About The Author

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He was a founding and the lead author of the widely-used Wiley GAAP and Wiley IFRS through 2010, and author of Thomson Reuters’ Handbook of Accounting and Auditing, through 2013, and has authored scores of professional articles for major publications.

As a speaker, Dr. Epstein has appeared on over one hundred programs over his career, including previous lectures delivered in Singapore and Indonesia, as well as in the Middle East, Canada and the U.S. As an accounting expert, he has testified or assisted in 150 litigation matters, including white-collar (fraud) criminal matters and contractual disputes, and has assisted the US Securities and Exchange Commission and Commodity Futures Trading Commission some twenty times. He advised the US Department of Justice on both the Enron and WorldCom fraud cases, and is currently engaged on several major cases, including the Parmalat matter, which may be the largest accounting fraud to date, amounting to US$18 billion.

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FINANCIAL INSTRUMENTS

I. INTRODUCTION

A. Singapore FRS 39, Financial Instruments: Recognition and Measurement, is the major standard that addresses the accounting for financial assets and financial liabilities, and is identical to IAS 39, as revised. The original IAS 39 was issued in 1998, and was revised or amended in 2000, 2003, 2005 and 2009. It is now in the process of being replaced, on a piecemeal basis, by IFRS 9, which – if and when adopted in Singapore – will become FRS 109.

B. More specifically, FRS 39 contains requirements for:

1. When a financial asset or financial liability should first be recognized in the statement of financial position;

2. When a financial asset or a financial liability should be derecognized (i.e., removed from the statement of financial position);

3. How a financial asset or financial liability should be classified into one of the discrete categories of financial assets or financial liabilities;

4. How a financial asset or financial liability should be measured, including:
   a. When a financial asset or financial liability should be measured at cost, amortized cost, or fair value in the statement of financial position;
   b. When to recognize and how to measure impairment of a financial asset or group of financial assets; and
   c. Special accounting rules for hedging relationships involving a financial asset or financial liability; and

5. How a gain or loss on a financial asset or financial liability should be recognized either in profit or loss or as a separate component of equity.

C. FRS 39 does not deal with presentation of issued financial instruments as liabilities or equity, nor does it address the disclosures that entities need to provide about financial instruments. Presentation issues are addressed in FRS 32, Financial Instruments: Presentation. Disclosure issues were originally dealt with by FRS 32 but are now addressed by FRS 107, Financial Instruments: Disclosures.

D. Many viewed FRS 39 as one of the most complex, if not the most complex, standard to apply in practice. Some of the more complex areas that must be mastered include the application of the derecognition requirements for financial assets, fair value measurement, and the designation and measurement of hedging relationships. Some of these matters will be dealt with in later phases of the IFRS 9 project, and these are summarized later in this document.

II. IFRS 9 AS THE REPLACEMENT FOR FRS 39

A. The first portion of IFRS 9 was promulgated in late 2009, ostensibly in response to the world-wide financial crisis triggered by the collapse of the U.S. housing market bubble, the desire to simplify certain aspects of IAS 39, and to further the goal of IFRS convergence with U.S. GAAP. Singapore has yet to act on adoption
of IFRS 9 (which will become, when adopted, FRS 109), but recent commitment to full IFRS conformity by 2018 means that this will ultimately happen.

1. The initial component of IFRS 9, released in 2009, addressed only the classification and measurement of financial assets.

2. A revised version of IFRS 9 was released in late 2010, which added requirements pertinent to the classification and measurement of financial liabilities.

3. All aspects of IFRS 9 are discussed later in this document. FRS 39 remains fully effective until Singapore adopts IFRS 9.

B. The remaining aspects of the replacement for IAS 39 that have been actively pursued by IASB.

1. Not fully addressed by original IAS 39, the matter of hedge accounting has been dealt with more expansively by amendments to IAS 39 made in 2004 and 2008; and now by hedge accounting chapter added to IFRS 9 (not yet enacted by Singapore).

2. Yet to be dealt with are matters concerning impairments; IASB is currently at the ballot stage on new materials for IFRS 9 that will address accounting for impairments of financial assets that are carried at amortized cost, and will deal with loan loss provisions and with credit quality deterioration of financial assets.

3. The matter of offsetting financial assets and financial liabilities, also omitted from the first round of pronouncements comprising IFRS 9, was later addressed by amendment to IAS 32 (incorporated into FRS 32, Singapore FRS 32) in late 2011. Related disclosure matters were addressed by concurrent changes to IFRS 7 (Singapore FRS 107).

4. Disclosures attendant to de-recognition of financial assets or liabilities were imposed by amendments to IFRS 7, in late 2010, effective in mid-2011.

III. DEFINITIONS OF KEY TERMS (As per IFRS 9)

<table>
<thead>
<tr>
<th><strong>Derecognition.</strong></th>
<th>The removal of a previously recognized financial asset or financial liability from an entity's statement of financial position.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Derivative.</strong></td>
<td>A financial instrument or other contract within the scope of IFRS 9 with all three of the following characteristics.</td>
</tr>
<tr>
<td></td>
<td>(a) Its value changes in response to the change in 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 (sometimes called the ‘underlying’).</td>
</tr>
<tr>
<td></td>
<td>(b) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.</td>
</tr>
<tr>
<td></td>
<td>(c) It is settled at a future date.</td>
</tr>
<tr>
<td><strong>Fair value.</strong></td>
<td>The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.</td>
</tr>
</tbody>
</table>
**Financial guarantee contract.** A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

**Financial liability at fair value through profit or loss.** A financial liability that meets either of the following conditions.

(a) It meets the definition of held for trading, or

(b) Upon initial recognition it is designated by the entity as at fair value through profit or loss.

**Held for trading.** A financial asset or financial liability that either:

(a) Is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;

(b) on initial recognition 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) is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

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

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**IV. FUNDAMENTAL ASPECTS OF FRS 39 (CURRENT STANDARD IN SINGAPORE)**

A. In general, FRS 39 applies to all entities in the accounting for both:

1. Financial instruments; and

2. Other contracts that are specifically included within the scope of the standard.

B. Financial instruments

1. FRS 39 applies in the accounting for all financial instruments except for those financial instruments specifically exempted. As first set forth by FRS 32, a financial instrument is defined as any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Thus, financial instruments include financial assets, financial liabilities, and equity instruments.

**Financial Instruments Under FRS 39**

*Financial assets within the scope of FRS 39 include:*

- Cash
- Deposits in other entities
- Receivables (e.g., trade receivables)
- Loans to other entities
- Investments in bonds and other debt instruments issued by other entities
- Investments in shares and other equity instruments issued by other entities
Financial liabilities within the scope of FRS 39 include:

- Deposit liabilities
- Payables (e.g., trade payables)
- Loans from other entities
- Bonds and other debt instruments issued by the entity

2. Apart from the preceding traditional types of financial instruments, FRS 39 also applies to more complex, derivative financial instruments (e.g., call options, put options, forwards, futures, and swaps). Derivatives are contracts that allow entities to speculate regarding – or hedge against – future changes in market factors at a relatively low or with no initial cost.

**Derivative financial instruments under FRS 39**

- A purchased call option to purchase (call) a financial asset at a fixed price at a future date or during a period ending on a defined future date. The call option gives the entity the right, but not the obligation, to purchase the asset.

- A purchased put option to sell (put) a financial asset at a fixed price at a future date or during a period ending on a defined future date. The put option gives the entity the right, but not the obligation, to sell the asset.

- A forward contract for the purchase (or sale) of a financial asset at a fixed price at a defined future date.

- An interest rate swap under which the entity pays a floating interest rate and receives a fixed interest rate on a specified notional amount, or vice-versa.

C. Other contracts within the scope of FRS 39

1. Aside from items that meet the definition of financial instruments, FRS 39 also applies to some contracts that do not meet the definition of a financial instrument but have characteristics similar to derivative financial instruments. This expands the scope of FRS 39 to contracts for the purchase or sale of non-financial items (e.g., gold, electricity, or gas) at a future date if, and only if, they have each of the following two characteristics:

   a. The contract is subject to potential net settlement. Specifically, the entity either can settle the contract net in cash or by some other financial instrument, or by exchanging financial instruments, rather than by delivering or receiving the underlying non-financial item; and

   b. The contract is not part of the entity's expected purchase, sale, or usage requirements (i.e., the contract is not a “normal” purchase or sale). Specially, when the contract is entered into and held for the purpose of making or taking delivery of the non-financial item (e.g., gold, electricity, or gas) in accordance with the entity's expected purchase, sale, or usage requirements, it is not within the scope of FRS 39.

2. By including contracts that meet the preceding two characteristics in the scope of FRS 39, derivatives are accounted for under FRS 39, whether they meet the definition of financial instrument or not.
Example

If an entity today (e.g., 25 June 2014) enters into a contract to purchase gold at a fixed price (e.g., S$965 per ounce) at a certain date in the future (e.g., 31 October 2014), the contract would be within the scope of FRS 39, if the entity could settle the contract net in cash and the entity does not expect to use the gold in its business activities. In such case, the contract is sufficiently similar to a derivative financial instrument that it is appropriate to recognize and measure in accordance with FRS 39. Recognition and measurement requirements are discussed later in this paper.

If, however, the entity enters into a contract to purchase electricity and the purpose is to take delivery of the electricity in accordance with the entity's expected usage requirements, that contract would be outside the scope of FRS 39. Such a contract would instead be accounted for as an executory contract, and such arrangements are usually not formally recognized until one of the parties has performed under the contract. Disclosure would, however, be required, if deemed to be material to an understanding of the reporting entity's operations, including how it handles risk.

