

Heads Up

In This Issue:

- Introduction
- Scope
- Classification
- Classification Criteria
- Equity Investments
- Embedded Derivatives
- Application Issues
- Reclassification
- Impact of IFRS 9
- Effective Date and Transition
- Next Steps
- Appendix A
- Appendix B
- Appendix C
- Appendix D

The issuance of IFRS 9 represents the completion of the first phase of the IASB's project to replace IAS 39.

IASB Issues IFRS on Classification and Measurement of Financial Assets.

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Introduction

On November 12, 2009, the IASB issued IFRS 9,¹ which significantly overhauls the accounting requirements for financial instruments under IFRSs. IFRS 9 is mandatory for annual periods beginning on or after January 1, 2013, with early application permitted (see [Effective Date and Transition](#)).

IFRS 9 replaces the existing classification and measurement requirements in IAS 39² for financial assets. It changes the manner in which entities classify and measure investments in debt and equity securities, loan assets, trade receivables, and derivative financial assets by requiring entities to classify financial assets as being measured at either amortized cost or fair value depending on the entity's business model and the contractual cash flow characteristics of the asset.

The issuance of IFRS 9 represents the completion of the first phase of the IASB's project to replace IAS 39. The project addresses classification and measurement of financial assets as well as the accounting for financial liabilities, recognition and measurement of impairments, hedge accounting, and derecognition. The IASB expects to replace the remaining portions of IAS 39 during 2010.

In parallel, the FASB is developing proposals to replace the current accounting requirements for financial instruments under U.S. GAAP. The FASB plans to issue a comprehensive exposure draft (ED) in the first quarter of 2010 that will address classification and measurement of financial instruments as well as impairments and hedge accounting. In a [Joint Statement](#) issued by the FASB and the IASB on November 5, 2009, the two boards indicated that they are committed to working together on this project and to issuing standards by the end of 2010 "that provide international comparability." For a comprehensive overview of the two boards' approaches to changing the accounting for financial instruments and their principles for convergence, see [Deloitte's October 27, 2009, Heads Up](#).

The key provisions of IFRS 9 are summarized below. In addition, the flowchart in Appendix A depicts the classification and measurement model for financial assets. The table in Appendix B compares the key provisions of IFRS 9 and the IASB's ED on classification and measurement of financial instruments. The table in Appendix C compares the key provisions of IFRS 9 and the FASB's tentative decisions on the project to date. The tables in Appendix D compare the IASB's ED on impairments and the tentative decisions reached by the FASB on impairments as well as the two boards' tentative decisions on hedge accounting.

¹ IFRS 9, *Financial Instruments*.

² IAS 39, *Financial Instruments: Recognition and Measurement*.

The standard requires reclassification between amortized cost and FVTPL (or vice versa) if a financial asset no longer meets the criteria for its original classification.

Scope

IFRS 9 applies to all assets within the scope of IAS 39, such as investments in debt and equity securities, loan assets, trade receivables, and derivative assets.

Classification

IFRS 9 requires that a financial asset be classified into one of three categories for measurement and income recognition:

- Amortized cost.
- Fair value through profit or loss (FVTPL).
- Fair value through other comprehensive income (FVTOCI).

The standard requires reclassification between amortized cost and FVTPL (or vice versa) if a financial asset no longer meets the criteria for its original classification (see [Reclassification](#) below). However, IFRS 9 specifically states that such reclassification is expected to occur very infrequently.

Classification Criteria

IFRS 9 states that in determining the measurement attribute for a financial asset (i.e., amortized cost or fair value), an entity must use two classification criteria:

- *The business model test* — Is the asset held within a business model whose objective is to hold assets in order to collect contractual cash flows (rather than to sell the instrument before its contractual maturity to realize its fair value changes)?
- *The cash flow characteristics test* — Do the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the outstanding principal?

If the financial asset satisfies the two classification criteria above, the financial asset typically must be measured at amortized cost. Thus, loan assets, trade receivables, and investments in debt securities that meet these criteria would typically be measured at amortized cost. However, an entity may irrevocably elect on initial recognition to designate a financial asset as FVTPL if that designation eliminates or significantly reduces an accounting mismatch had the financial asset been measured at amortized cost. This is the so-called “fair value option.”

