# IFRS 9 Financial Instruments: Classification, Impairment & More

IFRS 9 Financial Instruments is an international accounting standard specifying terms for classifying and measuring financial instruments for impairment and hedging. The principles are based on a forward-looking concept, especially in line with the expected credit loss model introduced by IFRS 9. This replaces IAS 39 and is intended to promote transparency and uniformity in financial reporting concerning how companies recognize their monetary assets and liabilities. The IFRS 9 impairment framework will also make possible early recognition of potential credit losses. This article covers all niches and aspects of IFRS 9, such as IFRS 9 classification and measurement, IFRS 9 hedging, IFRS 9 provisioning, and IFRS 9 disclosure requirements.

IFRS 9 Financial Instruments explains how classification and measurement for financial instruments work. It is the new way IFRS has been introduced to classify and measure financial instruments. Financial instruments classified differ in their accounting for financial statement purposes, affecting balance sheets and income statements. Assessment of the financial assets would depend on the business model and contractual cash flow characteristics. Classification would also determine whether the financial instrument would be measured applying IFRS 9 fair value or amortized cost.

Classification of Financial Instruments

IFRS 9 divides financial assets into three categories:

- **Amortised Cost** - If the asset is held within a business model that aims to collect contractual cash flows, which consist solely of principal and interest, it is measured at amortised cost.
- **Fair Value Through Other Comprehensive Income (FVOCI)** - If the asset meets the contractual cash flow criteria but is held in a business model where the company also sells financial assets, it is measured at FVOCI.
- **Fair Value Through Profit or Loss (FVTPL)** - If the asset does not meet the above criteria, it must be measured at fair value through profit or loss.

Measurement of Financial Instruments

That classification is clear and straightforward. It is a bit of a simplification from the old standard IAS 39. Measurement of financial instruments according to IFRS 9 is dependent on the classification:

- **Amortized Cost** - The financial asset is measured at the initial measurement of fair value plus transaction costs and subsequently measured using the effective interest method.
- **FVOCI -** These assets are measured at fair value; unrealized gains or losses are recorded in other comprehensive income until disposed of.
- **FVTPL -** The assets are measured at their fair value, which recognition of profit or loss from changes in fair value occurs.

Key Principles and Application of the IFRS 9

IFRS 9 includes the requirement for earlier recognition of credit losses as compared to IAS 39 in the new IFRS 9 expected credit loss (ECL) model. The idea is to provide a better picture of credit risk. There is a three-stage approach to expected credit loss. The three-stage approach is:

- **Stage 1- Financial Instruments are recognised:** When the financial instrument is recognised, it mainly attends to 12-month expected credit loss estimates over the next 12 months, which has to be done by the entity.
- **Stage 2-Lifetime expected credit:** Leaving lifetime expected credit is where it goes to stage 2 when there is a significant increase in credit risk. Such lifetime expected credit losses have to be recognized by the companies.
- **Stage 3-Assets Have become Credit Impaired:** Thus, continue recognising lifetime expected credit losses; interest revenue based on the net carrying amount must also be calculated when the financial instrument becomes credit-impaired.

Practical Implementation of the Expected Credit Loss Model

All relevant, reasonable, and supportable information, including historical and forward-looking information, should be used to estimate credit losses. This ensures that the risks are immediately reflected in the financial statements rather than waiting until they materialize in credit losses. This is more directed toward banking and financial institutions that rigorously apply the model and ensure that they make adequate provisions of their loans as bad loans. Thus, IFRS 9 provisioning systems build the economic stability of an economy from unexpected shocks.

IFRS 9 Impairment: How It Affects Financial Reporting?

As per the ECL model, IFRS 9 impairment rules are very early in recognising credit loss. Before, under IAS 39, the actual credit loss was proven, and only the impairment was recognized. However, with IFRS 9, the recognition would have come earlier by the expectation of loss, not the actual loss recognized.

