to assess investments in equity instruments and in financial assets carried at cost for impairment at the end of each reporting period~~ and, if required, to recognise an impairment loss at that date in accordance with HKAS 36 ~~and HKAS 39~~. However, …

2 The Interpretation addresses the interaction between the requirements of HKAS 34 and the recognition of impairment losses on goodwill in HKAS 36 ~~and certain financial assets in HKAS 39~~, and the effect of that interaction on subsequent interim and annual financial statements.

7 The Interpretation addresses the following issue:

> Should an entity reverse impairment losses recognised in an interim period on goodwill ~~and investments in equity instruments and in financial assets carried at cost~~ if a loss would not have been recognised, or a smaller loss would have been recognised, had an impairment assessment been made only at the end of a subsequent reporting period?

8 An entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill ~~or an investment in either an equity instrument or a financial asset carried at cost~~.

11 HKFRS 9, issued in November 2009, amended paragraphs 1, 2, 7 and 8 and deleted paragraphs 5 and 6. An entity shall apply those amendments when it applies HKFRS 9.

HK(IFRIC)-Int 12 *Service Concession Arrangements*

C30 In the ‘References’ section, a reference to HKFRS 9 *Financial Instruments* is added. Paragraphs 23–25 are amended and paragraph 28A is added as follows:

23 HKASs 32 and 39 and HKFRSs 7 <u>and 9</u> apply to the financial asset recognised under paragraphs 16 and 18.

24 The amount due from or at the direction of the grantor is accounted for in accordance with <u>HKFRS 9</u> ~~HKAS 39~~ as:

(a) <u>at amortised cost</u> ~~a loan or receivable~~; <u>or</u>

(b) <u>measured at fair value through profit or loss</u> ~~an available-for-sale financial asset; or~~<u>.</u>

~~(c)~~ ~~if so designated upon initial recognition, a financial asset at fair value through profit or loss, if the conditions for that classification are met.~~

25 If the amount due from the grantor is accounted for ~~either as a loan or receivable or as an available-for-sale financial asset~~ <u>at amortised cost, HKFRS 9</u> ~~HKAS 39~~ requires interest calculated using the effective interest method to be recognised in profit or loss.

28A HKFRS 9, issued in November 2009, amended paragraphs 23–25. An entity shall apply those amendments when it applies HKFRS 9.

Amendments to guidance on other HKFRSs

The following amendments to guidance on HKFRSs are necessary in order to ensure consistency with HKFRS 9 Financial Instruments *and the related amendments to other HKFRSs. In the amended paragraphs, new text is underlined and deleted text is struck through.*

HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

IGA1 In the guidance on implementing HKFRS 1 (both June 2003 and November 2008 versions), the heading above paragraph IG52 and paragraphs IG52-IG55, IG56, IG58, IG58A and IG59 are amended as follows:

HKAS 39 *Financial Instruments: Recognition and Measurement* and HKFRS 9 *Financial Instruments*

IG52 An entity recognises and measures all financial assets and financial liabilities in its opening HKFRS statement of financial position in accordance with HKFRS 9 and HKAS 39 respectively, except as specified in paragraphs B2–B6 of the HKFRS, which address derecognition and hedge accounting.

IG53 An entity recognises all financial assets and financial liabilities (including all derivatives) that qualify for recognition in accordance with HKAS 39 and HKFRS 9 and have not yet qualified for derecognition in accordance with HKAS 39, except non-derivative financial assets and non-derivative financial liabilities derecognised in accordance with previous GAAP before 1 January 2004, to which the entity does not choose to apply paragraph B3 (see paragraphs B2 and B3 of the HKFRS). For example, an entity that does not apply paragraph B3 does not recognise assets transferred in a securitisation, transfer or other derecognition transaction that occurred before 1 January 2004 if those transactions qualified for derecognition in accordance with previous GAAP. However, if the entity uses the same securitisation arrangement or other derecognition arrangement for further transfers after 1 January 2004, those further transfers qualify for derecognition only if they meet the derecognition criteria of HKAS 39.

IG54 An entity does not recognise financial assets and financial liabilities that do not qualify for recognition in accordance with HKAS 39 or HKFRS 9, or have already qualified for derecognition in accordance with HKAS 39.

IG55 When HKAS 39 requires an entity to separate an embedded derivative from a host contract outside the scope of HKFRS 9 *Financial Instruments*, the initial carrying amounts of the components at the date when the instrument first satisfies the recognition criteria in HKAS 39 reflect circumstances at that date (HKAS 39 paragraph 11). If the entity cannot determine the initial carrying amounts of the embedded derivative and host contract reliably, it ~~treats~~ designates the entire combined contract as ~~a financial instrument held for trading~~ at fair value through profit or loss (HKAS 39 paragraph 12). ~~This results in fair value measurement (except when the entity cannot determine a reliable fair value, see HKAS 39 paragraph 46(c)), with changes in fair value recognised in profit or loss.~~

IG56 In preparing its opening HKFRS statement of financial position, an entity applies the criteria in HKAS 39 and HKFRS 9 to identify on the basis of the facts and circumstances that exist at the date of transition to HKFRSs those financial assets and financial liabilities that are measured at fair value and those that are measured at amortised cost. The resulting classifications are applied retrospectively. ~~In particular:~~

~~(a) to comply with ...~~

...