Financial assets that do not meet the above criteria are required to be measured at fair value, including all equity investments, all derivative assets, all trading assets, and those loans, receivables, and debt securities that do not meet the two criteria described above.

Business Model Test

The business model test noted above requires an entity to assess whether its business objective for financial assets is to collect the contractual cash flows of the assets rather than realize their fair value change from sale before their contractual maturity. This determination is made at a business unit level and not an individual financial instrument level and therefore is not based on management’s intent for individual instruments.

IFRS 9 acknowledges that an entity may have different business units that are managed differently. For example, an entity may have a retail banking business whose objective is to collect contractual cash flows of loan assets and an investment banking business whose objective is to realize fair value changes through the sale of loan assets before their maturity. Therefore, financial instruments held in the retail banking business that give rise to cash flows that are payments of principal and interest (see [Cash Flow Characteristics Test](#) below) may qualify for amortized cost measurement even if similar financial instruments in the investment banking business do not. Note that all instruments that meet the existing held-for-trading definition in IAS 39 will continue to be classified as FVTPL because they are not held to collect the contractual cash flows of the instrument.

IFRS 9 requires all equity investments to be measured at fair value.

Because the assessment under the business model test is performed at the portfolio level and not the financial instrument level, an entity's business model can be to hold financial assets to collect contractual cash flows even when there are some sales of financial assets. For example, an entity's conclusion that it holds investments to collect their contractual cash flows is still valid even if the entity sells the investments to fund capital expenditures.

Cash Flow Characteristics Test

The requirement in IFRS 9 for an entity to assess the contractual cash flow characteristics of a financial asset has been adapted from a similar approach outlined in *IFRS for Small and Medium-sized Entities*, which was recently issued by the IASB. The concept is that only instruments with contractual cash flows of principal and interest on principal could qualify for amortized cost measurement. IFRS 9 describes interest as consideration for the time value of money and credit risk associated with the principal outstanding during a specific period. Therefore, an investment in a convertible debt instrument would not qualify because of the inclusion of the conversion option, which is not deemed to represent payments of principal and interest.

The cash flow characteristics criterion is met when the cash flows on a loan are entirely fixed (e.g., a fixed interest rate loan or zero coupon bond), when interest is floating (e.g., when interest is contractually linked to LIBOR), or when interest is a combination of fixed and floating (e.g., LIBOR plus a fixed spread).

Other examples of financial instruments described in IFRS 9 that satisfy this criterion include:

- A variable-rate instrument with a stated maturity date that permits the borrower to choose to pay three-month LIBOR for a three-month term or one-month LIBOR for a one-month term.
- A fixed-term, variable-market-interest-rate bond whose variable interest rate is capped.
- A fixed-term bond whose payments of principal and interest are linked to an unleveraged inflation index of the currency in which the instrument is issued.

Equity Investments

IFRS 9 requires all equity investments to be measured at fair value. This means that unquoted equity investments for which the fair value measurement is not sufficiently reliable can no longer be measured at cost less impairment. IFRS 9 suggests, however, that cost might be the best estimate of fair value of an equity investment if it is difficult to value because of little or no timely or relevant information. It also gives examples of when cost will not be representative of fair value.

Equity investments are classified as FVTPL unless the entity irrevocably designates it at initial recognition as FVTOCI. Designation as FVTOCI is not permitted if the equity instrument is held for trading.

If the equity investment is designated as FVTOCI, all gains or losses except dividend income, which is recognized in profit or loss, are recognized directly in equity without any reclassifications to profit or loss even if the investment is subsequently sold.

The FVTOCI classification for equity investment removes the current requirement in IAS 39 for an entity to perform an assessment of impairment and to reclassify the cumulative fair value gain or loss on disposal, because all fair value changes other than dividend income remain permanently in equity.

IFRS 9 also amends IFRS 7³ to require extensive disclosure of investments in equity instruments designated as FVTOCI, including why an entity has chosen to designate the equity instruments as FVTOCI.

³ IFRS 7, *Financial Instruments: Disclosures*.