D. Scope Exceptions Under FRS 39

1. FRS 39 does not apply to an entity's own issued equity instruments that are classified in the equity section of the entity's balance sheet (e.g., ordinary [common] shares, preference shares, warrants, and share options classified in equity). Investments in equity instruments issued by other entities, however, are financial assets and fall within the scope of IAS 39, unless some other scope exception applies.

2. FRS 39 also provides scope exceptions for some other items that meet the definition of a financial instrument, because they are accounted for under other Singaporean Financial Reporting Standards (FRS). Such scope exceptions are listed in the following table.

<table>
<thead>
<tr>
<th>Scope exception</th>
<th>Applicable standard</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lease receivables and lease payables</td>
<td>FRS 17, Leases</td>
</tr>
<tr>
<td>Employee benefit plans</td>
<td>FRS 19, Employee Benefits</td>
</tr>
<tr>
<td>Interests in subsidiaries</td>
<td>FRS 27, Consolidated and Separate</td>
</tr>
<tr>
<td></td>
<td>Financial Statements</td>
</tr>
<tr>
<td>Interests in associates</td>
<td>FRS 28, Investments in Associates</td>
</tr>
<tr>
<td>Interests in joint ventures</td>
<td>FRS 31, Interests in Joint Ventures</td>
</tr>
<tr>
<td>Share-based payment transactions</td>
<td>FRS 102, Share-Based Payment</td>
</tr>
<tr>
<td>Contingent consideration in business</td>
<td>FRS 103, Business Combinations</td>
</tr>
<tr>
<td>combinations</td>
<td></td>
</tr>
<tr>
<td>Insurance contracts</td>
<td>FRS 104, Insurance Contracts</td>
</tr>
</tbody>
</table>
V. CLASSIFICATION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

A. In order to determine the appropriate accounting for a financial asset or financial liability, the asset or liability must first be classified into one of the categories specified by FRS 39. There are four categories of financial assets and two categories of financial liabilities. [Note: this is one of the areas that will be most affected by the new requirements of IFRS 9, which establishes a different, simpler classification scheme, described below.] The classification of a financial asset or financial liability determines:

1. Whether the asset or liability should be measured at cost, amortized cost, or fair value in the balance sheet; and
2. Whether a gain or loss should be recognized immediately in profit or loss or as a separate component of equity (with recognition in profit or loss at a later point in time).

B. Financial assets

1. An entity reporting under FRS 39 is required to classify its financial assets into one of these four categories:
   a. Financial assets at fair value through profit or loss (FVTPL)
   b. Held-to-maturity investments (HTM)
   c. Loans and receivables (L&R)
   d. Available-for-sale financial assets (AFS)

2. The first category – financial assets at fair value through profit or loss – includes financial assets that the reporting entity either:
   a. Holds for trading purposes, or
   b. Otherwise has elected to classify into this category (i.e., at fair value with changes in value recognized in profit or loss for the period).

3. Financial assets that are held for trading are always classified as financial assets at fair value through profit or loss under FRS 39.
   a. A financial asset is considered held for trading if the entity acquired or incurred it principally for the purpose of selling or repurchasing it in the near term or is part of a portfolio of financial assets subject to trading.
   b. Trading generally reflects active and frequent buying and selling with an objective to profit from short-term movements in price or dealer’s margin. In addition, derivative assets are always treated as held for trading unless they are designated and effective hedging instruments. The designation of hedging instruments is discussed later in this chapter.

4. Financial assets other than those held for trading may also be classified selectively, upon initial recognition, as financial assets carried at fair value through profit or loss.
a. This ability to selectively classify financial instruments as items measured at fair value with changes in fair value recognized in profit or loss is referred to as the fair value option (this was added to FRS 39 in 2005).

b. The fair value option may be applied only at initial recognition and only if one of the following specified conditions is met:

i) Where such designation 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 recognizing the gains and losses on them on different bases; or

ii) For a group of financial assets, financial liabilities, or both that are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy, and information is provided internally on that basis; or

iii) For an instrument that contains an embedded derivative (unless that embedded derivative does not significantly modify the instrument’s cash flows under the contract or it is clear with little or no analysis that separation of the embedded derivative is prohibited).

5. The second category — held-to-maturity investments — includes financial assets with fixed or determinable payments and fixed maturity that the entity has the positive intention and ability to hold to maturity.

a. This category is intended for investments in bonds and other debt instruments that the entity will not sell before their maturity date irrespective of changes in market prices or the entity's financial position or performance. For instance, a financial asset cannot be classified as held to maturity if the entity stands ready to sell the financial asset in response to changes in market interest rates or risks or liquidity needs.

b. Since investments in shares and other equity instruments generally do not have a maturity date, such instruments cannot be classified as held-to-maturity investments.

6. Classification decisions have serious consequences. If an entity sells or reclassifies more than an insignificant amount of held-to-maturity investments (that is, a very small amount in proportion to the total amount of held-to-maturity investments) prior to maturity, such sales or reclassifications normally will disqualify the entity from using the held-to-maturity classification for any financial assets during the following two-year period. This is because sales of held-to-maturity investments call into question (or “taint”) the entity’s intentions with respect to holding such investments.

7. There are a few exceptions, where sales would not disqualify use of the held-to-maturity classification, including:

a. Sales that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset’s fair value;

b. Sales that occur after the entity has collected substantially all of the financial asset’s original principal through scheduled payments or prepayments; and

c. Sales that are attributable to an isolated event that is beyond the entity’s control, are nonrecurring, and could not have been reasonably anticipated by the entity (e.g., a significant deterioration in the issuer’s creditworthiness).
8. In order to be classified as held to maturity, a financial asset must also be quoted in an active market. This condition distinguishes held-to-maturity investments from loans and receivables. Loans and receivables and financial assets that are held for trading, including derivatives, cannot be classified as held-to-maturity investments.

9. The third category – loans and receivables – include financial assets with fixed or determinable payments that are not quoted price in an active market. In addition to not being quoted in an active market, loans and receivables differ from held-to-maturity investments in that there is no requirement that the entity demonstrates a positive intention and ability to hold loans and receivables to maturity.
   a. For example, an entity may classify items such as accounts receivable, notes receivable, and loans to customers in this category.
   b. Financial assets with a quoted price in an active market and financial assets that are held for trading, including derivatives, cannot be classified as loans and receivables.
   c. Financial assets for which the holder may not recover substantially all of its investment (for reasons other than because of credit deterioration) cannot be classified as loans and receivables.

10. The fourth category – available-for-sale financial assets – includes financial assets that do not fall into any of the other categories of financial assets or that the entity otherwise has elected to classify into this category.
   a. For example, an entity could classify some of its investments in debt and equity instruments as available-for-sale financial assets.
   b. Financial assets that are held for trading, including derivatives, cannot be classified as available-for-sale financial assets.

C. Financial liabilities

1. There are two principal categories of financial liabilities:
   a. Financial liabilities at fair value through profit or loss (FVTPL), and
   b. Financial liabilities measured at amortized historical cost.

2. Additionally, FRS 39 provides accounting requirements for issued financial guarantee contracts and commitments to provide a loan at a below-market interest rate.

3. Financial liabilities at fair value through profit or loss include financial liabilities that the entity either has incurred for trading purposes or otherwise has elected to classify into this category.
   a. Derivative liabilities are always treated as held for trading unless they are designated and effective hedging instruments.
   b. The designation of hedging instruments is discussed later in this paper.

4. An example of a liability held for trading is an issued debt instrument that the entity intends to repurchase in the near term to realize a gain from short-term movements in interest rates. Another example of a liability held for trading is the obligation that arises when an entity sells a security that it has borrowed and does not own (a so-called short sale).
5. As with financial assets, the ability to selectively classify financial instruments as items measured at fair value with changes in fair value recognized in profit or loss is referred to as the fair value option. This fair value option may be applied only at initial recognition, and only if at least one of these conditions is met:

   a. Such designation 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 recognizing the gains and losses on them on different bases; or

   b. A group of financial assets, financial liabilities, or both are managed and evaluated on a fair value basis in accordance with a documented risk management or investment strategy, and information is provided internally on that basis; or

   c. An instrument contains an embedded derivative (unless that embedded derivative does not significantly modify the instrument’s cash flows under the contract or it is clear with little or no analysis that separation of the embedded derivative is prohibited).

6. The second category of financial liabilities is financial liabilities measured at amortized historical cost. Under FRS 39, this is the default category for financial liabilities that do not meet the definition of financial liabilities at fair value through profit or loss.

   a. For most entities, most financial liabilities will fall into this category.

   b. Examples of financial liabilities that generally would be classified in this category are accounts payable, notes payable, issued debt instruments, and deposits received from customers.

7. In addition to the two categories of financial liabilities just listed, FRS 39 also addresses the measurement of certain issued financial guarantee contracts and loan commitments.

   a. A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

   b. After initial recognition, FRS 39 requires issued financial guarantee contracts to be measured at the greater of

      i) The amount determined in accordance with FRS 37, Provisions, Contingent Liabilities and Contingent Assets, or

      ii) The amount initially recognized less, when appropriate, cumulative amortization.

   c. A similar requirement applies to issued commitments to provide a loan at a below-market interest rate.