~~(e) ... any of the previous categories.~~

IG58 An entity's estimates of ~~loan~~ impairments of financial assets measured at amortised cost at the date of transition to HKFRSs are consistent with estimates made for the same date …

IG58A An entity shall treat an adjustment to the carrying amount of a financial asset or financial liability as a transition adjustment to be recognised in the opening balance of retained earnings at the date of transition to HKFRSs only to the extent that it results from adopting HKAS 39 and HKFRS 9. Because all derivatives, other than those that are financial guarantee contracts or are designated and effective hedging instruments, are ~~classified as held for trading~~ measured at fair value through profit or loss, the differences between the previous carrying amount (which may have been zero) and the fair value of the derivatives are recognised as an adjustment of the balance of retained earnings at the beginning of the financial year in which HKAS 39 and HKFRS 9 are ~~is~~ initially applied (other than for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

IG59 An entity may, in accordance with its previous GAAP, have measured investments at fair value and recognised the revaluation gain outside profit or loss. If an investment is classified as at fair value through profit or loss, the pre-~~HKAS 39~~ HKFRS 9 revaluation gain that had been recognised outside profit or loss is reclassified into retained earnings on initial application of ~~HKAS 39~~ HKFRS 9. If, on initial application of ~~HKAS 39~~ HKFRS 9, an investment in an equity instrument is classified as ~~available for sale~~ at fair value through other comprehensive income, then the pre-~~HKAS 39~~ HKFRS 9 revaluation gain is recognised in a separate component of equity. Subsequently, the entity recognises gains and losses on the ~~available-for-sale~~ financial asset in other comprehensive income (except dividends, which are recognised in profit or loss) and accumulates the cumulative gains and losses in that separate component of equity. ~~until the investment is impaired, sold, collected or otherwise disposed of.~~ On subsequent derecognition ~~or impairment of the available-for-sale financial asset~~, the entity ~~reclassifies to profit or loss the cumulative gain or loss remaining in equity (HKAS 39 paragraph 55(b)).~~ may transfer that separate component of equity within equity.

IGA2 IG Example 11 in paragraph IG63 is amended as follows:

The table 'Reconciliation of equity at 1 January 20X4 (date of transition to HKFRSs)' is amended to read as follows:

Reconciliation of equity at 1 January 20X4 (date of transition to HKFRSs)

Note		*Previous GAAP*	*Effect of transition to HKFRSs*	*HKFRSs*
		CU	CU	CU
1	Property, plant and equipment	8,299	100	8,399
2	Goodwill	1,220	150	1,370
2	Intangible assets	208	(150)	58
3	Financial assets	3,471	420	3,891
	Total non-current assets	13,198	520	13,718
	Trade and other receivables	3,710	0	3,710
4	Inventories	2,962	400	3,362
5	Other receivables	333	431	764
	Cash and cash equivalents	748	0	748
	Total current assets	7,753	831	8,584
	Total assets	20,951	1,351	22,302
	Interest-bearing loans	9,396	0	9,396
	Trade and other payables	4,124	0	4,124
6	Employee benefits	0	66	66
7	Restructuring provision	250	(250)	0
	Current tax liability	42	0	42
8	Deferred tax liability	579	460	1,039
	Total liabilities	14,391	276	14,667
	Total assets less total liabilities	6,560	1,075	7,635
	Issued capital	1,500	0	1,500
5	Hedging reserve	0	302	302
9	Retained earnings	5,060	773	5,833
	Total equity	6,560	1,075	7,635

Note 3 to the reconciliation of equity at 1 January 20X4 is amended as follows:

3	Financial assets are all classified as ~~available for sale~~ at fair value through profit or loss in accordance with HKFRSs and are carried at their fair value of CU3,891. They were carried at cost of CU3,471 in accordance with previous GAAP. The resulting gains of CU294 (CU420, less related deferred tax of CU126) are included in ~~the revaluation surplus~~ retained earnings.

Note 9 to the reconciliation of equity at 1 January 20X4 is amended to read as follows:

9 The adjustments to retained earnings are as follows:

	CU
Depreciation (note 1)	100
Financial assets	420
Production overhead (note 4)	400
Pension liability (note 6)	(66)
Restructuring provision (note 7)	250
Tax effect of the above	(331)
Total adjustment to retained earnings	773

The reconciliation of total comprehensive income for 20X4 is amended to read as follows:

Reconciliation of total comprehensive income for 20X4

Note		*Previous GAAP*	*Effect of transition to HKFRSs*	*HKFRSs*
		CU	CU	CU
	Revenue	20,910	0	20,910
1, 2, 3	Cost of sales	(15,283)	(97)	(15,380)
	Gross profit	5,627	(97)	5,530
6	Other income	0	180	180
1	Distribution costs	(1,907)	(30)	(1,937)
1, 4	Administrative expenses	(2,842)	(300)	(3,142)
	Finance income	1,446	0	1,446
	Finance costs	(1,902)	0	(1,902)
	Profit before tax	422	(247)	175
5	Tax expense	(158)	74	(84)
	Profit (loss) for the year	264	(173)	91
7	Cash flow hedges	0	(40)	(40)
8	Tax relating to other comprehensive income	0	(29)	(29)
	Other comprehensive income	0	(69)	(69)
	Total comprehensive income	264	(242)	22