Embedded derivatives that under IAS 39 would have been separately accounted for at fair value because they were not closely related to the financial host asset will no longer be separated.

Embedded Derivatives

IFRS 9 does not retain the embedded derivative concept that exists in IAS 39 for hybrid contracts in which the host contract is a financial asset within the scope of IFRS 9. Consequently, embedded derivatives that under IAS 39 would have been separately accounted for at fair value because they were not closely related to the financial host asset will no longer be separated. Instead, the contractual cash flows of the hybrid financial asset are assessed in their entirety and the hybrid financial asset as a whole is required to be classified as FVTPL if any of its cash flows do not represent payments of principal and interest.

Because IFRS 9 only applies to assets within the scope of IAS 39, the embedded derivative concept, at least for now, is retained for all hybrid financial liabilities and asset host contracts that are outside the scope of IAS 39.

Application Issues

Nonrecourse Lending

For nonrecourse debt instruments in which the borrower's claim is limited to specific assets of the lender, an entity will need to determine whether the terms of the instrument only represent contractual cash flows that are payments of principal and interest. IFRS 9 requires an entity to look through to the underlying assets or cash flows to make this determination. If the terms of the instrument give rise to any other cash flows or limit the cash flows in a manner inconsistent with payments representing principal and interest, the instrument does not meet the cash flow characteristics test and is precluded from being measured at amortized cost.

Distressed Debt

IFRS 9 clarifies that financial assets acquired at a discount as a result of incurred credit losses (e.g., distressed debt) are not precluded from being measured at amortized cost if the asset passes the business model test. Previously, the IASB had proposed that an entity should be required to classify such financial instruments as FVTPL.

Securitization Tranches

IFRS 9 clarifies that an investment in a tranche of contractually linked instruments (e.g., beneficial interests issued by a structured investment vehicle in an underlying pool of financial instruments) meets the cash flow characteristics test for amortized cost measurement only if **all** the following criteria are met:

- The tranche must only have cash flow characteristics that are solely payments of principal and interest on the outstanding principal (e.g., the interest rate is not linked to a commodity index).
- The underlying pool of instruments must contain one or more financial assets whose contractual cash flows are only payments of interest and principal (e.g., loans or receivables). The underlying pool of instruments can contain other instruments (e.g., caps, floors, purchased credit derivatives, interest rate swaps, or currency swaps), but these must (1) reduce the cash flow variability of the pool of instruments whose contractual cash flows are only payments of interest and principal or (2) align the interest rate risk, foreign currency risk, or timing differences of the cash flows of the tranches and the cash flows of the underlying pool of financial instruments.
- The exposure to credit risk in the underlying pool of financial instruments inherent in the tranche is equal to or lower than the exposure to credit risk of the underlying pool of financial instruments.

In cases in which the underlying pool of instruments can change, all possible instruments must be considered as part of this assessment. For example, if the underlying pool, at initial recognition, does not include written credit derivatives, but could include these in the future, then the tranche is not eligible for amortized cost measurement.

One of the greatest changes will be an entity's ability to measure some debt instruments, such as many investments in government and corporate bonds, at amortized cost when they were previously measured at fair value because they were classified as available for sale.

In addition, if it is impracticable to assess the underlying pool of instruments, the tranche must be classified as FVTPL.

Reclassification

For financial assets that meet the cash flow characteristics test, reclassification is required between FVTPL and amortized cost, or vice versa, if the entity's business model objective for its financial assets changes. For example, reclassification from amortized cost to FVTPL is required when a financial services firm decides to exit its retail mortgage business and is actively marketing its mortgage loan portfolio for sale. IFRS 9 indicates that such reclassifications are expected to occur very infrequently.

Impact of IFRS 9

For some entities, IFRS 9 will result in more financial assets being accounted for at fair value; for others, fewer. The impact will depend on what financial assets an entity holds, how it has classified them previously, and what choices it makes under the new classification model.

In many circumstances, entities can continue to measure at amortized cost financial assets that are carried at amortized cost under IAS 39, such as loans, receivables, and held-to-maturity investments, provided they are held to collect the contractual cash flows and give rise to payments of principal and interest only.