Significant Features of IFRS 9 Impairment Model

- **Expected Loss vs. Incurred Loss** - These are forward-looking estimates and are not waiting for the occurrence of a credit event.
- **Provisioning Based on Credit Deterioration** - Entities shall keep track of their financial instruments and update provisioning in line with risk changes.
- **Simplified Approach for Trade Receivables** - All trade receivables would be lifetime expected loss measured under a simplified approach.

This model tends to lessen the element's financial volatility while impairments align with the changes in the economy.

IFRS 9: Effective Risk Management

Hedging in IFRS 9 is more principles-based, enabling greater congruence between the company's risk management strategies and hedge accounting. The new model reduces the incidence of accounting activities being out of sync with economic hedge management activities.

The Salient Features of IFRS 9 Hedging

- **Flexibility** – IFRS 9 has much more flexibility with instruments qualifying for hedge accounting, beginning with options and ending with non-derivative financial assets.
- **Risk Component Enhanced Hedging** – Risk components may now be the focus of hedges versus whole exposures.
- **Easier Harm Thresholds** – Testing for hedge effectiveness will be less rigid to enable better alignment with the risk management strategy.

These changes alter reporting integrity toward a more accurate reflection of risk management.

IFRS 9 versus IFRS 15

While IFRS 9 deals with all financial instruments, IFRS 15 concerns contracts covering revenue recognition. Comparing IFRS 9 and 15 clarifies the financial reporting for the business organizations concerned.

| **Aspect** | **IFRS 9 Financial Instruments** | **IFRS 15 Revenue from Contracts with Customers** |
|---|---|---|
| Scope | Applies to financial instruments | This applies to revenue recognition |
| Measurement | Based on fair value and amortized cost | Based on performance obligations |
| Loss Recognition | Uses expected credit loss model | Recognizes revenue when control transfers |
| Impact on Companies | Affects banks and financial institutions | Affects businesses with long-term contracts |

Both standards play a crucial role in financial reporting, but they address different aspects of accounting.

IFRS 9 Financial Assets: Its Recognition and Measurement

IFRS 9 financial assets are recognized based on two parameters, namely business models and contractual cash flows. The classification also determines the accounting policies applicable to these assets in financial statements.

Recognition of Financial Assets

Companies recognize a financial asset once it enters into a contract. This includes

- Trade Receivables
- Loans and Advance
- Debt and Equity Instruments

Measurement of Financial Assets

Financial assets are measured at amortized cost, at fair value through other comprehensive income (FVOCI), or at fair value through profit or loss (FVTPL), as per their classification. The proper recognition creates a clear picture of the financial assets in the financial statements, thereby addressing the needs of all stakeholders in assessing financial health.

IFRS 9 Fair Value

With IFRS 9, the fair value measurements ensure that financial instruments are accurately valued. The fair value is the price received to sell an asset in an orderly transaction between market participants at the measurement date.

Measurement of Fair Value Under IFRS 9

- **Market-Based Valuation:** Uses active market prices when available.
- **Comparable Analysis:** Estimates the fair value of an instrument based on other similar instruments.

- **Discounted Cash Flow Method:** Calculates the fair value of an instrument based on present values of expected future cash flows.

The market confidence and financial transparency add up with accurate fair value measurement.

IFRS 9 Disclosure Requirements

Sections on disclosures of financial instruments in IFRS 9 dictate that all adequate and transparent information should be provided in financial statements.

Key Disclosure Requirements

- **Credit Risk:** Companies must disclose policies for managing and exercising credit risk.
- **Fair Value Measurements:** Companies' comprehensive disclosure should be made for fair value calculations.
- **Impairment:** Companies must disclose their expected credit loss estimates and their effects on financial statements.

These disclosures serve to protect investors from misrepresentation and enhance the level of financial accountability.

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Relevance to ACCA Syllabus

IFRS 9 Financial Instruments is crucial to the ACCA syllabus, particularly within the Financial Reporting (FR) and Strategic Business Reporting (SBR) exams. ACCA students must understand how financial instruments are classified, measured, and reported in financial statements. IFRS 9 is key in ensuring accurate recognition of financial assets and liabilities, which is essential for decision-making and risk assessment. The knowledge of IFRS 9 also supports preparing consolidated financial statements and interpreting complex financial data.

