Financial Instruments: Classification and Measurement

Date (2013)	Discussions	IASB Tentative Decisions
17 September (Joint meeting between IASB and FASB)	**Agenda Paper 6B** • Discussed, for educational purposes, the key observations on amortised cost as a measurement basis.	• No tentative decisions were made.
	Agenda Paper 6C • IASB and FASB discussed the term 'principal' for the purposes of the application to the solely principal and interest (P&I) condition.	Principal (IASB and FASB) • principal should be described as the amount transferred by the holder for the financial asset on initial recognition.
	Agenda Paper 6D • IASB and FASB discussed the term 'interest' for the purposes of the application to the solely P&I condition, including the meaning of 'time value of money' and the application of that concept to regulated interest rates.	Interest (IASB and FASB) • to clarify the meaning of 'interest', specifically 1. to clarify that de minimis features should be disregarded for classification; 2. to emphasise the underlying conceptual basis for the solely P&I condition—that is, the notion of a basic lending-type return; 3. to confirm that time value of money and credit risk are typically the most significant components of a basic lending-type return however not the only possible components; 4. to clarify that a basic lending-type return also generally includes consideration for liquidity risk, profit margin and consideration for costs associated with holding the financial asset over time (such as servicing costs); 5. to emphasise what are not the components of a basic lending-type return and why (for example, indexation to equity prices); and 6. to clarify the meaning of the time value of money, specifically:

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		a) to clarify the objective of the consideration for the time value of money—that is, to provide consideration for just the passage of time, absent return for other risks and costs associated with holding the financial asset over time; b) to articulate the factors relevant to providing consideration for the passage of time—notably, the tenor of the interest rate and the currency of the instrument; c) to clarify that both qualitative and quantitative approaches could be used to determine whether the interest rate provides consideration for just the passage of time, if the time value of money component of the interest rate is modified (for example, by an interest rate tenor mismatch feature) but do not prescribe when each approach should be used; and d) to not allow a fair value option in lieu of the quantitative assessment. • to accept regulated interest rates as a proxy for the consideration for the time value of money if those rates provide consideration that is broadly consistent with consideration for the passage of time and do not introduce exposure to risks or volatility in cash flows that are inconsistent with the basic lending-type relationship [IASB and FASB].
		• to provide guidance on how the quantitative assessment of a financial asset with a modified time value of money component should be performed—that is, by considering the contractual (undiscounted) cash flows of the instrument relative to the benchmark instrument—and to replace the 'not more than insignificant' threshold in the boards' proposals by the 'not significant' threshold (that is, a financial asset with the modified time value of money component of the interest rate would meet the solely P&I condition if its contractual cash flows could not be significantly different from the benchmark instrument's cash flows). • [FASB directed staff to perform further analysis of the operational aspects of this assessment].

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<tr><th>Date (2013)</th><th>Discussions</th><th>IASB Tentative Decisions</th></tr>
<tr><td></td><td>Agenda Paper 6E
• IASB and FASB discussed the application of the solely P&I condition to financial assets with contingent features.</td><td><u>Contingent features (IASB and FASB)</u>

• to clarify that the nature of the contingent trigger event in itself does not determine the classification of the financial asset. In addition, the boards tentatively decided that in clarifying the guidance on contingent features no distinction should be made between contingent prepayment and extension features and other types of contingent features [IASB and FASB].

• a contingent feature that results in contractual cash flows that are not solely P&I is inconsistent with the solely P&I condition unless the feature is non-genuine.

[FASB only - if a contingent feature results in contractual cash flows that are not solely P&I but those non- P&I cash flows have a remote probability of occurrence, it is consistent with the solely P&I condition. If the occurrence of non-P&I cash flows no longer remains remote, an entity will be required to reclassify the financial asset into the fair value through profit or loss (FVPL) category. However, reclassifications out of the FVPL category will be prohibited. (4 of 7 FASB members agreed). FASB directed staff to perform further analysis of contingent features that provide protective rights to the holder.]</td></tr>
<tr><td></td><td>Agenda Paper 6F
• IASB and FASB discussed the application of the solely P&I condition to financial assets with prepayment and extension features.</td><td><u>Contingent prepayment features (IASB and FASB)</u>

• to clarify that the nature of the contingent trigger event in itself does not determine the classification of the financial asset. The boards tentatively decided that no distinction should be made between contingent prepayment and extension features and other types of contingent features.