One of the greatest changes will be an entity's ability to measure some debt instruments, such as many investments in government and corporate bonds, at amortized cost when they were previously measured at fair value because they were classified as available for sale. The existing held-to-maturity classification and associated "tainting" requirements for held-to-maturity investments no longer apply (i.e., an entity would be permitted to sell financial assets classified as amortized cost to some degree without being precluded from using the amortized cost category for other financial assets).

Hybrid financial assets with separated embedded derivatives classified as FVTPL (e.g., synthetic-collateralized debt obligations) will now be classified as FVTPL in their entirety.

The elimination of the available-for-sale category and the requirement for all equity investments to be measured at fair value removes the multiple impairment methods that exist in IAS 39. IFRS 9 only requires impairment assessment for financial assets measured at amortized cost.

Effective Date and Transition

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

IFRS 9 requires retrospective application. However, the business model assessment shall be made as of the date of initial application. Also, classification as FVTPL or FVTOCI, or de-designation of financial assets that were previously designated as FVTPL under the fair value option, is made on the basis of the facts and circumstances that existed as of the date of initial application. A fair value option election for a financial asset or financial liability on the basis of a measurement mismatch can only be retained for an instrument if the measurement mismatch exists as of the date of initial application. If the measurement mismatch does not exist as of the date of initial application, the previously elected fair value option must be revoked. An entity may also choose to revoke its previous designation of a financial asset or financial liability as FVTPL if it had previously been designated as a result of an accounting mismatch.

In cases in which retrospective application is not practical or requires hindsight, other practical expedients other than full retrospective application are required.

Entities adopting the new standard with an initial application date before January 1, 2012, will be exempt from the requirement to provide comparatives.

Next Steps

The IASB expects to replace the remaining components of IAS 39 in the second half of 2010. Thus, it plans to incorporate requirements in IFRS 9 addressing the following topics:

- *Classification and measurement of financial liabilities* — As issued, IFRS 9 only addresses the classification and measurement of financial assets. Although financial liabilities were initially included in the IASB's ED on classification and measurement issued in July 2009,⁴ the IASB decided to exclude financial liabilities from IFRS 9 for the time being to allow further consideration of concerns raised by constituents. These concerns primarily relate to the proposal in the ED to require financial liabilities with cash flow characteristics that do not represent payments solely of principal and interest to be measured at FVTPL, including the effect of changes in the entity's own credit risk.
- *Impairment* — On November 5, 2009, the IASB issued an ED proposing an expected loss model for recognizing and measuring impairment of financial assets measured at amortized cost.⁵ Comments on the ED are due by June 30, 2010.
- *Hedge accounting* — The IASB plans to issue an ED on hedge accounting in the first half of 2010.
- *Derecognition* — The IASB issued an ED on derecognition of financial assets and financial liabilities in March 2009⁶ with a comment period that closed in July 2009. The IASB is currently discussing the feedback received from constituents.

IASB and FASB Financial Instruments Project: A Closer Look

Deloitte will host a 90-minute webcast on Wednesday, December 9, at 2:00 p.m. (EST) on the IASB's and FASB's joint project on accounting for financial instruments. [Register now](#) for this special webcast.

