

IFRS 9 Financial Instruments: Classification and Measurement

The International Accounting Standards Board (IASB) published on 12 November 2009 the new IFRS 9 Financial Instruments: Classification and Measurement. The IASB intends to publish IFRS 9, that will ultimately replace IAS 39, in its entirety by the end of 2010. The project to replace IAS 39 has been divided in three phases and a separate project on derecognition of financial instruments. Excluded from the current standard is also the classification and measurement of financial liabilities as the IASB decided not to finalise the requirements for financial liabilities before considering the issues relating to recognising changes in an entity's own credit risk in the remeasurement of financial liabilities.

The main feature of IFRS 9 is that it emphasizes the entity's business model when classifying financial assets. Accordingly, the business model and the characteristics of the contractual cash flows of the financial asset determine whether the financial asset is subsequently measured at amortised cost or fair value.

The effect the new IFRS 9 will have on the financial reporting of investment funds, hedge funds, private equity funds, real estate funds or other alternative funds is expected to vary significantly depending on the fund's investment objectives.

- Entities that manage their investments and monitor performance on a fair value basis will continue to fair value their financial assets with gains and losses recognised in profit or loss as their business model is not considered to manage the investment portfolio to collect the contractual cash flows.
- Entities that classify their investments as loans and receivables need to carefully assess whether their business model is that of managing the investment portfolio to collect the contractual cash flows from the financial assets. To meet that objective the entity does not need to hold all of its investments until maturity, but there are limits to what sales do not contradict the objective.
- Entities that have made use of the cost exception in IAS 39.46(c) for their unquoted equity investments may continue to use cost only if this is an appropriate estimate of fair value. The use of cost as the best estimate of fair value within a range of possible fair value measurements is limited to cases when insufficient more recent information is available to determine the fair value. The scenarios in which cost would be an appropriate estimate of fair value are limited. Significant changes e.g. in the

performance of the investment compared with budgets, plans or milestones or in the performance of comparable entities respective in the valuations applied to the overall market would prevent the entity from using cost as the best estimate of fair value.

- Entities that classify their financial assets as available-for-sale and plan to make use of the "OCI-Option" should be aware that the OCI-Option is only available for equity investments on an instrument-by-instrument basis and will irrevocably prevent the entity from recycling gains and losses through profit or loss.

IFRS 9, which shall be applied retrospectively, is mandatory for all annual periods beginning on or after 1 January 2013. An entity is permitted to early adopt the standard. The extensive transitional requirements may have different effects on the financial reporting and the performance of the entity depending on the date of initial application and the facts and circumstances that exist at the date of initial application. An entity shall take those effects into account when deciding on when to apply IFRS 9 for the first time.

As IFRS 9 is only the first part of the project to replace IAS 39 interested parties should lookout for

- **Phase 2: Impairment methodology:** The ED Financial Instruments: Amortised Cost and Impairment has been published in November 2009 with a comment period to the end of 30 June 2010.
- **Phase 3: Hedge accounting:** The IASB started to consider how to improve and simplify hedge accounting and expects to publish an exposure draft later in 2009.

For more information on the new requirements and on how PricewaterhouseCoopers can help your company make the change to IFRS 9, please contact your local Asset Management Industry IFRS Champion:

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