8. Settlement of financial liabilities via the issuance of equity instruments (INT FRS 119).

   a. If a debtor issues equity instruments to a creditor to extinguish all or part of a financial liability, those equity instruments are deemed to be consideration paid.

   b. The debtor should derecognize the financial liability fully or partially.

   c. The debtor should measure the equity instruments issued to the creditor at fair value, unless fair
value is not reliably determinable, in which case the equity instruments issued are measured at the fair value (not the book value!) of the liability extinguished.

d. If only part of a liability is extinguished, the debtor must determine whether any part of the consideration paid relates to modification of the terms of the remaining liability; if so, the debtor must allocate the fair value of the consideration paid between the liability extinguished and the liability retained.

e. The debtor recognizes in profit or loss the difference between the carrying amount of the financial liability (or part thereof) extinguished and the measurement of the equity instruments issued (if necessary, by reference to the fair value of the liability extinguished).

f. When only part of the liability is extinguished, the debtor must determine whether the terms of the remaining debt have been substantially modified (taking into account any portion of the consideration paid that was allocated to the remaining debt), and if so, must account for an extinguishment of the old remaining liability and the recognition of a new liability per FRS 39.

g. This does not apply to those situations where the creditor is already a direct or indirect shareholder and is acting in its capacity as a shareholder; or where the creditor and the entity are controlled by the same party or parties before and after the transaction, and the substance of the transaction includes an equity distribution from, or contribution to, the entity; or where the extinguishment of the financial liability by issuing equity shares is in accordance with the original terms of the financial liability.

h. INT FRS 119 was to be applied in annual periods beginning on or after 1 July 2010, with earlier application permitted; it was to be applied retrospectively from the beginning of the earliest comparative period presented.

D. Reclassifications

1. FRS 39 severely restricted the ability to reclassify (i.e., transfer) financial assets and financial liabilities from one category to another.

   a. Reclassifications into or out of the fair value through profit or loss (FVTPL) category are not permitted.

   b. Reclassifications between the available for sale (AFS) and held to maturity (HTM) categories are possible, although reclassifications of more than an insignificant amount of HTM investments normally would necessitate reclassification of all remaining HTM investments to AFS.

   c. An entity cannot reclassify from loans and receivables (L&R) to AFS.

2. Without having these restrictions on reclassifications, the concern would be that entities would be able to manage earnings (i.e., to adjust the figures reported in profit or loss at will) by selectively reclassifying financial instruments. For instance, if the entity desired to increase profit or loss in a period, it would reclassify assets on which it could recognize a gain following reclassification (e.g., if an asset measured at amortized cost has a higher fair value).
E. Summary of FRS 39 Requirements

The table on the next page summarizes FRS 39’s classification requirements and provides examples of financial assets and financial liabilities in the different categories.

<table>
<thead>
<tr>
<th>Category</th>
<th>Classification requirements</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial assets at fair value through profit or loss</td>
<td>Financial assets that are either (1) held for trading or (2) electively designated into the category</td>
<td>Derivative assets and investments in debt and equity securities that are held in a trading portfolio</td>
</tr>
<tr>
<td>Available-for-sale financial assets</td>
<td>Financial assets that are either (1) electively designated into the category or (2) do not fall into any other category</td>
<td>Investments in debt and equity securities that do not fall into any other category</td>
</tr>
<tr>
<td>Held-to-maturity investments</td>
<td>Quoted financial assets with fixed or determinable payments for which the entity has an intent and ability to hold to maturity</td>
<td>Investments in quoted debt securities for which the entity has an intent and ability to hold to maturity</td>
</tr>
<tr>
<td>Loans and receivables</td>
<td>Unquoted financial assets with fixed or determinable payments</td>
<td>Accounts receivable, notes receivable, loan assets, and investments in unquoted debt securities</td>
</tr>
<tr>
<td>Financial liabilities at fair value through profit or loss</td>
<td>Financial liabilities that are either (1) held for trading or (2) electively designated into the category</td>
<td>Derivative liabilities and other trading liabilities</td>
</tr>
<tr>
<td>Financial liabilities at amortized cost</td>
<td>All financial liabilities other than those at fair value through profit or loss</td>
<td>Accounts payable, notes payable, and issued debt securities</td>
</tr>
</tbody>
</table>

VI. RECOGNITION

A. The term “recognition” refers to when an entity should record an asset or liability initially on its statement of financial position.

B. The principle for recognition under FRS 39 is that an entity should recognize a financial asset or financial liability on its statement of financial position when, and only when, the entity becomes a party to the contractual provisions of the instrument. This means that an entity recognizes all the contractual rights and obligations that give rise to financial assets or financial liabilities on its balance sheet.

C. A consequence of FRS 39’s recognition requirement is that a contract to purchase or sell a financial instrument at a future date is itself a financial asset or financial liability that is recognized in the statement of financial position currently. The contractual rights and obligations are recognized when the entity becomes a party to the contract, rather than when the transaction is settled. Accordingly, derivatives are recognized in the financial statements even though the entity may have paid or received nothing on entering into the derivative.
D. Planned future transactions and other expected transactions, no matter how likely, are not recognized as financial assets or financial liabilities because the entity has not yet become a party to a contract. Thus, a forecasted transaction is not recognized in the financial statements even though it may be highly probable. In the absence of any right or obligation, there is no financial asset or financial liability to recognize.

Example 1 — Accounting for a note issued for both cash and a contractual right

1. Miller borrows S$10,000 via a non-interest-bearing three-year note from Krueger.
2. Miller agrees to sell S$50,000 of merchandise to Krueger at less than the ordinary retail price for the duration of the outstanding note.
3. The fair rate of interest on a note such as this is 10%.

As set forth in the discussion above, the difference between the present value of the note and the face value of the loan is to be regarded as part of the cost of the products purchased under the agreement. The present value factor for a lump-sum amount due in three years at 10% is .75132. Therefore, the present value of the note is S$7,513 (= S$10,000 x .75132). The S$2,487 (= S$10,000 – S$7,513) difference between the face value and the present value is to be recorded as a discount on the note payable and as unearned revenue on the future purchases. The following entries would be made to record the transaction:

<table>
<thead>
<tr>
<th>Miller</th>
<th>Krueger</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>Note receivable</td>
</tr>
<tr>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Discount on note payable</td>
<td>Contract right with supplier</td>
</tr>
<tr>
<td>2,487</td>
<td>2,487</td>
</tr>
<tr>
<td>Note payable</td>
<td>Cash</td>
</tr>
<tr>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Unearned revenue</td>
<td>Discount on note receivable</td>
</tr>
<tr>
<td>2,487</td>
<td>2,487</td>
</tr>
</tbody>
</table>

The discount on note payable (and the discount on the note receivable) should be amortized using the effective interest (constant yield) method, while the unearned revenue account and contract right with supplier account are amortized on a pro rata basis as the right to purchase merchandise is used up. Since this expires over a time horizon, ratable reduction over time would be the only appropriate (or workable) method of amortization. Thus, if Krueger purchased S$20,000 of merchandise from Miller in the first year, the following entries would be necessary:

<table>
<thead>
<tr>
<th>Miller</th>
<th>Krueger</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unearned revenue</td>
<td>Inventory (or cost of sales)</td>
</tr>
<tr>
<td>Sales</td>
<td>995</td>
</tr>
<tr>
<td>995*</td>
<td>995</td>
</tr>
<tr>
<td>Interest expense</td>
<td>Contract right with supplier</td>
</tr>
<tr>
<td>751</td>
<td>995</td>
</tr>
<tr>
<td>Discount on note payable</td>
<td>Discount on note receivable</td>
</tr>
<tr>
<td>751**</td>
<td>Interest revenue</td>
</tr>
<tr>
<td></td>
<td>751</td>
</tr>
</tbody>
</table>

* S$2,487 x (20,000/50,000)
** S$7,513 x 10%
The amortization of unearned revenue and contract right with supplier accounts will fluctuate with the amount of purchases made. If there is a balance remaining in the account at the end of the loan term, it is amortized to the appropriate account in that final year.

**Example 2 — Accounting for debt exchange or restructuring with gain deferral**

Assume now that Hopeless Corp. owes Callous Bank $90,000 on a 5% interest-bearing non-amortizing note payable in five years, plus accrued and unpaid interest, due immediately, of $4,500. Callous Bank agrees to a restructuring to assist Hopeless Corp., which is also suffering losses and is threatening to declare bankruptcy. However, Callous is only willing to reduce the principal amount from $90,000 to $85,000, and reduce interest to 4.5% from 5%. It is not willing to forego the currently owed $4,500 interest payment, and furthermore requires that the loan maturity be shortened to three years, from five, in order to limit its risk. Hopeless agrees to the new terms.

In order to comply with FRS 39, the present value of the new debt must be compared to the present value of the old, existing obligation. As in the preceding example, the present value of the old debt is simply the principal amount, $90,000, plus the interest due at present, $4,500, for a total of $94,500.

The present value of the replacement debt is the discounted present value of the reduced principal and the reduced future interest payments, plus the interest using a 5% discount factor (= .86384 for the new three-year term), has a present value of $73,426. The stream of future interest payments ($85,000 x .045 = $3,825 annually in arrears), discounted at 5% (= 2.7231 annuity factor), has a present value of $10,416. The total present value, therefore, is ($73,426 + $10,416 + $4,500 =) $88,342, which is about 7% below the present value of the old debt obligation. Accordingly, since the 10% threshold is not exceeded, the difference of ($94,500 – $88,342 =) $6,158 is not recognized as a gain at the date of the restructuring, but rather is deferred and amortized over the new three-year term of the restructured loan.