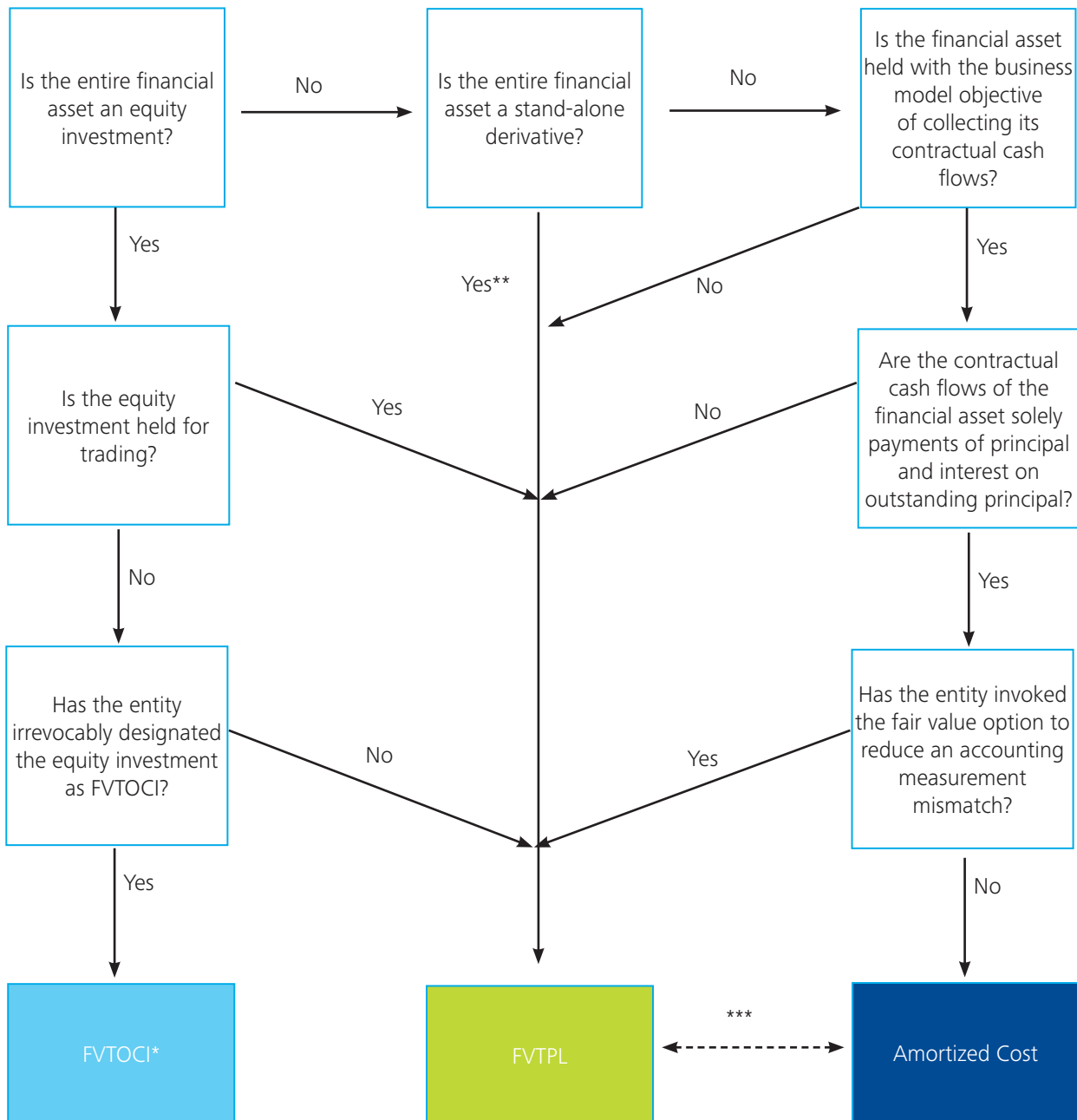
⁴ See Deloitte's [July 27, 2009, Heads Up](#) for a discussion of proposals in the IASB Exposure Draft, *Financial Instruments: Classification and Measurement*.

⁵ See Deloitte's [November 10, 2009, Heads Up](#) for a discussion of the expected-loss model proposed in the IASB Exposure Draft, *Financial Instruments: Amortised Cost and Impairment*.

⁶ IASB Exposure Draft, *Derecognition*.

Appendix A

The flow chart below illustrates the application of the classification guidance in IFRS 9.



* Dividend income is presented in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment.

** The hedge accounting provisions of IAS 39 remain applicable to derivatives designated in effective hedge relationships.

*** Reclassification required when and only when an entity changes its business model for managing its financial assets.

Appendix B

The following table compares (1) the IASB's July 2009 ED on classification and measurement of financial instruments⁷ and (2) IFRS 9.