**IFRS 9 Financial Instruments ACCA Questions**

**Q1: Under IFRS 9, how are financial assets classified?**
A) Amortized Cost, Fair Value Through Profit or Loss (FVTPL), and Fair Value Through Other Comprehensive Income (FVOCI)
B) Current and Non-Current Assets
C) Revenue and Non-Revenue Assets
D) Tangible and Intangible Assets

**Ans:** A) Amortized Cost, Fair Value Through Profit or Loss (FVTPL), and Fair Value Through Other Comprehensive Income (FVOCI)

**Q2: What is the key principle of the IFRS 9 Expected Credit Loss (ECL) model?**
A) Recognizing credit losses only when they occur
B) Recognizing expected credit losses over the lifetime of the asset
C) Writing off bad debts immediately
D) Not recognizing any credit losses until a default occurs

**Ans:** B) Recognizing expected credit losses over the lifetime of the asset

**Q3: Which of the following is NOT considered a financial instrument under IFRS 9?**
A) Trade receivables
B) Loans and advances
C) Inventory
D) Bonds

**Ans:** C) Inventory

**Q4: How does IFRS 9 classify financial liabilities?**
A) Fair Value Through Profit or Loss (FVTPL) and Amortized Cost
B) Current and Non-Current Liabilities
C) Tangible and Intangible Liabilities
D) Capital and Non-Capital Liabilities

**Ans:** A) Fair Value Through Profit or Loss (FVTPL) and Amortized Cost

**Q5: Under IFRS 9, which method calculates interest revenue for financial assets measured at amortized cost?**
A) Straight-line method
B) Effective interest rate method
C) FIFO method
D) Weighted average cost method

**Ans:** B) Effective interest rate method

Relevance to US CMA Syllabus

IFRS 9 Financial Instruments is relevant to the US(Certified Management Accountant) CMA syllabus as it helps management accountants assess financial risk, measure fair values, and determine impairment losses. It aligns with topics such as financial reporting, planning, performance, and control. CMAs must understand IFRS 9 principles to make informed decisions regarding financial assets and liabilities, ensuring compliance with global accounting standards.

**IFRS 9 Financial Instruments US CMA Questions**

**Q1: What is the main difference between IFRS 9 and IAS 39 regarding credit loss recognition?**
A) IAS 39 uses an expected loss model, while IFRS 9 uses an incurred loss model
B) IFRS 9 uses an expected credit loss model, while IAS 39 uses an incurred loss model
C) Both standards use the same credit loss model
D) IFRS 9 eliminates credit loss recognition

**Ans:** B) IFRS 9 uses an expected credit loss model, while IAS 39 uses an incurred loss model

**Q2: What impact does IFRS 9 have on the risk management strategies of financial institutions?**
A) Encourages early recognition of credit risks
B) Reduces the need for risk assessment
C) Eliminates the need for hedge accounting
D) Does not impact financial risk management

**Ans:** A) Encourages early recognition of credit risks

**Q3: Which financial instruments are classified as Fair Value Through Profit or Loss (FVTPL) under IFRS 9?**
A) A bank loan held to maturity
B) A bond actively traded in the stock market
C) Inventory
D) Property, plant, and equipment

**Ans:** B) A bond actively traded in the stock market

**Q4: How does IFRS 9 affect financial statements in terms of volatility?**
A) It reduces volatility by using amortized cost for all financial instruments
B) It increases volatility by recognizing fair value changes more frequently

C) It eliminates fair value adjustments from financial statements
D) It has no impact on financial statement volatility

**Ans:** B) It increases volatility by recognizing fair value changes more frequently

**Q5: What is the primary goal of the IFRS 9 impairment model?**
A) To delay recognition of credit losses
B) To recognize credit losses at an earlier stage
C) To eliminate impairment losses
D) To write off all financial assets immediately

**Ans:** B) To recognize credit losses at an earlier stage

Relevance to US CPA Syllabus

The US CPA exam covers IFRS 9 in the Financial Accounting and Reporting (FAR) section, focusing on financial instrument classification, measurement, impairment, and disclosure. CPA candidates must understand how IFRS 9 differs from US GAAP and its implications on financial reporting for multinational companies. IFRS 9 knowledge is essential for accountants working in global markets.