The entry to record this event would be:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt obligation (old) payable</td>
<td>90,000</td>
</tr>
<tr>
<td>Discount on debt obligation (new)</td>
<td>1,158</td>
</tr>
<tr>
<td>Debt obligation (new) payable</td>
<td>85,000</td>
</tr>
<tr>
<td>Deferred gain on debt restructuring</td>
<td>6,158</td>
</tr>
</tbody>
</table>

Note that the new debt obligation is recorded at a net of $83,842, not at the face value of $85,000. The difference of $1,158 represents a discount to be amortized to interest expense over the subsequent three years; this will result in interest expense at the actual market rate of 5%, rather than at the nominal 4.5% rate. Amortization should be computed on the effective yield method, although if the discrepancy is not material the straight-line method may be employed. The deferred gain, $6,158, will be amortized over the three-year revised term. While the discount amortization will be added to interest expense, IAS 39 is silent as to how the amortization of the deferred gain should be handled. However, by reference to how a gain in excess of the 10% threshold (and thus been subject to immediate recognition) would have been reported, it is thought likely that this amortization should be included in “other income,” and should not be offset against interest expense.
Example 3 — Accounting for the extinguishment of debt

1. A 10%, ten-year, S$200,000 bond is dated and issued on 1/1/11 at 98, with the interest payable semiannually.

2. Associated bond issue costs of S$14,000 are incurred.

3. Four years later, on 1/1/15, the entire bond issue is repurchased at 102 per 100 of face value (i.e., a 2% premium is paid) and is retired.

4. The straight-line method of amortization is used since the result is not materially different from that when the effective interest method is used.

The gain or loss on the repurchase is computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reacquisition price [(102/100) x S$200,000]</td>
<td>S$204,000</td>
</tr>
<tr>
<td>Net carrying amount:</td>
<td></td>
</tr>
<tr>
<td>Face value</td>
<td>S$200,000</td>
</tr>
<tr>
<td>Unamortized discount [2% x S$200,000 x (6/10)]</td>
<td>(2,400)</td>
</tr>
<tr>
<td>Unamortized issue costs [S$14,000 x (6/10)]</td>
<td>(8,400)</td>
</tr>
<tr>
<td>Loss on bond repurchase</td>
<td>S$ 14,800</td>
</tr>
</tbody>
</table>

Example 4 — Residual allocation method

Istanbul Corp. sells convertible bonds having aggregate par (face) value of S$25 million to the public at a price of 98 on January 2, 2011. The bonds are due December 31, 2018, but can be called at 102 anytime after January 2, 2014. The bonds carry a coupon of 6% and are convertible into Istanbul Corp. common stock at an exchange ratio of twenty-five shares per bond (each bond having a face value of S$1,000). Taking the discount on the offering price into account, the bonds were priced to yield about 6.3% to maturity.

The company’s investment bankers have advised it that without the conversion feature, Istanbul’s bonds would have had to carry an interest yield of 8% to have been sold in the then-current market environment. Thus, the market price of a pure bond with a 6% coupon at January 2, 2011, would have been about S$883.48 (the present value of a stream of semiannual interest payments of S$30 per bond, plus a terminal value of S$1,000, discounted at a 4% semiannual rate).

This suggests that of the S$980 being paid for each bond, S$883.48 is being paid for the pure debt obligation, and another S$96.52 is being offered for the conversion feature. Given this analysis, the entry to record the original issuance of the S$25 million in debt securities on January 2, 2011, would be as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>24,500,000</td>
</tr>
<tr>
<td>Discount on bonds payable</td>
<td>2,913,000</td>
</tr>
<tr>
<td>Bonds payable</td>
<td>25,000,000</td>
</tr>
<tr>
<td>Paid-in capital—conversion feature</td>
<td>2,413,000</td>
</tr>
</tbody>
</table>
The discount is to be amortized to interest expense, ideally by the effective yield method (constant return on increasing base) over the eight years to the maturity date. For purposes of this example, however, straight-line amortization ($2,913,000 ÷ 16 periods = $182,000 per semiannual period) will be used. Thus, the entry to record the June 30, 2011, interest payment would be as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest expense</td>
<td>932,000</td>
</tr>
<tr>
<td>Discount on bonds payable</td>
<td>182,000</td>
</tr>
<tr>
<td>Cash</td>
<td>750,000</td>
</tr>
</tbody>
</table>

The paid-in capital account arising from the foregoing transaction would form a permanent part of the capital of Istanbul Corp. If the bonds are later converted, this would be transferred to the common stock accounts, effectively forming part of the price paid for the shares ultimately issued. If the bondholders decline to convert and the bonds are eventually paid off at maturity, the paid-in capital from the conversion feature will form a type of “donated capital” to the entity, since the bondholders effectively will have forfeited this capital that they had contributed to the company.

VII. CHANGES IMPOSED BY IFRS 9 (Effective 2013) – NOT YET ADOPTED AS FRS

A. The project to replace IAS 39 (Singapore FRS 39) has been completed in phases, now largely done, but with a few remaining components still under development.

1. First exposed by IASB in mid-2009, the initial parts of the complete replacement for IAS 39 were formally promulgated in late 2009, with a 2013 mandatory effective date (but with early application permitted). This addressed accounting for financial assets only. This has yet to be adopted in Singapore, but when it is (the ultimate outcome is a certainty now that Singapore has pledged full IFRS endorsement by 2018, at least for listed companies), it will be designated as FRS 109.

2. IFRS 9 was altered in late 2010 with the addition of materials setting forth requirements for recognition and measurement of financial liabilities. The effective date for mandatory adoption remained 2013 for jurisdictions adopting full IFRS (which Singapore has not yet done). The derecognition provisions carried forward from IAS 39 remained unchanged at this time, but was subsequently dealt with by IASB as a separate amendment.

3. Later in the process, hedging and other topics were addressed, with further materials added to IFRS 9 (with some amendments also made to IAS 32 and IFRS 7, pertaining to presentation and disclosure matters, respectively).

4. As of mid-2014, comment periods have closed on exposure drafts of further provisions dealing with impairment of financial instruments being carried at historical cost, and regarding certain classification and measurement amendments. It is anticipated that these will be promulgated in 2014, perhaps very soon.

B. Recognition and measurement for financial assets and liabilities: the major changes from practice under FRS 39 under IFRS 9.

1. In a major change from FRS 39 (and also from U.S. GAAP’s FAS 115/ASC 320), the longstanding four-way division of financial instruments carried as assets (into held for trading, available for sale, loans and receivables, and held to maturity classifications) has been abolished.

2. However, as discussed later in this module, this change, said to effect simplification and to eliminate or lessen the importance of “management intent,” is much more apparent than real. Indeed, the
new classification rules introduce a different – but in many ways no less subjective – element that is essentially also driven by expressions of management intent.

a. Financial assets and liabilities are to be initially measured at fair value. Unless the asset or liability is to be subsequently accounted for at amortized historical cost (see below for criteria to be satisfied), transaction costs are not to be included in this initial measurement, because doing so would inevitably result in a “day one” loss in fair value.

i) The former “held to maturity” criterion, under which investments in debt instruments for which management intended to hold to maturity would be accounted for by amortized historical cost, will be eliminated.

ii) Fair value is usually, but not always, revealed by the price paid in arm’s-length transactions.

iii) If a portion of the initial consideration is for something other than the instrument, a valuation process must be applied to ascertain the fair value to be recorded for the asset or liability itself.

b. For financial assets and liabilities that are not to be subsequently measured at fair value, transaction costs are to be added or subtracted from the initial carrying value, as appropriate.

c. In order to determine whether a financial asset is to be subsequently carried at other than fair value (i.e., at amortized historical cost), it must be evaluated and classified based upon two factors: the reporting entity’s business model, and the contractual cash flow characteristics of the financial asset.

i) The entity’s business model for managing financial assets drives subsequent accounting (fair value vs. historical cost), and requires an understanding of the objective of the business model as it has been determined by the reporting entity’s key management personnel.

- This is not to be done on an instrument-by-instrument basis, but rather must be done at some higher level of aggregation (which is not more precisely defined by IFRS 9).

- A given entity may have multiple business models (e.g., affecting the accounting for different portfolios of financial assets).

- IFRS 9 believes this is a sharp break from the oft-criticized past reliance on “management intent” for classifying investments, but others (including the dissenting votes on IFRS 9) find this to be not substantially less subjective, and likely to be equally difficult to operationalize (and to audit).

- It does appear that the risk of “tainting” an entire portfolio of financial assets accounted for by amortized historical cost (what formerly would be called the “held to maturity” portfolio) because of asset dispositions before maturity, has been reduced under IFRS 9.

  • Under IFRS 9, an asserted business model of holding investments in order to collect contractual cash flows is not contradicted by a few before-maturity dispositions, such as when a given investment is found to no longer meet the investment policy, or to better match cash outflow needs, or to fund capital expenditures.
• Nonetheless, if more than infrequent dispositions are made, it is necessary to reassess whether the portfolio’s business objective is really to collect contractual cash flows.

• IFRS 9 sets forth a number of hypothetical situations and provides guidance regarding whether a goal of collecting contractual cash flows appears reasonable. Examples are as follow:

  • An entity holds investments to collect their contractual cash flows but would sell an investment in particular circumstances.

  • 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, e.g., 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.

  • An entity has a business model with the objective of originating loans to customers and subsequently to sell those loans to a securitization vehicle, which issues instruments to investors. The originating entity controls the securitization vehicle and thus consolidates it, and it collects the contractual cash flows from the loans and passes them on to its investors.

• The business model is not to collect contractual cash flows, however, if, e.g.,

  • A portfolio of financial assets is managed with the objective of realizing cash flows through the sale of assets.

  • A portfolio of assets is actively managed in order to realize fair value changes arising from changes in credit spreads and yield curves, resulting in buying and selling of the holdings.

ii) Cash flows must solely be for payments of principal and interest on the principal amount outstanding in order to warrant accounting for the financial asset in accordance with the amortized cost method.

• Leveraged contractual arrangements, under which some cash flows do not have the characteristic of interest (as is the case with options, forwards and swaps), would not meet the criterion – and thus could never be accounted for at amortized historical cost.