Subject	IASB's July 2009 ED	IFRS 9
Scope	Financial assets and financial liabilities within scope of IAS 39.	Financial assets within scope of IAS 39.
Categories of financial assets and financial liabilities	Effectively, three categories for financial assets and financial liabilities: <ol style="list-style-type: none"> 1. Fair value through profit or loss (FVTPL). 2. Amortized cost. 3. Fair value through other comprehensive income (FVTOCI). Available-for-sale and held-to-maturity categories in IAS 39 would be eliminated.	Same as ED, except categories now apply to financial assets only.
Criteria for amortized cost measurement	A financial asset or financial liability generally must be measured at amortized cost if it meets both of the following criteria: <ol style="list-style-type: none"> 1. <i>Cash flow characteristics test</i> — Has only basic loan features; e.g., its interest is either fixed or market interest or a combination of the two; it is not leveraged; it is prepayable; it has no variability other than nonpayment (i.e., default). 2. <i>Business model test</i> — Is managed on a contractual-yield basis (based on management's focus on the cash flows under the instrument, not on cash flows arising from sale). There is an exception for items that qualify and are designated under the fair value option (see below).	A financial asset must be carried at amortized cost if it meets both of the following criteria: <ol style="list-style-type: none"> 1. <i>Business model test</i> — Objective of entity's business model is to hold assets to collect the contractual cash flows. 2. <i>Cash flow characteristics test</i> — Asset's contractual cash flows represent payment of principal and interest. As in the ED, there is an exception for items that qualify and are designated under the fair value option (see below).
Criteria for FVTOCI	Upon initial recognition, an entity has the option to elect to irrevocably designate an equity investment as FVTOCI. For this category, dividend income and realized gains and losses are also recorded in OCI.	Same as ED, except that dividend income is recognized in profit or loss in accordance with IAS 18 ⁸ unless the dividend clearly represents a recovery of part of the cost of the investment.
Reclassification of accumulated OCI to net income	Never. Amounts in OCI are permanently deferred in equity.	Same as ED.
Equity investments	All measured at fair value. Unlike IAS 39, the ED does not contain an exception for unquoted equity investments that do not have a reliably determinable fair value.	Same as ED. However, IFRS 9 provides additional measurement guidance on measuring fair value of unquoted equity instruments.
Embedded derivatives in financial hybrid contracts	Embedded derivative guidance is eliminated for hybrid financial contracts. Typically, hybrid financial contracts with embedded derivatives, which currently must be bifurcated, would not meet the cash flow characteristics test, so the ED would require an entity to measure the hybrid contract at FVTPL.	Same as ED, except the embedded derivative guidance in IAS 39 would continue to apply to financial liabilities (see "Scope" above).
Securitization tranches	If contractually linked instruments are issued by an entity in tranches that allocate credit risk between the tranches, generally only the most senior tranche could meet the cash flow characteristics test for amortized cost measurement. All more junior tranches would be classified as FVTPL since they are deemed to have written credit protection to the more senior tranches.	Tranches of contractually linked instruments pass the cash flow characteristics test for amortized cost measurement if they meet all of the following three conditions: <ul style="list-style-type: none"> • The tranche has contractual cash flows of principal and interest on principal. • The underlying pool of financial instruments meets certain criteria ("look through" test). • The exposure to credit risk in the underlying pool of financial instruments inherent in the tranche is equal to or lower than the exposure to credit risk of the underlying pool of financial instruments.

⁷ See Deloitte's [July 27, 2009, Heads Up](#) for a discussion of this ED.

⁸ IAS 18, *Revenue*.

Subject	IASB's July 2009 ED	IFRS 9
Financial assets acquired at a discount that reflect incurred credit losses	Does not meet the business model test for amortized cost measurement.	Could meet the business model test for amortized cost measurement.
Fair value option	Retained when a fair value designation eliminates an accounting mismatch.	Same as ED, except the revised fair value option would apply to financial assets only (see "Scope" above). The existing IAS 39 fair value option would continue to apply to financial liabilities designated as FVTPL.
Reclassification	Not permitted.	Reclassifications are required for financial assets that meet the cash flow characteristics test if the business model changes. However, a change in business model is expected to be very infrequent.

Appendix C

The following table compares IFRS 9 and the FASB's tentative decisions reached through November 16, 2009, on the classification and measurement model.⁹ Note that the FASB has not made any final decisions.