Note 6 to the reconciliation of total comprehensive income for 20X4 is amended as follows:

6	~~Available-for-sale f~~ Financial assets at fair value through profit or loss ~~carried at fair value in accordance with HKFRSs~~ increased in value by CU180 during 20X4. They were carried at cost in accordance with previous GAAP. ~~The entity sold available-for-sale financial assets during the year, recognising a gain of CU40 in profit or loss. Of that realised gain CU30 had been included in the revaluation surplus as at 1 January 20X4 and is reclassified from revaluation surplus to profit or loss (as a reclassification adjustment).~~

HKFRS 4 *Insurance Contracts*

IGA3 The guidance on implementing HKFRS 4 is amended as described below.

In the table in IG Example 1, the 'Treatment in Phase I' column of contract type 1.18 is amended as follows:

> Insurance risk is insignificant. Therefore, the contract is a financial ~~instrument~~ asset within the scope of ~~HKAS 39~~ HKFRS 9. Servicing fees are within the scope of HKAS 18 (recognise as services are provided, subject to various conditions).

IG Example 4 in paragraph IG10 is amended as follows:

IG Example 4: Shadow accounting
Background ... At the inception of a contract, insurer A has DAC of CU20 relating to that contract and the present value, at inception, of EGP is CU100. In other words, DAC is 20 per cent of EGP at inception. Thus, for each CU1 of realised gross profits, insurer A amortises DAC by CU0.20. For example, if insurer A sells assets and recognises a gain of CU10, insurer A amortises DAC by CU2 (20 per cent of CU10). Before adopting HKFRSs for the first time in 20X5, insurer A measured financial assets on a cost basis. (Therefore, EGP under those national requirements considers only realised gains and losses.) However, under HKFRSs, it classifies its financial assets as measured at fair value through profit or loss. ~~available for sale. Thus, insurer A measures the assets at fair value and recognises changes in their fair value in other comprehensive income. In 20X5, insurer A recognises unrealised gains of CU10 on the assets backing the contract.~~ ~~In 20X6, insurer A sells the assets for an amount equal to their fair value at the end of 20X5 and, to comply with HKAS 39, reclassifies the now-realised gain of CU10 from equity to profit or loss as a reclassification adjustment.~~ *Application of paragraph 30 of the HKFRS* ...

HKFRS 7 *Financial Instruments: Disclosures*

IGA4 In the guidance on implementing HKFRS 7, the table in paragraph IG13A is amended to read as follows:

Assets measured at fair value

		Fair value measurement at end of the reporting period using:		
		Level 1	**Level 2**	**Level 3**
Description	**31 Dec 20X2**	**CU million**	**CU million**	**CU million**
Financial assets at fair value through profit or loss				
Trading securities	100	40	55	5
Trading derivatives	39	17	20	2
Financial assets at fair value through other comprehensive income				
Equity investments	75	30	40	5
Total	214	87	115	12

(Note: For liabilities, a similar table might be presented.)

IGA5 The table in paragraph IG13B is amended to read as follows:

Assets measured at fair value based on Level 3				
	Financial value measurement at the end of the reporting period			
	Financial assets at fair value			**Total**
	Trading securities	Trading derivatives	Equity investments	
	CU million	CU million	CU million	CU million
Opening balance	6	5	3	14
Total gains or losses				
in profit or loss	(2)	(2)	-	(4)
in other comprehensive income	–	–	1	1
Purchases	1	2	1	4
Issues	–	–	–	–
Settlements	–	(1)	–	(1)
Transfers out of Level 3	–	(2)	–	(2)
Closing balance	5	2	5	12
Total gains or losses for the period included in profit or loss assets held at the end of the reporting period	(1)	(1)	-	(2)

Gains or losses included in profit or loss for the period (above) are presented in trading income and in other income as follows:

	Trading Income
Total gains or losses included in profit or loss for the period	(4)
Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period	(2)

(Note: For liabilities, a similar table might be presented.)

IGA6 Paragraph IG14 is amended as follows:

IG14 ... In these circumstances, the difference will be recognised in profit or loss in subsequent periods in accordance with HKAS 39 (for financial liabilities) or HKFRS 9 (for financial assets) and the entity's accounting policy. Such recognition ...

In the illustrative disclosure following paragraph IG14, the references to 'HKAS 39' are replaced with 'HKFRS 9'.

IGA7 Paragraph IG36 is amended as follows:

IG36 The following example illustrates the application of the disclosure requirement in paragraph 40(a):

Interest rate risk

At 31 December 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, post-tax profit for the year would have been CU1.7 million (20X1—CU2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings~~, and other comprehensive income would have been CU2.8 million (20X1—CU3.2 million) higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as available for sale~~. If interest rates had been 10 basis points higher, with all other variables held constant, post-tax profit would have been CU1.5 million (20X1—CU2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings~~, and other comprehensive income would have been CU3.0 million (20X1—CU3.4 million) lower, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as available for sale~~. Profit is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X). [footnote omitted] ...