• Under certain conditions, the existence of prepayment penalties or a holder’s right to put the debt back to the issuer would not be deemed to be cash flows other than for interest and principal. Those conditions are that:
• The provision is not contingent on future events, other than to protect the holder against the issuer’s credit deterioration, or a change in control at the issuer; or to protect against the effects of tax law changes; or

• The prepayment amount substantially represents principal and interest outstanding, with a reasonable premium for early termination.

• The existence of a provision giving the issuer or the holder a right to extend the term of the debt instrument would not be deemed to involve cash flows other than for interest and principal under certain conditions. Those conditions are that:
  
  • The provision is not contingent on future events, other than to protect the holder against the issuer’s credit deterioration, or a change in control at the issuer; or to protect against the effects of tax law changes; or

  • The terms of the extension option result in cash flows during the extension period that will be strictly for principal and interest payments.

• A contractual term that changes the timing or amount of payments of principal or interest precludes a decision that contractual payments are solely for interest and principal unless certain conditions are satisfied. Those conditions are that the contractual term:
  
  • Is a variable interest rate that is reflective of the time value of money and credit risk (to be determined at initial recognition only, and so fixed) associated with the principal amount of the obligation; and

  • If it is a prepayment option or an extension option, it also meets the conditions set forth above, regarding not being contingent and having cash flows only for principal and interest payment purposes.

• IFRS 9 sets forth a non-exhaustive set of hypothetical situations and provides guidance regarding the determination of whether cash flows are solely for principal and interest.

• The rules relative to determining whether cash flows are for principal and interest are quite complex, particularly with regard to complex financial instruments, such as tranches of securitized loans. The extended implementation period for IFRS 9 was granted in part to accommodate an anticipated lengthy learning curve.

3. In order to ascertain whether a financial liability is to be subsequently carried at other than fair value (i.e., at amortized historical cost), the same criteria as found in FRS 39 are to be applied (that is, these criteria have not been revised, unlike those for financial assets). Two measurement categories continue to exist:

a. Fair value through profit or loss (FVTPL), used for financial liabilities that are held for trading, and

b. Amortized historical cost, used for all other financial liabilities, unless the fair value option is elected.

C. Changes in fair value, for investments carried at fair value, will still not necessarily all flow through current profit or loss.
1. Certain of these changes in fair value will be captured in other comprehensive income, leaving OCI as a repository for various items that, from an economic perspective, are income events in the reporting period despite being excluded from profit or loss.

2. Unlike under FRS 39, gains and losses first reported in OCI (e.g., unrealized gains on available-for-sale investments per FRS 39) will not be “recycled” through profit or loss when ultimately realized.

D. Under IFRS 9, the default requirement is to recognize changes in the fair values of financial assets, other than those held for hedging purposes, in profit or loss currently.

1. IFRS 9 creates a new option for holders of equity instruments: an irrevocable election available only at initial recognition, to present changes in fair value within comprehensive income.
   a. This is not available for investments in equity instruments held for trading purposes.
   b. This is somewhat of a mirror image of the “fair value option” under FRS 39, whereby the carrying amount financial instruments could be adjusted to fair value through profit or loss even if not otherwise required to be.
   c. If changes in fair value are reported in comprehensive income, as a result of the election, any gains or losses may not be “recycled” through profit or loss, as is the practice under current standards.
      i) This is a major change from current practice.
      ii) Although “recycling” is eliminated, there is no prohibition against transfers within equity accounts, and thus amounts can be moved from accumulated other comprehensive income to retained earnings, e.g., when fair value changes in equity instruments elected to be reported in OCI are finally disposed of and the cumulative gain or loss from fair value changes may be seen as having finally been “realized.”

2. Even if accounting using amortized historical cost is indicated, fair value through profit or loss may be elected.
   a. Accounting using amortized historical cost is indicated (i.e., is the default accounting requirement) where both
      i) The entity’s business model objective is to hold assets in order to collect contractual cash flows, and
      ii) The contractual terms of the asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
   b. For such financial assets, upon initial acquisition, accounting at fair value through profit or loss may be elected, if doing so would eliminate or significantly reduce the occurrence of a so-called accounting mismatch.
      i) This fair value option is generally similar to that under FRS 39, but
      ii) This election is not freely available, as was the FRS 39-based option, but rather is limited to those situations where one of two criteria will be met:
• The designation eliminates or significantly reduces an accounting mismatch, or

• A group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis by the entity.

iii) Regarding the elimination or mitigation of an accounting mismatch, examples are:

• If the reporting entity has liabilities under insurance contracts whose measurement incorporates current information (as permitted by IFRS 4), and financial assets it considers related that would otherwise be measured at amortized cost.

• The 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, but only some of the instruments would typically be measured at fair value through profit or loss (i.e., they are derivatives, or are classified as held for trading), or if the requirements for hedge accounting are not met, for example because the requirements for effectiveness are not met.

• The 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, but the entity does not qualify for hedge accounting because none of the instruments is a derivative.

• The entity has financed a specified group of loans by issuing traded bonds whose changes in fair value tend to offset each other, and 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 amortized cost and recognizing a gain or loss each time a bond is repurchased.

iv) Regarding the management of a group of financial assets or liabilities:

• Documentation of the entity’s strategy need not be extensive but should be sufficient to demonstrate compliance.

• Such documentation is not required for each individual item, but may be on a portfolio basis; e.g., if the performance management system for a department, as approved by the entity’s key management personnel, clearly demonstrates that its performance is evaluated on a total return basis, no further documentation is required.

c. IFRS 9 eliminates the FRS 39 requirement that investments in unquoted equity instruments be carried at historical cost.

i) Fair value may be assessed by means other than direct market quotations (cf. the hierarchy of fair value methodologies in FRS 113, Fair Value Measurement).

ii) However, historical cost may be an appropriate measure if, e.g.,

• Updated fair value information post-acquisition cannot be obtained, or

• There are a range of fair value measures and historical cost represents the best estimate within that range.
iii) According to IFRS 9, however, historical cost might not be representative of fair value if, e.g.,

- There has been a significant change in the investee’s performance post-acquisition vis-à-vis budgets or other expectations;
- There are changed expectations regarding technical milestones being achieved;
- There has been significant change in the market for the investee’s actual or potential products or services;
- There have been significant changes to the global, regional or local economy, whichever is more relevant to the value of the investment;
- There have been significant changes to the performances of comparable entities or in the valuations implied by market forces observed for those entities;
- There have been adverse internal developments at the investee, such as discovery of fraud, commercial disputes, litigation involving the entity’s patents or other intellectual property, or changes in management strategy;
- There is relevant evidence from external transactions, such as issuance of new equity by the investee or other transfers involving its debt or equity.

d. Under provisions of IFRS 9, the application of the optional “fair value through profit or loss” strategy to financial liabilities is somewhat more complicated than its application to financial assets.

i) An entity may, upon initial recognition only, irrevocably designate a financial liability for measurement at fair value through profit or loss, if doing so results in more relevant information, because either:

- It eliminates or significantly reduces a measurement or recognition inconsistency (an accounting mismatch) that would otherwise arise from measuring assets or liabilities, or recognizing the gains and losses on them, on different bases; or
- A group of financial liabilities, or 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 FRS 24) – for example, the entity’s board of directors and chief executive officer.

ii) The major impediment to the development of a fair value reporting model for liabilities was the concern over how the effects of changes in the entity’s own credit risk would be interpreted.

- A decline in the reporting entity’s credit-worthiness (i.e., increase in perceived risk) causes the fair value of its already-issued debt to decrease, the recording of which would give rise, ceteris paribus, to recognition of a gain (and vice-versa, for credit-worthiness improvements, which would give rise to an apparent loss).

  - This is counter-intuitive for most users of the financial statements, and IASB was determined to not report such a result in profit or loss.
• However, the logic can be explained: a decline in credit-worthiness (increase in perceived credit risk) increases the entity's cost of current borrowing, but the debt incurred previously and still outstanding, carrying lower interest coupons, means the entity has benefited from an economic event, having borrowed before the decline in credit-worthiness (and vice-versa for credit risk decreases).

• The issue was resolved by a mandate for bifurcation of fair value changes (if fair value reporting is elected) into “own credit risk” and other causes.

• Changes in fair value of the entity's liabilities that is the result of changes in its own credit risk are to be reported in other comprehensive income, not in profit or loss.

• Determining the portion of fair value change that is the result of changes in the entity's own credit risk can be approached as follows:

  • The application guidance in FRS 107 (which will be relocated to FRS 109 when it is adopted in Singapore) provides a default method for determining that amount. If the only relevant changes in market conditions for the liability are changes in an observed (benchmark) interest rate, that method attributes all changes in fair value, other than changes in the benchmark interest rate, to changes in the credit risk of the liability.

  • FRS 107 permits entities to use a different method if it provides a more faithful representation of the changes in the liability's credit risk.

  • The default method illustrated in FRS 107 is appropriate only if the only relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate. If that is not the case, the reporting entity will be required to use a more precise method. Moreover, an entity is always permitted to use a different method if that method more faithfully represents the effects of changes in a liability's credit risk.

iii) For financial liabilities to be carried at amortized historical cost, the guidance from FRS 39 has been carried forward without changes.

• Liabilities held for trading and derivatives must be carried at fair value, and all changes in the fair value of these liabilities will be reported in profit or loss (i.e., no part of these changes in fair value is assigned to changes in the entity's own credit-riskiness, and thus no part is reported in other comprehensive income.

• Liabilities having embedded derivatives that are not closely related to the host contract must be separated and accounted for at fair value, and the residual host contract will be measured at amortized historical cost.

iv) Example of accounting for entity debt at fair value, with effect of credit-risk change to be reported in other comprehensive income:
Example — Liability value changes separated into credit-risk-related and other

On 1 January 2015 Temasek Ventures issues a 10-year bond with a par value of S$1,500,000 and an annual fixed coupon rate of 4.5 per cent, payable semi-annually, which is consistent with market rates for bonds with similar characteristics issued by other entities. The issuer elects to report this liability at fair value on each reporting date.