**IFRS 9 Financial Instruments US CPA Questions**

**Q1: Which key change did IFRS 9 introduce to hedge accounting?**
A) Increased flexibility in hedge effectiveness testing
B) Eliminated hedge accounting requirements
C) Restricted hedging to derivatives only
D) Allowed all financial instruments to be hedged

**Ans:** A) Increased flexibility in hedge effectiveness testing

**Q2: How are financial instruments measured under IFRS 9 if they do not meet the amortized cost or FVOCI criteria?**
A) At Fair Value Through Profit or Loss (FVTPL)
B) At a cost
C) At historical value
D) At liquidation value

**Ans:** A) At Fair Value Through Profit or Loss (FVTPL)

**Q3: How does IFRS 9 impact loan loss provisions in banks?**
A) It requires earlier recognition of credit losses
B) It eliminates the need for loan loss provisions
C) It delays credit loss recognition
D) It allows banks to recognize provisions only after default

**Ans:** A) It requires earlier recognition of credit losses

**Q4: What information must companies disclose under IFRS 9 regarding financial instruments?**
A) Credit risk, liquidity risk, and market risk
B) Inventory valuation
C) Depreciation policies
D) Employee compensation details

**Ans:** A) Credit risk, liquidity risk, and market risk

**Q5: How does IFRS 9 differ from US GAAP regarding financial asset classification?**
A) IFRS 9 classifies financial assets into three categories, while US GAAP has more rigid classifications
B) US GAAP allows for greater flexibility in classification

C) IFRS 9 does not allow fair value measurement
D) US GAAP eliminates impairment losses

**Ans:** A) IFRS 9 classifies financial assets into three categories, while US GAAP has more rigid classifications

Relevance to CFA Syllabus

The CFA exam includes IFRS 9 in the Financial Reporting and Analysis section. Investment professionals must assess financial instruments accurately, evaluate fair value, and understand expected credit loss models. IFRS 9 affects financial statements, impacting investment decisions and risk management strategies.

**IFRS 9 Financial Instruments CFA Questions**

**Q1: How does IFRS 9 affect the valuation of financial instruments?**
A) Requires fair value measurement for all instruments
B) Allows both amortized cost and fair value measurement
C) Eliminates fair value accounting
D) Requires financial instruments to be valued at cost

**Ans:** B) Allows both amortized cost and fair value measurement

**Q2: What is the significant impact of IFRS 9 on investment portfolios?**
A) Increased volatility in financial reporting
B) Decreased transparency in financial statements
C) Elimination of fair value adjustments
D) Removal of financial risk considerations

**Ans:** A) Increased volatility in financial reporting

**Q3: What type of financial asset is measured using the effective interest rate method under IFRS 9?**
A) Financial assets at amortized cost
B) Fair value through profit or loss assets
C) Intangible assets
D) Inventory

**Ans:** A) Financial assets at amortized cost

**Q4: What principle does IFRS 9 follow for recognizing financial asset impairment?**
A) Expected Credit Loss (ECL) Model
B) Historical Cost Model
C) Straight-Line Depreciation Model
D) Revenue Recognition Model

**Ans:** A) Expected Credit Loss (ECL) Model

**Q5: What does IFRS 9 require in hedge accounting?**
A) Alignment of risk management objectives with hedge accounting
B) Prohibition of hedge accounting
C) Valuation at cost
D) Recognition of hedging instruments at book value

**Ans:** A) Alignment of risk management objectives with hedge accounting

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