HKAS 1 *Presentation of Financial Statements*

IGA8 In the guidance on implementing HKAS 1, the heading above paragraph IG7 and paragraphs IG7–IG9 are deleted. Paragraph IG2 is amended as follows:

IG2 The guidance is in ~~three~~ two sections. Paragraphs IG3–IG6 provide examples of the presentation of financial statements. Paragraphs IG7–IG9 have been deleted. ~~provide an example of the determination of reclassification adjustments for available-for-sale financial assets in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*.~~ Paragraphs IG10 and IG11 provide examples of capital disclosures.

IGA9 In the illustrative financial statements, references to 'Available-for-sale financial assets' are replaced by 'Investments in equity instruments'. The heading and table 'Disclosure of components of other comprehensive income' are amended to read as follows:

Part I: Illustrative presentation of financial statements

Disclosure of components of other comprehensive income
[footnote omitted]

Notes

Year ended 31 December 20X7
(in thousands of currency units)

		20X7		**20X6**
Other comprehensive income:				
Exchange differences on translating foreign operations		5,334		10,667
Investments in equity instruments		(24,000)		26,667
Cash flow hedges:				
Gains (losses) arising during the year	(4,667)		(4,000)	
Less: Reclassification adjustments for gains (losses) included in profit or loss	3,333		–	
Less: Adjustments for amounts transferred to initial carrying amount of hedged items	667	(667)	–	(4,000)
Gains on property revaluation		933		3,367
Actuarial gains (losses) on defined benefit pension plans		(667)		1,333
Share of other comprehensive income of associates		400		(700)
Other comprehensive income		(18,667)		37,334
Income tax relating to components of other comprehensive income		4,667		(9,334)
Other comprehensive income for the year		**(14,000)**		**28,000**

IGA10 Footnote (b) is deleted and the second paragraph in footnote (k) to the illustrative financial statements is amended as follows:

(k) The amount included in the translation, investments in equity instruments ~~available-for-sale~~ and cash flow hedge reserves represent other comprehensive income for each component, net of tax and non-controlling interests, eg other comprehensive income related to investments in equity instruments ~~available-for-sale financial assets~~ for 20X6 of 16,000 is 26,667, less tax 6,667, less non-controlling interests 4,000.

IGA11 The second paragraph in footnote (l) to the illustrative financial statements is amended as follows:

(l) The amount included in the translation, investment in equity instruments ~~available-for-sale~~ and cash flow hedge reserves represent other comprehensive income for each component, net of tax and non-controlling interests, eg other comprehensive income related to the translation of foreign operations for 20X7 of 3,200 is 5,334, less tax 1,334, less non-controlling interests 800.

HKAS 18 *Revenue*

IGA12 In the appendix to HKAS 18, examples 5 and 14(a) are amended as follows:

5 ...

For a sale and repurchase agreement on an asset other than a financial asset, the terms of the agreement need to be analysed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer and hence revenue is recognised. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue. For a sale and repurchase agreement on a financial asset, HKFRS 9 *Financial Instruments* and HKAS 39 *Financial Instruments: Recognition and Measurement* apply ~~applies~~.

14 *Financial service fees*

...

(a) *Fees that are an integral part of the effective interest rate of a financial instrument.*

...

(i) *Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under HKFRS 9 ~~HKAS 39~~ is measured ~~classified~~ ~~as a financial asset~~ ~~‘~~at fair value through profit or loss~~’~~.*

Such fees may include compensation for activities such as evaluating the borrower’s financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related transaction costs [footnote omitted] (as defined in HKAS 39), are deferred and recognised as an adjustment to the effective interest rate.

...

HKAS 27 *Consolidated and Separate Financial Statements*

IGA13 In the guidance on implementing HKAS 27 *Consolidated and Separate Financial Statements*, HKAS 28 *Investments in Associates*, and HKAS 31 *Interests in Joint Ventures*, paragraph IG7 is amended as follows:

IG7 HKAS 39 *Financial Instruments: Recognition and Measurement* and HKFRS 9 *Financial Instruments* do~~es~~ not apply to interests in subsidiaries, associates and jointly controlled entities that are consolidated, accounted for using the equity method or proportionately consolidated in accordance with HKAS 27, HKAS 28 and

HKAS 31 respectively. When instruments containing potential voting rights in substance currently give access to the economic benefits associated with an ownership interest, and the investment is accounted for in one of the above ways, the instruments are not subject to the requirements of HKAS 39 <u>and HKFRS 9</u>. In all other cases, instruments containing potential voting rights are accounted for in accordance with HKAS 39 <u>and HKFRS 9</u>.