The entity uses LIBOR as its observable (benchmark) interest rate. At the date of issuance of the bond, 10-year LIBOR is 2.5 per cent, meaning the entity's borrowing cost was 200 basis points over LIBOR. However, as of the end of the first year, 31 December 2015:

(a) The relevant (9-year) LIBOR has decreased to 2.25 per cent; and
(b) The fair value (i.e., the observable, Level 1, market value) for the bond is S$1,533,437, which is consistent with an interest rate of 4.2 per cent demanded by investors.

Since the obligor’s borrowing cost, expressed as a spread over LIBOR, has now narrowed to only 195 basis points (down from 200 basis points at the time of the borrowing), it is concluded that the market’s view of Temasek’s credit-riskiness is that it has diminished a bit (i.e., that Temasek is now more credit-worthy than when the borrowing was made). The change in fair value must be bifurcated so that the portion resulting from the change in the perceived riskiness of the entity can be reported in other comprehensive income, rather than in profit or loss, which is where the remainder of the value change will be displayed.

Temasek therefore calculates the present value of the cash flows associated with the liability using the liability’s contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period and (ii) the instrument-specific component of the internal rate of return as determined in accordance with IFRS 9. As of year-end 2015, the relevant benchmark rate (9-year LIBOR) is 2.25 per cent; the instrument-specific component (the risk premium at issuance) is 2.00 per cent; the total discount rate to be employed is thus 4.25 per cent, which results in a computed value for the bond as of 31 December 2015 of S$1,527,804, which is S$5,633 lower than the actual market value of S$1,533,437.

Under provisions of IFRS 9, therefore, the gross increase in the value of Temasek's debt, which amounts to (S$1,500,000 – S$1,533,437 =) S$33,437, must be given financial statement recognition. This represents an economic loss for the company (because it borrowed funds when costs were higher, and it is now locked into paying at an above-current-market interest rate for the next nine years), coupled with another economic loss resulting from the improved credit-worthiness of the entity occurring after it became contractually bound to the higher rate.

Thus, the S$33,437 loss to be recognized at year-end 2015 is actually comprised of two components: a S$27,804 loss resulting from a decrease in the benchmark borrowing rate, LIBOR, and a further loss of S$5,633 due to the fact that the entity’s perceived credit-worthiness has improved, but only after it has become committed to paying the higher rate associated with its former, lower credit standing. If the liability is to be carried at fair value, therefore, the 2015 statement of income will include a charge for S$27,804, identified as being the result of the change in the fair value of the debt; the 2015 statement of comprehensive income will include a further S$5,633 loss item described as the impact on reported debt obligations of the improvement in the entity’s credit-worthiness, separate and apart from the effect of changes in the general cost of money affecting all borrowers. (Interest expense of S$67,500 would also be reported, of course.)

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E. In the unusual circumstance where the reporting entity changes its business model for managing financial assets, all affected financial assets are to be appropriately reclassified.

1. Reclassification is applied prospectively from the reclassification date, with no restatement of prior gains, losses or interest.

2. If the reclassification is to measurement at fair value, fair value is determined as of the reclassification date, with any adjustment from prior carrying amount to the fair value being recognized in current profit or loss.

3. If the reclassification is to measurement at amortized cost, the fair value as of the reclassification date becomes the new carrying amount (i.e., the deemed cost) which will be adjusted or accreted to face value via amortization (e.g., to interest income).

F. Financial guarantee contracts (and commitments to provide below-market rate loans), subsequent to initiation, are carried at the greater of the amount determined in accordance with FRS 37, or the amount initially recognized, adjusted, if appropriate by cumulative amortization recognized in accordance with FRS 18.

G. Specific requirements for transition to the procedures set forth by IFRS 9 include:

1. FRS 8, regarding a change in accounting principles, is to be applied, with limited exceptions; this means retrospective application is required.

2. The date of initial application of IFRS 9 was to be either:
   a. Any date between the issuance date of the standard (late 2009) and the end of 2010, for entities applying the standard before the beginning of 2011, or
   b. The beginning of a reporting period in which the entity adopts IFRS 9, if adopted thereafter.

3. The business model as of the date of initial application, and the classification of financial assets based thereon, is applied retrospectively to earlier periods, without regard to what the entity’s business model actually was during those earlier periods.

4. Based on the facts and circumstances at the date of initial application, elections are made regarding the application of fair value through profit or loss, and recognition of changes in value of equity investments in comprehensive income. These elections are then applied retrospectively.

5. At the date of initial application of IFRS 9, previous elections to account for gains and losses arising in connection with financial assets through current profit or loss must be revoked if the new criterion (regarding the avoidance of an “accounting mismatch”) is not satisfied; and the earlier election optionally may be revoked even if the criterion could be satisfied.

6. At the date of initial application of IFRS 9, previous elections to account for gains and losses arising in connection with financial liabilities through current profit or loss should be re-examined on the basis of the criteria in FRS 39, which are not altered by IFRS 9.

H. Impairment of financial assets carried at historical cost.

1. As part of the ongoing convergence efforts concerning financial instruments accounting and reporting, IASB and FASB deliberated for several years regarding how impairments (i.e., losses due to
declines in credit quality) to financial instruments carried on the amortized cost method of accounting were to be dealt with. This was part of a second phase of an overall project to replace FRS 39 with IFRS 9.

a. Traditionally, losses due to credit quality declines have been recognized using a so-called incurred loss model, whereby a loss is recognized if and when some threshold conditions (e.g., “probable” and “reasonably estimable” under U.S. GAAP’s FAS 5; “more likely than not” – slightly over 50% likelihood – under FRS 37) is first breached. Critics note that this results, often, in delayed accounting recognition of economic losses.

b. An alternative approach, which can be understood to be an anticipated (or expected) loss model, would anticipate future losses to be incurred on groups of financial assets, and would either

i) Accrue these losses on some ratable basis over the average life of the portfolio, or

ii) Recognize the total of the expected future losses at the acquisition or inception of the portfolio.

c. The need for a more forward-looking approach to recognition of credit losses was underscored, for some, by the world-wide financial crisis that arguably began in 2008 and continues, in many countries, as of mid-2014. The argument made was that, had credit losses been recognized earlier, either by ratable accrual over the portfolios’ lives or by full recognition (based on informed estimates) at inception, banks and other holders of financial assets would have taken more cautious steps and consequently have been exposed to less total loss than in fact occurred.

d. A 2009 exposure draft, Financial Instruments: Amortized Cost and Impairment, proposed a fairly complex methodology for earlier recognition of credit losses, which would have required that initial expected credit losses be used in the determination of the effective yields on the instruments.

i) Under that approach, holders of financial assets accounted for at amortized cost would recognize interest revenue, less initial expected credit losses, over the life of the financial assets by adjusting the interest rate used to calculate interest revenue. This was proposed to show the relationship between expected credit losses and the pricing of loans. Conceptually, this was probably valid, inasmuch as asset pricing (e.g., when a loan portfolio is acquired) does take into account the expected credit losses to be incurred.

ii) Arguably, however, there would be a range of possible values to assign for purposes of computing a credit-adjusted yield for interest accretion. There was also the more important practical impediment that interest rates that are used to determine interest revenue are calculated in accounting systems, whereas expected losses are monitored in credit systems, and (reportedly) these accounting and credit functions are not integrated.

iii) IASB received a good deal of negative response to the draft, and thus undertook a re-deliberation, which culminated in a January 2011 supplementary exposure draft, which is explained in the following paragraphs. To achieve an outcome similar to what it originally wanted more simply, the IASB proposed separating the calculation of interest rates from the recognition of expected losses. This is known as the “decoupled approach.”

• IASB observes that many financial institutions have two broad groups of financial assets that are monitored differently: those loans that are considered problematic (the “bad book”), and those that are not (the “good book”).
• Financial assets in the “good book” are generally monitored on a portfolio basis, while those in the “bad book” are managed more closely and, often, on an individual basis.

• Building upon this observation, the current supplementary draft proposes separate methods to recognize expected losses for these groups. For the “good book,” expected losses are recognized over time, using a “time-proportional” approach. For the “bad book,” expected losses are recognized immediately.

iv) In 2013 a further revised exposure draft was issued by IASB, with the following features:

• Continues with expected loss approach, under which it would not be necessary for a credit event to have occurred before a credit loss would be recognized.

• Credit losses would always be recognized, even at acquisition or inception of the loan or other financial asset, but the amounts would be reassessed at each reporting date.

• Unlike under the current standards, under which only past events are considered, under proposed approach future events would also be taken into account – i.e., relevant information about past (historical) events, including those affecting similar financial instruments, as well as reasonable and supportable future events would be evaluated in determining allowances for uncollectible amounts.

• Although this was part of joint FASB/IASB project, achieving convergence now appears unlikely.

• Expected credit losses would be comprised (under the IASB version) of:
  • Yield on the instruments, which compensates for creditworthiness at time of lending or commitment to lend, and
  • Changes in creditworthiness after lending or commitment to lend has occurred, thus not priced into the original yield.

• The 12-month expected credit loss would be computed as 12-month default probability-weighted portion of the lifetime expected credit losses arising from a default.
  • This is not the same as a forecast of the amount of the actual default to occur over the 12-month horizon.
  • Also, this is not projected cash shortfall over next twelve months.
  • Projected loss is present-valued (i.e., time value is applied).