Subject	IFRS 9	FASB's Tentative Decisions
Categories of financial assets and financial liabilities	<p>Effectively, three categories for financial assets:</p> <ol style="list-style-type: none"> 1. Fair value through profit or loss (FVTPL). 2. Amortized cost. 3. Fair value through other comprehensive income (FVTOCI). <p>The available-for-sale and held-to-maturity categories in IAS 39 would be eliminated.</p>	<p>Effectively, three categories for financial instruments:</p> <ol style="list-style-type: none"> 1. Fair value through earnings. 2. FVTOCI. 3. Amortized cost. <p>All financial assets and financial liabilities (within the project's scope) would be measured at fair value on the balance sheet, with an optional exception for certain types of an entity's own debt, which may be recorded at amortized cost if it meets certain criteria.</p> <p>The available-for-sale and held-to-maturity categories in ASC 320¹⁰ (formerly Statement 115¹¹) and the held-for-sale and held-for-investment categories of loans under ASC 948¹² (formerly Statement 65¹³) and ASC 310¹⁴ (formerly SOP 01-6¹⁵) would be eliminated.</p>
Criteria for amortized cost measurement	<p>A financial asset must be carried at amortized cost if it meets both of the following two criteria:</p> <ol style="list-style-type: none"> 1. <i>Business model</i>— Objective of the entity's business model is to hold assets to collect the contractual cash flows. 2. <i>Cash flow characteristics</i>— Asset's contractual cash flows represent payment of principal and interest. 	<p>An entity has the option to elect to carry certain types of its own debt liabilities at amortized cost if it meets the criteria for classification as FVTOCI (see below) and such designation addresses an accounting mismatch.</p>
Criterion for FVTOCI classification	<p>Upon initial recognition, an entity has the option to irrevocably elect to classify an equity investment as FVTOCI. For this category, realized gains and losses are recorded in OCI, and dividend income is recorded in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment.</p>	<p>An entity has the option to classify a financial asset or financial liability as FVTOCI if it meets the following (business model and cash flow characteristics) criterion:</p> <p>Its business strategy is to hold a debt instrument with principal amount for collection or payment of contractual cash flows rather than sell or settle the debt instrument.</p>
Reclassification of accumulated OCI to net income	<p>Amounts in OCI are permanently deferred in equity.</p>	<p>Amounts in accumulated OCI are recycled to net income upon sale, settlement, or impairment.</p>
Equity investments	<p>All measured at fair value. Unlike current IAS 39, IFRS 9 does not contain an exception for unquoted equity investments that do not have a reliably determinable fair value. IFRS 9 provides additional measurement guidance on measuring fair value of unquoted equity instruments.</p>	<p>All measured at fair value through earnings. The FASB's tentative decisions do not allow nonmarketable equity securities to be accounted for at cost less impairment.</p>
Embedded derivatives in financial hybrid contracts	<p>Embedded derivative guidance is eliminated for hybrid financial assets within the scope of IAS 39. Typically, hybrid financial assets with embedded derivatives, which currently must be bifurcated, would not meet the cash flow characteristics test, so an entity will be required to classify the entire hybrid financial asset as FVTPL.</p>	<p>Hybrid financial contracts with an embedded derivative, which currently must be bifurcated under ASC 815¹⁶ (formerly Statement 133¹⁷), would instead be classified in their entirety as fair value through earnings.</p> <p>Hybrid financial contracts with an embedded derivative that does not require bifurcation under ASC 815 and meet the FVTOCI classification criteria (described above) are permitted to be classified as FVTOCI.</p>

⁹ See Deloitte's [October 27, 2009, Heads Up](#) for a comprehensive overview of the approaches of the two boards.

¹⁰ FASB Accounting Standards Codification Topic 320, *Investments — Debt and Equity Securities*.

¹¹ FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

¹² FASB Accounting Standards Codification Topic 948, *Financial Services — Mortgage Banking*.

¹³ FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*.

¹⁴ FASB Accounting Standards Codification Topic 310, *Receivables*.

¹⁵ AICPA Statement of Position 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*.

¹⁶ FASB Accounting Standards Codification Topic 815, *Derivatives and Hedging*.