• With one exception (see the following tentative decision), the IASB also tentatively decided to confirm that a prepayment feature that results in contractual cash flows that are not solely P&I is inconsistent with the solely P&I condition unless the feature is non-genuine.

• Notwithstanding the previous tentative decision, the IASB tentatively decided to provide an exception for financial assets that meet the following conditions:

1. the financial asset is acquired or originated with a significant premium or discount</td></tr>
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		2. the financial asset is prepayable at the amount that represents par accrued and unpaid interest (and may include reasonable additional compensation for the early termination of the contract), and 3. the fair value of the prepayment feature on initial recognition of the financial asset is insignificant. • Such financial assets will be eligible for classification at other than FVPL (subject to the business model assessment). • [FASB only - if a prepayment feature results in contractual cash flows that are not solely P&I but those non- P&I cash flows have a remote probability of occurrence, it is consistent with the solely P&I condition. If the occurrence of non-P&I cash flows no longer remains remote, an entity will be required to reclassify the financial asset into FVPL category. However, reclassifications out of the FVPL category will be prohibited.]
29 October Meeting of the IASB and FASB	**Jointly held education session between the IASB and FASB** • on the business model assessment. The boards discussed possible clarifications to the business model assessment in general, as well as possible clarifications related specifically to each of the three measurement categories.	• No tentative decisions were made.
21 November Meeting of the IASB and FASB	**Agenda Paper 6A: Overall Business Model Assessment** • The IASB and FASB discussed the clarifications to the business model assessment meaning of the term business model.	The meaning of the term *business model*, the role of cash flow realisation and the level on which the business model is assessed (IASB and FASB) • the business model assessment should: a) refer to the actual management of financial assets in order to generate cash flows and create value for the entity—ie whether the likely actual cash flows will result primarily from the collection of contractual cash flows, sales proceeds or both; b) allocate financial assets to the measurement attribute that will provide the most relevant and useful information about how activities and risks are managed to

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		generate cash flows and create value; and c) be assessed at a level that reflects (groups of) financial assets managed together to achieve a particular (common) objective. <u>How the business model and a change in the business model should be assessed (IASB and FASB)</u> IASB and FASB; to clarify that: a) the entity's business model for managing financial assets is often observable through particular activities that are undertaken to achieve the objectives of that business model; b) sales do not drive the business model assessment and information about sales activity should not be considered in isolation; and c) a change in the business model will occur only when an entity has either stopped or started doing something on a level that is significant to its operations—and that would generally be the case only when the entity has acquired or disposed of a business line. (4 of 7 FASB members agreed). IASB only to clarify that: a) business activities usually reflect the way in which the performance of the business model and underlying financial assets in that business model are evaluated and reported (ie key performance indicators) as well as the risks that typically affect the performance of the business model and how those risks are managed; b) an entity should consider all relevant and objective information that is available at the date of the assessment but should not consider every 'what if' or worse-case scenario if the entity does not reasonably expect those scenarios to occur; and c) if cash flows are realised in a way that is different from the entity's expectations at the date that the business model assessment was made, it will neither:

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		i. result in the restatement of prior period financial statements; nor ii. change the classification of the remaining financial assets in the business model as long as the entity considered all relevant and objective information that was available at the time that it made the assessment. d) [FASB only - to converge the guidance in its tentative classification and measurement model with IFRS 9 Financial Instruments regarding the date on which reclassification is reflected in the financial statements. Specifically, the FASB tentatively decided that the reclassification date would be the first day of the first reporting period following the change in the business model. The FASB had earlier proposed that the reclassification date should be the last day of the reporting period in which the change in the business model occurs. (4 of 7 FASB members agreed)].
	Agenda Paper 6B: Hold to Collect Business Model • The IASB and FASB discussed clarifications to the hold and collect business model.	<u>Hold to collect business model (IASB and FASB)</u> • IASB and FASB: to clarify the application guidance for the hold to collect business model as set out in paragraph 62 (a)-(d) of the observer notes for Agenda Paper 6B, specifically: a) to reinforce the current hold to collect 'cash flows (value) realisation' concept; b) to emphasise that insignificant and/or infrequent sales may not be inconsistent with the hold to collect business model; c) to clarify that sales information should not be considered in isolation and is not determinative; and d) to clarify that credit risk management activities aimed at minimising potential credit losses due to credit deterioration are integral to the hold to collect objective. • [FASB only - as part of the clarifications under point (a), the guidance on the hold to collect business model should emphasise activities aimed at achieving the business model's objective.] • IASB and FASB: sales made in managing concentration of credit risk should be assessed