• Mechanically, at stage 1, this would involve projection of 12-month expected credit loss as of date of origination or acquisition, for which an allowance (reserve) would be established.
  • This is intended as a proxy for the initial expectation of credit loss that is implicit in the pricing of the asset.
  • In the case of financial assets, interest revenue is to be computed based on the gross carrying value of the asset, without allowance for the credit loss reserve.
• At stage 2, which is when there has been both a significant increase in credit-riskiness (i.e., a significant decrease in credit quality has occurred) and credit quality is deemed to be below “investment grade,” the full amount of lifetime credit loss would be subject to recognition.
  • Lesser declines in credit quality would not receive this treatment.
  • Calculation of interest income would not be altered (i.e., it will still be based on gross carrying amount)

• At stage 3, which is when credit loss has actually been incurred (e.g., missed interest payments) or the asset is credit-impaired, lifetime credit loss is still recognized.
  • Interest income, however, will be based on the net carrying value of the asset.

• By setting threshold of “significant deterioration” to “below investment grade” creditworthiness level, objective is to minimize the extent to which accrual of lifetime credit losses will have to occur.
  • The presumption is that instrument price already reflected 12-month loss expectation.
  • This methodology provides users with more information: namely, about changes in credit quality.


  1. The objective of hedge accounting has been clarified.
     
     a. Hedge accounting, as prescribed by FRS 39, represents an exception to normal recognition and measurement requirements of IFRS, because it prescribes:
        
        i) The recognition of items that would otherwise not be recognized (e.g., firm commitments);
        
        ii) The measurement of items on bases that are different from those that are normally required (e.g., adjusting the measurement of a hedged item in a fair value hedge); and
        
        iii) The deferral of changes in the fair values of hedging instruments for cash flow hedges (e.g., for the hedging of highly probable forecast transactions) in other comprehensive income (which otherwise would have been recognized in current profit or loss).

     b. These exceptions are to be preserved, because for many situations the information that otherwise would be reported (i.e., without applying hedge accounting) would not provide useful information or would omit important information.

     c. However, the new standard holds that consistent application of hedge accounting requires an objective that describes when and how an entity should:
        
        i) Override the general recognition and measurement requirements in IFRS (i.e., when and how an entity should apply hedge accounting); and
        
        ii) Recognize effectiveness and/or ineffectiveness of a hedging relationship (i.e., when and how gains and losses should be recognized).
d. Other possible objectives (more formally linking the reporting entity's risk management and its financial reporting, and mitigating the recognition and measurement anomalies between the accounting for derivatives and the accounting for hedged items) were rejected; those advocated are deemed to reflect a broad articulation of a principle-based approach with a focus on the purpose of the entity's risk management activities.

2. Instruments that qualify for designation as hedging instruments have been expanded to include non-derivative instruments.

a. This will be limited to only non-derivative instruments that are measured at fair value through profit or loss; those measured on other bases would be excluded.

b. It was concluded that extending the eligibility to non-derivative financial instruments that are measured at fair value through profit or loss, if designated in their entirety (rather than by risk components), would not give rise to the need to change the measurement basis of the financial instrument. This was seen to also align more closely with the classification model of IFRS 9, and make the new hedge accounting model better able to address hedging strategies that could evolve in the future.

c. Since IFRS has curtailed (but not ended) the previous practice of bifurcating the accounting for instruments having embedded derivatives, derivative features embedded in financial assets would not be eligible hedging instruments, even though they can be an integral part of a hybrid financial asset that is measured at fair value through profit or loss and designated as the hedging instrument in its entirety.

d. Internal derivatives (e.g., intra-group derivatives in the consolidated financial statements) will not be eligible as hedging instruments in the financial statements of the reporting entity, because they do not represent an instrument that the reporting entity uses to transfer the risk to a party outside the reporting entity. This prohibition is carried forward unchanged from FRS 39.

e. Likewise, intra-group monetary items will not be eligible hedging instruments, also retaining the restriction imposed under FRS 39.

3. An aggregated exposure that is a combination of an exposure and a derivative is subject to designation as a hedged item. The fact that an aggregated exposure is created by including an instrument that has the characteristics of a derivative does not, per se, preclude designation of the aggregated exposure as a hedged item.

4. The reporting entity may designate all changes in the cash flows or fair value of an item as the hedged item in a hedging relationship; and may also designate as the hedged item something other than the entire fair value change or cash flow variability of an item.

a. A component of the hedged item thus may designated for hedging.

b. However, when the entity designates only changes in the cash flows or fair value of an item attributable to a specific risk or risks (i.e., a risk component) that risk component must be separately identifiable and reliably measurable.

5. A layer component (e.g., the first 1,000 barrels of oil to be delivered under a contract) of the nominal amount of an item will be eligible for designation as a hedged item, except that a layer component of a contract that includes a prepayment option will not be eligible as a hedged item in a fair value hedge if the option's fair value is affected by changes in the hedged risk.
6. A hedging relationship would qualify for hedge accounting only if all the following criteria are met:
   
a. The hedging relationship consists only of eligible hedging instruments and hedged items.

b. At the inception of the hedge there is formal designation and documentation of the hedging relationship and the entity’s risk management objective and strategy for undertaking the hedge. That documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the entity will assess whether the hedging relationship meets the hedge effectiveness requirements (including its analysis of the sources of hedge ineffectiveness and how it determines the hedge ratio).

c. The hedging relationship meets the hedge effectiveness requirements, which holds if it:
   
   i) Meets the objective of the hedge effectiveness assessment; and

   ii) Is expected to achieve other-than-accidental offsetting.

7. Re-balancing of hedging relationships to again meet the objective of the hedge assessment should be effected when a hedging relationship no longer meets the objective of the hedge effectiveness assessment but the risk management objective for that designated hedging relationship remains the same. When an entity expects that a hedging relationship might cease to meet the objective of the hedge effectiveness assessment in the future, it may proactively re-balance the hedging relationship.

   a. In these circumstances the revised hedging relationship should be accounted for as a continuation of an existing hedge, rather than as a discontinuation.

   b. However, if the adjustment represents an overhaul of the existing hedging relationship, such an adjustment should result in the discontinuation of that hedging relationship. An example is a hedging relationship with a hedging instrument that experiences a severe deterioration of its credit quality and hence is no longer used for risk management purposes.

8. The reporting entity will be required to discontinue hedge accounting prospectively only when the hedging relationship ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable).

   a. This includes when the hedging instrument expires or is sold, terminated or exercised.

   b. This may affect the entire hedging relationship or a part of it.

   c. It would be inappropriate for the entity to discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting and that continues to meet all other qualifying criteria.

9. Regarding fair value hedges:

   a. The standard holds that gains and losses on fair value hedges, and on the underlying hedged items, should be reported in other comprehensive income, to the extent effective.

   i) Gains or losses on ineffective hedges would be shown in profit or loss.

   ii) The hedging gains or losses on the hedged items will be presented as separate line items in the statement of financial position, adjacent to the line items that includes the hedged assets
or liabilities, and included in the same category (i.e., asset or liability) as the hedged item whether an addition or subtraction, but not netted against the related hedged items.

iii) In the situation where a hedged item is an unrecognized firm commitment (or a component thereof), the subsequent cumulative change in the fair value of the hedged item will be recognized as an asset or liability with a corresponding gain or loss recognized in other comprehensive income.

iv) If the hedged item in a fair value hedge is a firm commitment (or a component thereof) to acquire a non-financial asset or assume a non-financial liability, the initial carrying amount of the non-financial asset or non-financial liability that results from the entity meeting the firm commitment will be adjusted to incorporate the cumulative change in the fair value of the hedged item that was recognized in the statement of financial position.

v) The gains or losses reported in the statement of financial position in connection with financial instruments are to be amortized to profit or loss if they pertain to financial assets or liabilities measured at amortized cost,

- Amortization can begin as soon as the gains or losses are first recognized, but no later than the date when the separate line item ceases to be adjusted for changes in the fair value of the hedged item.
- Amortization is to be based on a recalculated effective interest rate at the date amortization begins (taking into account the carrying amounts of the separate line item and the financial instrument that it relates to).

b. Arguably, the new rules will end some of the current practices that are seen as dysfunctional:

i) Mixed measurements, with amortized cost and fair value being used;

ii) Some of the volatility now shown in other comprehensive income;

iii) The current reporting of different hedging gains and losses (i.e., those associated with cash flow hedges and those with fair value hedges) in different places in the financial statements (since these will all be in other comprehensive income); and

iv) The failure to clearly display the extent of offsetting achieved by fair value hedging.

c. The use of a so-called “linked presentation,” whereby gross amounts of hedged and hedging items would be reported together in the statement of financial position, but not offset, was rejected, because it could result in misleading inferences being drawn regarding the hedging items and other items that are only partially being hedged (i.e., regarding certain, but not all, attributes). Disclosure was seen as being more useful a strategy for informing users.

10. Regarding cash flow hedges, under the new standard:

a. The separate component of equity associated with the hedged item (i.e., the cash flow hedge reserve) is adjusted to the lower of the following (in absolute amounts):

i) The cumulative gain or loss on the hedging instrument from inception of the hedge; and

ii) The cumulative change in fair value (present value) of the hedged item (i.e. the present value of the change in the hedged expected future cash flows) from inception of the hedge.
b. To the extent effective as a hedge, the gains or losses (i.e., the changes in the cash flow reserve) on the hedging instruments will be reported in other comprehensive income; to the extent ineffective, they are to be included in profit or loss.

c. The amount accumulated in the cash flow hedge reserve ultimately will be:

i) Removed from the cash flow hedge reserve and included directly in the initial cost or other carrying amount of the associated assets or liabilities, if hedges of forecasted transactions that later result in the recognition of non-financial assets or liabilities, or of forecasted transactions for non-financial assets or liabilities that become firm commitments for which fair value hedge accounting is applied; the accounting is not in the nature of reclassifications affecting other comprehensive income.

ii) Reclassified from the cash flow hedge reserve to profit or loss as reclassification adjustments, as per FRS 1, thus affecting profit or loss in the periods during which the hedged expected future cash flows affect profit or loss, for all other cash flow hedges.

iii) Currently reclassified to profit or loss, to the extent the accumulated cash flow hedge amounts are loss amounts, and no longer expected to be recoverable in future periods.