HKAS 39 *Financial Instruments: Recognition and Measurement*

IGA14 In the guidance on implementing HKAS 39 the following Questions and Answers (Q&A) are deleted:

- Section B Definitions: B.12–B.23
- Section C Embedded Derivatives: C.3, C.5, C.11
- Section E Measurement: E.3.1, E.3.2, E.4.9, E.4.10
- Section F Hedged items: F.1.1, F.1.10, F.2.9–F.2.11, F.2.19, F.2.20

IGA15 In the answer to Question B.4, the last paragraph is amended as follows:

If the fixed leg is prepaid during the term, that would be regarded as a termination of the old swap and an origination of a new instrument that is evaluated under HKAS 39 <u>and HKFRS 9</u>.

IGA16 In the answer to Question B.5, the reference to 'HKAS 39' in the second last sentence is replaced with 'HKAS 39 or HKFRS 9'.

IGA17 Question B.26 is amended as follows:

~~Financial assets that are excluded from fair valuation and have a fixed maturity should be measured at amortised cost.~~ How is amortised cost calculated <u>for financial assets measured at amortised cost in accordance with HKFRS 9</u>?

IGA18 In Q&As C.1 and C.2, references to 'hybrid instrument' are replaced with 'hybrid contract'.

IGA19 Q&A C.6 is amended as follows:

Entity A <u>issues</u> ~~acquires~~ a five-year floating rate debt instrument ~~issued by Entity B~~. At the same time, it enters into a five-year pay-<u>fixed</u> ~~variable~~, receive-<u>variable</u> ~~fixed~~ interest rate swap with Entity <u>B</u>~~C~~. Entity A regards the combination of the debt instrument and swap as a synthetic fixed rate instrument ~~and classifies the instrument as a held-to-maturity investment, since it has the positive intention and ability to hold it to maturity~~. Entity A contends that separate accounting for the swap is inappropriate since HKAS 39.AG33(a) requires an embedded derivative to be classified together with its host instrument if the derivative is linked to an interest rate that can change the amount of interest that would otherwise be paid or received on the host debt contract. Is the entity's analysis correct?

No. Embedded derivative instruments are terms and conditions that are included in non-derivative host contracts. It is generally inappropriate to treat two or more separate financial instruments as a single combined instrument ('synthetic instrument' accounting) for the purpose of applying HKAS 39 <u>or HKFRS 9</u>. Each of the financial instruments has its own terms and conditions and each may be transferred or settled separately. Therefore, the debt instrument and the swap are classified separately. The transactions described here differ from the transactions discussed in Question B.6, which had no substance apart from the resulting interest rate swap.

IGA20 In Q&A C.10, references to 'combined instrument' are replaced with 'combined contract'.

IGA21 The tables in Q&A D.2.1 are amended to read as follows:

Settlement date accounting			
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value with changes presented in other comprehensive income**	**Financial assets measured at fair value through profit or loss**
29 December 20X1			
Financial asset	–	–	–
Financial liability	–	–	–
31 December 20X1			
Receivable	–	2	2
Financial asset	–	–	–
Financial liability	–	–	–
Other comprehensive income (fair value adjustment)	–	(2)	–
Retained earnings (through profit or loss)	–	–	(2)
4 January 20X2			
Receivable	–	–	–
Financial asset	1,000	1,003	1,003
Financial liability	–	–	–
Other comprehensive income (fair value adjustment)	–	(3)	–
Retained earnings (through profit or loss)	–	–	(3)

Settlement date accounting			
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value with changes presented in other comprehensive income**	**Financial assets measured at fair value through profit or loss**
29 December 20X1			
Financial asset	1,000	1,000	1,000
Financial liability	(1,000)	(1,000)	(1,000)
31 December 20X1			
Receivable	–	–	–
Financial asset	1,000	1,002	1,002
Financial liability	(1,000)	(1,000)	(1,000)
Other comprehensive income (fair value adjustment)	–	(2)	–
Retained earnings (through profit or loss)	–	–	(2)
4 January 20X2			
Receivable	–	–	–
Financial asset	1,000	1,003	1,003
Financial liability	–	–	–
Other comprehensive income (fair value adjustment)	–	(3)	–
Retained earnings (through profit or loss)	–	–	(3)

IGA22 The tables in Q&A D.2.2 are amended to read as follows:

Settlement date accounting		
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value through profit or loss**
29 December 20X2		
Receivable	–	–
Financial asset	1,000	1,010
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	–	10
31 December 20X2		
Receivable	–	–
Financial asset	1,000	1,000
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	–	10
4 January 20X3		
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10

Trade date accounting		
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value through profit or loss**
29 December 20X2		
Receivable	1,010	1,010
Financial asset	–	–
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10
31 December 20X2		
Receivable	1,010	1,010
Financial asset	–	–
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10
4 January 20X3		
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10

IGA23 In the answer to Question D.2.3, the second paragraph is amended as follows:

To illustrate: on 29 December 20X2 (trade date) Entity A enters into a contract to sell Note Receivable A, which is ~~carried~~ measured at amortised cost, in exchange for Bond B, which meets the definition of ~~will be classified as~~ held for trading and is measured at fair value. Both assets have a fair value of CU1,010 on 29 December, while the amortised cost of Note Receivable A is CU1,000. Entity A uses settlement date accounting for ~~loans and receivables~~ financial assets measured at amortised cost and trade date accounting for assets that meet the definition of held for trading. On 31 December 20X2 (financial year-end), the fair value of Note Receivable A is CU1,012 and the fair value of Bond B is CU1,009. On 4 January 20X3, the fair value of Note Receivable A is CU1,013 and the fair value of Bond B is CU1,007. The following entries are made:

…

IGA24 The answer to Question E.1.1 is amended as follows:

For financial assets not measured at fair value through profit or loss, ~~incremental costs that are directly attributable to the acquisition of the asset, for example fees and commissions,~~ transaction costs are added to the fair value at initial recognition ~~amount originally recognised~~. For financial liabilities, transaction costs are deducted from the fair value at initial recognition. ~~directly related costs of issuing debt are deducted from the amount of debt originally recognised. For financial instruments that are measured at fair value through profit or loss, transaction costs are not added to the fair value measurement at initial recognition.~~

For financial instruments that are ~~carried~~ measured at amortised cost, ~~such as held-to-maturity investments, loans and receivables, and financial liabilities that are not at fair value through profit or loss,~~ transaction costs are subsequently included in the calculation of amortised cost using the effective interest method and, in effect, amortised through profit or loss over the life of the instrument.

~~For available-for-sale financial assets, transaction costs are recognised in other comprehensive income as part of a change in fair value at the next remeasurement. If an available-for-sale financial asset has fixed or determinable payments and does not have an indefinite life, the transaction costs are amortised to profit or loss using the effective interest method. If an available-for-sale financial asset does not have fixed or determinable payments and has an indefinite life, the transaction costs are recognised in profit or loss when the asset is derecognised or becomes impaired.~~

Transaction costs expected to be incurred on transfer or disposal of a financial instrument are not included in the measurement of the financial instrument.

IGA25 Q&A E.3.3 is amended as follows:

HKAS 21.32 and HKAS 21.48 states that all exchange differences resulting from translating the financial statements of a foreign operation should be recognised in other comprehensive income until disposal of the net investment. This would include exchange differences arising from financial instruments carried at fair value, which would include ~~both~~ financial assets ~~classified as~~ measured at fair value through profit or loss in accordance with HKFRS 9 *Financial Instruments* ~~and financial assets that are available for sale~~.

~~**HKAS 39.55 requires that changes in fair value of financial assets classified as at fair value through profit or loss should be recognised in profit or loss and changes in fair value of available-for-sale investments should be recognised in other comprehensive income.**~~

If the foreign operation is a subsidiary whose financial statements are consolidated with those of its parent, in the consolidated financial statements how are ~~HKAS 39.55~~ HKFRS 9 and HKAS 21.39 applied?

~~HKAS 39~~ HKFRS 9 applies in the accounting for financial instruments in the financial statements of a foreign operation and HKAS 21 applies in translating the financial statements of a foreign operation for incorporation in the financial statements of the reporting entity.

To illustrate: Entity A is domiciled in Country X and its functional currency and presentation currency are the local currency of Country X (LCX). A has a foreign subsidiary (Entity B) in Country Y whose functional currency is the local currency of Country Y (LCY). B is the owner of a debt instrument, which ~~is~~ meets the definition of held for trading and is therefore measured ~~carried~~ at fair value ~~under HKAS 39~~.

...

IGA26 Q&A E.3.4 is amended as follows:

E.3.4 HKFRS 9, HKAS 39 and HKAS 21 Interaction between HKFRS 9, HKAS 39 and HKAS 21

HKFRS 9 and HKAS 39 include~~s~~ requirements about the measurement of financial assets and financial liabilities and the recognition of gains and losses on remeasurement in profit or loss. HKAS 21 includes rules about the reporting of foreign currency items and the recognition of exchange differences in profit or loss. In what order are HKAS 21, ~~and~~ HKFRS 9 and HKAS 39 applied?

Statement of financial position

Generally, the measurement of a financial asset or financial liability at fair value, cost or amortised cost is first determined in the foreign currency in which the item is denominated in accordance with HKFRS 9 and HKAS 39. Then, the foreign currency amount is translated into the functional currency using the closing rate or a historical rate in accordance with HKAS 21 (HKAS 39.AG83). For example, if a monetary financial asset (such as a debt instrument) is measured ~~carried~~ at amortised cost in accordance with HKFRS 9 ~~under HKAS 39~~, amortised cost is calculated in the currency of denomination of that financial asset. Then, the foreign currency amount is recognised using the closing rate in the entity's financial statements (HKAS 21.23). That applies regardless of whether a monetary item is measured at cost, amortised cost or fair value in the foreign currency (HKAS 21.24). A non-monetary financial asset (such as an investment in an equity instrument) is translated using the closing rate if it is ~~carried~~ measured at fair value in the foreign currency (HKAS 21.23(c)) ~~and at a historical rate if it is not carried at fair value under HKAS 39 because its fair value cannot be reliably measured (HKAS 21.23(b) and HKAS 39.46(c))~~.

...

Profit or loss

...