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		in the same way as any other sales made in the business model. (4 of 7 FASB members agreed)
	Agenda Paper 6C: Fair Value Categories • The IASB and FASB discussed the fair value measurement categories.	<u>Fair value measurement categories (IASB and FASB)</u> • to retain two fair value measurement categories, that is fair value through other comprehensive income (FVOCI) and FVPL, and to define the business model that results in measurement at FVOCI and to retain FVPL as the residual measurement category. <u>FVPL category (IASB and FASB)</u> • to clarify the application guidance for the FVPL measurement category, specifically that: a) financial instruments managed and evaluated on a fair value basis or held for trading purposes must be measured at FVPL; and b) for financial assets that are measured at FVPL, the entity makes decisions based on changes in—and with the objective of realising—the assets' fair value. • IASB only - to clarify that the activities that the entity undertakes in the FVPL measurement category are primarily focused on fair value information, and key management personnel uses that fair value information to assess the assets' performance and to make decisions accordingly. In addition, another indicator is that the users of the financial statements are primarily interested in fair value information of these assets in order to assess the entity's performance.
		<u>FVOCI category (IASB and FASB)</u> • to clarify the application guidance for the FVOCI measurement category, as set out in paragraph 76(a)–(c), (d)(ii)–(d)(iv) and (e) of the observer notes for Agenda Paper 6C, specifically that: a) in the FVOCI business model, managing financial assets both to collect contractual cash flows and for sale is the outcome of the way in which financial assets are managed to achieve a particular objective rather than the objective itself; that is, the assets classified in FVOCI are managed to achieve the business model objectives

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		(such as liquidity management, interest rate risk management, yield management and duration mismatch management) by both collecting contractual cash flows and selling; b) both collection of contractual cash flows and realisation of cash flows through selling are integral to the performance of the FVOCI business model and there is no threshold for the frequency or amount of sales in the FVOCI business model; and c) particular activities are typically aimed at achieving the FVOCI business model objectives. • IASB only - to clarify that for financial assets in the hold to collect and sell business model, the key performance indicators include the contractual interest yield, impairment charges and fair value changes. [In addition, the FASB tentatively decided to remove the guidance in the FASB's Exposure Draft requiring an individual asset for which an entity has, at initial recognition, not yet determined whether it will hold the financial asset to collect contractual cash flows or sell to be measured at FVOCI.]
12 December Meeting of the IASB	• The IASB discussed the fair value option in IFRS 9 *Financial Instruments*.	• to confirm the proposal in its recent ED to extend the current fair value option in IFRS 9 to financial assets that would otherwise be mandatorily measured at fair value through other comprehensive income. Thus an entity may measure these financial assets at fair value through profit or loss if doing so would eliminate or significantly reduce a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch'). That designation would be permitted only at initial recognition and would be irrevocable.
23 January (2014) Meeting of the IASB	**Agenda Paper 6A: Interaction between the classification and measurement of financial assets and the accounting for insurance contracts liabilities** • The IASB discussed the interaction between the classification and measurement of financial assets under IFRS 9 Financial Instruments (including the tentative decisions made in redeliberating the	• The IASB noted that the proposals in the Limited Amendments ED that were tentatively reaffirmed in the redeliberations – specifically the introduction of the fair value through other comprehensive income (FVOCI) measurement category for financial assets that reflects the 'hold and sell' business model and the extension of the fair value option to financial assets that would otherwise be measured at FVOCI – are relevant to many entities that hold insurance contracts and result in an improved interaction. These tentative decisions also provide a 'toolkit' that the IASB can consider when finalising the accounting model for insurance contracts liabilities. The IASB also noted that it will consider the