11. The time value for options used for both fair value and cash flow hedges will be accounted for in a manner divergent from current practice.

a. Under FRS 39, the undesignated time value of options is accounted for at fair value through profit or loss, which is seen now as not being consistent with actual risk management objectives and strategies of reporting entities.

b. Accordingly, the draft proposes that, when time and intrinsic value of options are separated, the changes in the time value of options that hedge transaction-related hedged items will be recognized in other comprehensive income to the extent that they relate to the hedged items.

c. If hedged items later result in the recognition of a non-financial assets or non-financial liabilities, or firm commitments for which fair value hedge accounting is applied, the amounts in the separate component of equity are to be removed and included directly in the initial cost or other carrying amounts of the assets or liabilities, without affecting reported other comprehensive income.

d. For hedging relationships other than those covered by (c), the amounts will be reclassified from the separate component of equity to profit or loss as a reclassification adjustment, as per FRS 1, in the period during which the hedged expected future cash flows affect profit or loss (e.g., when a forecasted sale occurs), thereby affecting other comprehensive income in that period.

e. To the extent that all or a portion of the amount in accumulated other comprehensive income is no longer expected to be recovered in one or more future periods, that amount will be reclassified into profit or loss as a reclassification adjustment.

12. Regarding hedges of net investments in foreign operations, including hedges of monetary items accounted for as part of the net investments according to FRS 21, these are to be accounted for similarly to cash flow hedges, under the newly-promulgated rules, as follows:

a. They are to be recognized in other comprehensive income, for the portions of gains or losses on hedging instruments that are determined to be effective hedges;
b. They are to be recognized in profit or loss, otherwise; and

c. The gains or losses on hedging instruments relating to effective portions of hedges, accumulated in the cash flow hedge reserve, are to be reclassified from equity to profit or loss as reclassification adjustments, per FRS 21 upon the disposal or partial disposal of the foreign operation.

13. Concerning hedges of grouped items, they will be eligible to be treated as such if:

a. They individually are eligible hedged items;

b. The items in the group are managed together on a group basis for risk management purposes; and

c. For the purpose of cash flow hedge accounting only, any offsetting cash flows in the group of hedged items, exposed to the hedged risk, affect profit or loss in the same reporting periods, (including interim periods) exclusively.

14. IFRS 9 provides for changes to the presentation of hedges as follows:

a. For a hedges of groups of items with offsetting hedged risk positions that affect different line items in the income statement, any hedging instrument gains or losses recognized in profit or loss are to be presented in a separate line from those affected by the hedged items; and

b. For assets and liabilities that are hedged together as groups in fair value hedges, the gains or losses on the assets and liabilities are to be recognized in the statement of financial position separately but adjacent to the corresponding assets or liabilities. The gains or losses will be presented on a gross basis next to each line item that includes the related assets or liabilities.

15. Finally, concerning disclosures:

a. IFRS 9 requires the following:

   i) Information about the reporting entity's risk management strategy and how it is applied to manage risk;

   ii) How the entity's hedging activities may affect the amount, timing and uncertainty of its future cash flows; and

   iii) The effect that hedge accounting has had on the entity's statement of financial position, statement of comprehensive income and statement of changes in equity.

b. The reporting entity will be required to present the required disclosures in a single note or separate section in its financial statements.

   i) However, information already presented elsewhere need not be duplicated, provided that it is incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time.

   ii) Without the information incorporated by cross-reference, the financial statements will be deemed to be incomplete.
c. When otherwise required by the new standard to separate by risk category the information disclosed, the entity will have to determine each category of risk on the basis of the risk exposures it decides to hedge and for which hedge accounting is applied; this to be done consistently for all hedge accounting disclosures.

d. The level of aggregation of such disclosures is a matter of judgment, but must be consistent with other disclosures set forth by FRS 107.

G. Offsetting of assets and liabilities: changes to IAS 32 and IFRS 7.

1. Offsetting, or netting, takes place when entities present their rights and obligations to each other as a net amount in their respective statements of financial position.

2. In January 2011, IASB and FASB published the exposure draft, Offsetting Financial Assets and Financial Liabilities. This was in response to requests from users of financial statements and recommendations from the Financial Stability Board to achieve convergence of the requirements for offsetting financial assets and financial liabilities.

   a. The offsetting model in FAS 32, Financial Instruments: Presentation, required an entity to offset a financial asset and financial liability when, and only when, it currently has a legally enforceable right of set-off and intends either to settle on a net basis or to realize the financial asset and settle the financial liability simultaneously.

   b. The US GAAP offsetting model, although similar to the model in IFRS, also provided a broad exception that permits entities to present derivative assets and derivative liabilities subject to master netting arrangements net in the statement of financial position even if an entity doesn’t have a current right or intention to settle net.

   c. The different requirements resulted in a significant difference between amounts presented in statements of financial position prepared in accordance with IFRSs and the same amounts presented in accordance with US GAAP, particularly for entities that have large amounts of derivative activities.

   d. The proposals in the exposure draft would have replaced the requirements for offsetting financial assets and financial liabilities and would have established a common approach with the FASB. However, this was not to be.

3. The exposure draft proposed that offsetting should only apply when: an entity’s right of set-off is enforceable at all times (including in the events of default and bankruptcy) for all counterparties, the ability to exercise this right is unconditional (it does not depend on a future event), and the entity intends to settle the amounts due with a single payment or simultaneously. If all of these criteria were met, offsetting would have been required. The proposals would have amended IFRS and US GAAP and eliminated several industry-specific netting practices.

4. The exposure draft also proposed required disclosures of information about the effect of rights of set-off and related arrangements on an entity’s financial position. The disclosures would have applied to all recognized financial instruments with rights of set-off and/or collateral agreements, and would have been required by class of financial instrument.

5. In June 2011, in the light of feedback received on the exposure draft, the IASB and FASB decided to move forward separately with their respective offsetting models.
a. IASB and FASB also noted that users of financial statements consistently asked for information to help them compare amounts that are presented in statements of financial position prepared in accordance with IFRS with the amounts that are presented in statements of financial position prepared in accordance with US GAAP.

b. To meet the needs of users of financial statements, IASB and FASB agreed on common disclosure requirements by amending and finalizing the disclosures initially proposed in the exposure draft.

6. Inconsistencies in applying the offsetting criteria in FRS 32 were also highlighted during the outreach on the exposure draft. As a result, in July 2011 the IASB agreed to amend the application guidance to IAS 32 to clarify:

a. The meaning of ‘currently has a legally enforceable right of set-off’; and

b. That some gross settlement systems would be considered equivalent to net settlement if they eliminate or result in insignificant credit and liquidity risk and process receivables and payables in a single settlement process or cycle.


a. The new disclosures provide users of financial statements with information about the effect or potential effect of netting arrangements on an entity’s financial position.

b. These disclosures also provide comparable information between financial statements prepared in accordance with IFRS and those prepared in accordance with US GAAP.

c. The disclosures apply to:

i) All financial instruments set off in the statement of financial position in accordance with IAS 32, and

ii) Financial instruments subject to a master netting arrangement or similar agreement even if not set off in the statement of financial position.

d. They do not apply to:

i) Financial instruments with only non-financial collateral agreements,

ii) Financial instruments with financial collateral agreements but no other rights of set-off, and

iii) Loans and customer deposits with the same financial institution (unless they are set off in the statement of financial position).

8. In December 2011, IASB separately issued Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32), to clarify the application of certain offsetting criteria in IAS 32, namely:

a. The meaning of ‘currently has a legally enforceable right of set-off’; and

b. That some gross settlement systems would be considered equivalent to net settlement if they eliminate or result in insignificant credit and liquidity risk and process receivables and payables in a single settlement process or cycle.
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The Technical Standards Development and Advisory (TSDA) team is part of the Technical Knowledge Centre and Quality Assurance division of the Institute of Singapore Chartered Accountants (ISCA). It is committed to supporting the Institute in advancing and promoting technical developments within the profession as part of the effort to transform Singapore into a leading global accountancy hub by 2020.

ISCA TSDA engages external stakeholders in soliciting meaningful feedback on accounting and auditing related issues to develop a consistent approach to addressing industry issues identified. It also prescribes auditing and assurance standards that are closely aligned to international best practices, champions thought leadership initiatives with key stakeholders and drives projects in collaboration with various ISCA technical committees.

It actively engages international standard setters and strives to be an advocate of matters pertinent to the development of Singapore’s accountancy profession. Furthermore, it aims to cultivate a mindset change and raises awareness of new and revised standards through the publication of articles authored by the team.

Additionally, ISCA TSDA seeks to empower members and the profession at large to achieve their aspirations by equipping them with relevant technical expertise and this is achieved through the development of a range of resources that they can tap on.

Knowledge sharing with the accounting community is facilitated through a variety of print and online channels including the sharing of regular updates and thought leadership articles via in-house publications like the journal, “IS Chartered Accountant”, the E-newsletter, “ISCA Weekly”, and various online knowledge centres and a technical forum. Seminars and workshops are regularly organised and ISCA TSDA also provides value added technical clarification services to assist the profession in resolving accounting, auditing and ethics related issues.

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