Any exchange difference arising on recognising a *monetary item* at a rate different from that at which it was initially recognised during the period, or recognised in previous financial statements, is recognised in profit or loss or in other comprehensive income in accordance with HKAS 21 (HKAS 39.AG83, HKAS 21.28 and HKAS 21.32), unless the monetary item is designated as a cash flow hedge of a highly probable forecast transaction in foreign currency, in which case the requirements for recognition of gains and losses on cash flow hedges in HKAS 39 apply (HKAS 39.95). Differences arising from recognising a monetary item at a foreign currency amount different from that at which it was previously recognised are accounted for in a similar manner, since all changes in the carrying amount relating to foreign currency movements should be treated consistently. All other changes in the statement of financial position measurement of a monetary item are recognised in profit or loss or in other comprehensive income in accordance with HKFRS 9 or HKAS 39. ~~For example, although an entity recognises gains and losses on available-for-sale monetary financial assets in other comprehensive income (HKAS 39.55(b)), the entity nevertheless recognises the changes in the carrying amount relating to changes in foreign exchange rates in profit or loss (HKAS 21.23(a)).~~

Any changes in the carrying amount of a *non-monetary item* are recognised in profit or loss or in other comprehensive income in accordance with HKFRS 9 or HKAS 39 (HKAS 39.AG83). ~~For example, for available-for-sale financial assets the entire change in the carrying amount, including the effect of changes in foreign currency rates, is recognised in other comprehensive income.~~ If the non-monetary item is designated as a cash flow hedge of an unrecognised firm commitment or a highly probable forecast transaction in foreign currency, the requirements for recognition of gains and losses on cash flow hedges in HKAS 39 apply (HKAS 39.95).

When some portion of the change in carrying amount is recognised in other comprehensive income and some portion is recognised in profit or loss, ~~for example, if the amortised cost of a foreign currency bond classified as available for sale has increased in foreign currency (resulting in a gain in profit or loss) but its fair value has decreased in the functional currency (resulting in a loss recognised in other comprehensive income),~~ an entity cannot offset those two components for the purposes of determining gains or losses that should be recognised in profit or loss or in other comprehensive income.

IGA27 The answer to Question E.4.2 is amended as follows:

No. ~~HKAS 39.43~~ Paragraph 5.1 of HKFRS 9 requires a financial asset to be initially measured at fair value. For a loan asset, the fair value is the amount of cash lent adjusted for any fees and costs (unless a portion of the amount lent is compensation for other stated or implied rights or privileges). In addition, paragraph 5.2.2 of HKFRS 9 requires an entity to apply the impairment requirements in HKAS 39. HKAS 39.58 requires that an impairment loss is recognised only if there is objective evidence of impairment as a result of a past event that occurred after initial recognition. Accordingly, it is inconsistent with ~~HKAS 39.43~~ paragraph 5.1 of HKFRS 9 and HKAS 39.58 to reduce the carrying amount of a loan asset on initial recognition through the recognition of an immediate impairment loss.

IGA28 Question E.4.5 is amended as follows:

A financial institution calculates impairment in the unsecured portion of ~~loans and receivables~~ financial assets measured at amortised cost on the basis of a provision matrix that specifies fixed provision rates for the number of days a ~~loan~~ financial asset has been classified as non-performing (zero per cent if less than 90 days, 20 per cent if 90–180 days, 50 per cent if 181–365 days and 100 per cent if more than 365 days).

Can the results be considered to be appropriate for the purpose of calculating the impairment loss on the financial assets measured at amortised cost ~~loans and receivables~~ under HKAS 39.63?

IGA29 The last sentence of the answer to Question F.1.4 is deleted.

IGA30 The answer to Question F.2.1 is amended as follows:

No. Derivative instruments ~~are~~ always meet the definition of ~~deemed~~ held for trading and are measured at fair value with gains and losses recognised in profit or loss unless they are designated and effective hedging instruments (HKAS 39.9 and HKFRS 9 paragraphs 4.1–4.5, 5.4.1 and 5.4.3). As an exception, HKAS 39.AG94 permits the designation of a purchased option as the hedged item in a fair value hedge.

IGA31 The answer to Question F.2.5 is amended as follows:

Yes. A derivative instrument that will be settled gross can be designated as the hedging instrument in a cash flow hedge of the variability of the consideration to be paid or received in the future transaction that will occur on gross settlement of the derivative contract itself because there would be an exposure to variability in the purchase or sale price without the derivative. This applies to all fixed price contracts that are accounted for as derivatives under HKAS 39 and HKFRS 9.

For example, if an entity enters into a fixed price contract to sell a commodity and that contract is accounted for as a derivative under HKAS 39 and HKFRS 9 (for example, because the entity has a practice of settling such contracts net in cash or of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin), the entity may designate the fixed price contract as a cash flow hedge of the variability of the consideration to be received on the sale of the asset (a future transaction) even though the fixed price contract is the contract under which the asset will be sold. Also, …

IGA32 Q&A F.2.13 is amended as follows:

Is fair value hedge accounting permitted for exposure to interest rate risk in fixed rate loans that are ~~classified as loans and receivables~~ measured at amortised cost?