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	Limited Amendments ED) and the accounting for insurance contracts liabilities under the Exposure Draft ED/2013/7 Insurance Contracts (the '2013 Insurance Contracts ED'), including the feedback received on that interaction.	feedback related to the accounting model for the insurance contracts liabilities, and whether that model should be modified to reflect the interaction with the classification and measurement for financial assets, when redeliberating the 2013 Insurance Contracts ED.
	Agenda Paper 6B: Presentation and Disclosure • The IASB discussed the presentation and disclosure proposals in the Limited amendments ED and the feedback received on those proposals.	a) paragraph 12B of IFRS 7 Financial Instruments: Disclosures will be extended to reclassifications into and out of the FVOCI measurement category; b) paragraph 12C of IFRS 7 will be extended to reclassifications from the fair value through profit or loss (FVPL) measurement category into the FVOCI measurement category; c) paragraph 12D of IFRS 7 will be extended to: i. reclassifications from the FVPL measurement category into the FVOCI measurement category; and ii. reclassifications from the FVOCI measurement category into the amortised cost measurement category. d) paragraph 82 in IAS 1 Presentation of Financial Statements will be amended to require the presentation of any cumulative gain or loss previously recognised in other comprehensive income that is reclassified to profit or loss when a financial asset is reclassified from the FVOCI measurement category into the FVPL measurement category; and e) the judgement involved in the assessment of a financial asset's contractual cash flow characteristics will be added to paragraph 123 of IAS 1 as an example of a judgement that could have a significant effect on the amounts recognised in the financial statements.
	Agenda Paper 6C: Transition to IFRS 9—presentation of comparative information by first-time adopters of IFRS and the early application of IFRS 9	In regards to the presentation of comparative information the IASB tentatively decided: a) FTAs will not be required to present comparative information that complies with the completed version of IFRS 9 if the beginning of their first IFRS reporting period is

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	• The IASB discussed the presentation of comparative information by first-time adopters of IFRS (FTAs). • The IASB also discussed the early application by both existing IFRS preparers and FTAs of both the completed and the previous versions of IFRS 9.	earlier than the mandatory effective date of IFRS 9 plus one year; and b) if an FTA chooses to present comparative information that does not comply with the completed version of IFRS 9, it will be required to provide the same disclosures that were required by IFRS 1 First-time Adoption of International Financial Reporting Standards for an FTA that transitioned to IFRS 9 (2009) or IFRS 9 (2010) and that chose not to present comparative information that complied with those new Standards. Those disclosures are set out in paragraph E2 of IFRS 1. In regards to early application the IASB tentatively decided. a) entities will be permitted to early apply the completed version of IFRS 9; and b) entities will not be permitted to early apply a previous version of IFRS 9 if their date of initial application is six months or more after the completed version of IFRS 9 is issued. (However, if an entity has early applied a previous version of IFRS 9 before the 'six month window' expires, the entity is permitted to continue to apply that version until the completed version of IFRS 9 becomes mandatorily effective.)
	Agenda Paper 6D: Transition to IFRS 9—application of particular classification and measurement requirements and a transition issue on impairment • The IASB discussed the transition to the completed version of IFRS 9	a) if it is impracticable (as defined by IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors) on transition to IFRS 9 for an entity to assess a modified time value of money component of an asset's interest rate based on the facts and circumstances that existed at the initial recognition of the financial asset, then the entity must assess the contractual cash flow characteristics of that financial asset without taking into account the specific requirements related to the modification of the asset's interest rate. In addition, in those cases, the entity will be required to disclose the carrying value of the financial assets until those assets are derecognised. b) if it is impracticable (as defined by IAS 8) on transition to IFRS 9 for an entity to assess whether the fair value of a prepayment feature was insignificant at the initial recognition of a financial asset that was originated (or acquired) with a significant premium or discount and is prepayable at par (plus accrued and unpaid interest), an entity shall assess the contractual cash flow characteristics of that financial asset without taking into account the specific exception for prepayment features. In addition, in those cases the entity will be required to disclose the carrying value of the

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		financial assets until those assets are derecognised. c) entities that have already applied a previous version of IFRS 9 and are subsequently applying the completed version of IFRS 9 will be: i. required to revoke previous fair value option designations if an accounting mismatch no longer exists at initial application of the completed version of IFRS 9 as a result of the amended classification and measurement requirements, but are not permitted to revoke previous fair value option designations if an accounting mismatch continues to exist; and ii. permitted to apply the fair value option to new accounting mismatches that are created by the initial application of the amended classification and measurement requirements in the completed version of IFRS 9, but are not permitted to newly apply the fair value option to accounting mismatches that already existed before the initial application of the completed version of IFRS 9. d) the transition provisions on the initial application of the expected credit loss model that the IASB tentatively decided to require for existing IFRS preparers (see December IASB Update) should also be required for FTAs.