¹⁷ FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

Subject	IFRS 9	FASB's Tentative Decisions
Securitization tranches	<p>Tranches of contractually linked instruments pass the cash flow characteristics test for amortized cost measurement if they meet all three of these conditions:</p> <ul style="list-style-type: none"> • The tranche has contractual cash flows of principal and interest on principal. • The underlying pool of financial instruments meets certain conditions ("look through" test). • The exposure to credit risk in the underlying pool of financial instruments inherent in the tranche is equal to or lower than the exposure to credit risk of the underlying pool of financial instruments. 	<p>This will depend on what the FASB concludes in its deliberations on its proposed ASU, <i>Scope Exception Related to Embedded Credit Derivatives</i>. If an embedded credit feature would have been subject to bifurcation under ASC 815 (formerly Statement 133), the hybrid instrument would be recorded at fair value through earnings. If, however, the instrument would not meet the criteria for bifurcation, the hybrid instrument may be eligible for classification as FVTOCI.</p> <p>The proposed ASU (on scope exception related to embedded credit derivatives) clarifies that an embedded credit derivative that arises in a securitization structure that redistributes credit risk between tranches solely through subordination meets the embedded derivative scope exception. However, other embedded credit derivatives in the securitization structure that are not only in the form of subordination (e.g., credit default swaps) still would be subject to bifurcation analysis.</p>
Fair value option	Retained for financial assets when a fair value designation eliminates an accounting mismatch; irrevocable election at initial recognition.	No explicit fair value option.
Reclassification	Required for a financial asset that meets the cash flow characteristics test if the business model changes; however, changes in the business model are expected to be infrequent.	Not permitted.

Appendix D

The table below compares the FASB's tentative decisions and the IASB's ED on the impairment model.¹⁸

Subject	IASB's Exposure Draft, November 2009	FASB's Tentative Decisions
Scope of application	Financial assets measured at amortized cost.	Financial assets classified as FVTOCI.
Credit impairment model	Based on the present value of expected future cash flows taking into account future events (i.e., through the life of the financial asset).	Based on the present value of expected future cash flows taking into account all available information on past events and existing conditions. An entity would not consider possible future events.
Determination of the effective interest rate (EIR)	Based on the initial net carrying amount and initially expected future cash flows that are adjusted for expected future credit losses.	Not yet deliberated.
Trigger for impairment	No trigger.	No trigger.
Initial recognition	Recognition of a loss on initial recognition is prohibited.	Not yet deliberated.
Interest recognition	Net interest revenue is adjusted to exclude a margin for initially expected future credit losses through the application of the EIR method.	Not yet deliberated.
Allowance for expected future losses	Gradually built over the life of a financial asset as a result of the deduction of a margin for future credit losses from net interest revenue.	Not yet deliberated.
Subsequent impairments	Continual reassessment. Will result in recognition of a gain or loss in earnings if there is a change in expected future cash flows.	Continual reassessment. Will result in recognition of a gain or loss in earnings if there is a change in expected future cash flows.

The table below compares the tentative decisions by the FASB and IASB on the hedge accounting model.¹⁹

Subject	IASB's Tentative Decisions	FASB's Tentative Decisions
Cash flow hedge accounting	Assessment and measurement requirements would be simplified.	Not yet deliberated.
Fair value hedge accounting	Fair value hedge accounting would be replaced with a model similar to cash flow hedge accounting. This would result in: <ul style="list-style-type: none"> • Recognition outside of profit or loss of any gains or losses on the hedging instrument to the extent the hedge is effective. • No fair value adjustments to the carrying amount of the hedged item. • The "lower of" test will not apply to fair value hedges. Therefore, ineffectiveness resulting from both underhedges and overhedges is recognized in profit or loss. Unlike cash flow hedges, therefore, fair value changes arising on the hedged item in excess of fair value changes arising on the hedging instrument would be recognized in profit or loss. 	Not yet deliberated.

¹⁸ See Deloitte's [November 10, 2009, Heads Up](#) for a discussion of the impairment model proposed by the IASB.

¹⁹ See Deloitte's [October 27, 2009, Heads Up](#) for an overview of the approaches of the two boards.

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