Yes. Under HKFRS 9, ~~HKAS 39, loans and receivables~~ some fixed rate loans are ~~carried~~ measured at amortised cost. Banking institutions in many countries hold the bulk of their fixed rate loans to collect their contractual cash flows ~~and receivables until maturity~~. Thus, changes in the fair value of such fixed rate loans ~~and receivables~~ that are due to changes in market interest rates will not affect profit or loss. HKAS 39.86 specifies that a fair value hedge is a hedge of the exposure to changes in fair value that is attributable to a particular risk and that can affect profit or loss. Therefore, HKAS 39.86 may appear to preclude fair value hedge accounting for fixed rate loans ~~and receivables~~. However, ~~it follows from HKAS 39.79 that loans and receivables can be hedged items with respect to interest rate risk since they are not designated as held-to-maturity investments. T~~the entity could sell them and the change in fair values would affect profit or loss. Thus, fair value hedge accounting is permitted for fixed rate loans ~~and receivables~~.

IGA33 The last paragraph of the answer to Question F.2.17 is amended as follows:

To illustrate: Entity A acquires a 10 per cent fixed rate government bond with a remaining term to maturity of ten years. Entity A classifies the bond as ~~available for sale~~ measured at amortised cost. To hedge itself against fair value exposure on the bond associated with the present value of the interest rate payments until year 5, Entity A acquires a five-year pay-fixed, receive-floating swap. …

IGA34 In the answer to Question F.5.6, references to 'HKAS 39.55(a)' are replaced with 'HKAS 39.55'.

IGA35 In the answer to Question F.6.4, the reference to 'HKAS 39' in the second sentence is amended to 'HKAS 39 or HKFRS 9'.

IGA36 Q&A G.1 is amended as follows:

HKAS 39 and HKFRS 9 requires ~~financial assets classified as available for sale (AFS) and~~ remeasurement of financial assets and financial liabilities measured at fair value ~~through profit or loss to be remeasured to fair value~~. Unless a financial asset or a financial liability is designated as a cash flow hedging instrument, fair value changes for financial assets and financial liabilities at fair value through profit or loss are recognised in profit or loss, and fair value changes for ~~AFS assets~~ financial assets designated at fair value through other comprehensive income are recognised in other comprehensive income. What disclosures are required regarding the amounts of the fair value changes during a reporting period?

HKFRS 7.20 requires items of income, expense and gains and losses to be disclosed. This disclosure requirement encompasses items of income, expense and gains and losses that arise on remeasurement to fair value. Therefore, an entity provides disclosures of fair value changes, distinguishing between changes that are recognised in profit or loss and changes that are recognised in other comprehensive income. Further breakdown is provided of changes that relate to:

~~(a)~~ ~~AFS assets, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount that was reclassified from equity to profit or loss for the period as a reclassification adjustment;~~

(~~b~~a) financial assets or financial liabilities at fair value through profit or loss, showing separately those fair value changes on financial assets or financial liabilities (i) designated as such upon initial recognition and (ii) mandatorily classified as such ~~held for trading~~ in accordance with ~~HKAS 39~~ HKFRS 9; and

(~~c~~b) hedging instruments.

In addition, HKFRS 7.20A requires an entity to disclose the amount of gain or loss recognised in other comprehensive income for financial assets measured at fair value through other comprehensive income, including any amount transferred within equity.

HKFRS 7 neither requires nor prohibits disclosure of components of the change in fair value by the way items are classified for internal purposes. For example, an entity may choose to disclose separately the change in fair value of those derivatives that ~~in accordance with~~ meet the definition of held for trading in HKAS 39 ~~it categorises as held for trading~~, but the entity classifies as part of risk management activities outside the trading portfolio.

In addition, HKFRS 7.8 requires disclosure of the carrying amounts of financial assets or financial liabilities at fair value through profit or loss, showing separately: (i) those designated as such upon initial recognition and (ii) those mandatorily classified as such ~~held for trading~~ in accordance with HKAS 39 and HKFRS 9.

HK(IFRIC)-Int 12 *Service Concession Arrangements*

IGA37 In the illustrative examples accompanying HK(IFRIC)-Int 12, paragraphs IE7 and IE28 are amended as follows:

IE7 HKFRS 9 *Financial Instruments* may require the entity to measure the ~~The~~ amounts due from the grantor at amortised cost, unless the entity designates those amounts as measured at fair value through profit or loss ~~meet the definition of a receivable in HKAS 39 *Financial Instruments: Recognition and Measurement*~~. If the ~~The~~ receivable is measured at amortised cost in accordance with HKFRS 9, it is measured initially at fair value and~~. It is~~ subsequently ~~measured~~ at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount calculated using the effective interest method minus repayments.

IE28 HKFRS 9 Financial Instruments may require the entity to measure the ~~The~~ amount due from or at the direction of the grantor in exchange for the construction services at amortised cost ~~meets the definition of a receivable in HKAS 39 Financial Instruments: Recognition and Measurement~~. If the ~~The~~ receivable is measured at amortised cost in accordance with HKFRS 9, it is measured initially at fair value and~~. It is~~ subsequently ~~measured~~ at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount minus repayments.