AASB Exposure Draft

ED 184
July 2009

Financial Instruments: Classification and Measurement

Comments to AASB by 17 August 2009

Australian Government

Australian Accounting Standards Board

Commenting on this AASB Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 17 August 2009. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 14 September 2009. Comments should be addressed to:

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Respondents to the IASB are asked to send their comments electronically through the 'Open to Comment' page on the IASB website (www.iasb.org)

All non-confidential submissions to the AASB will be made available to the public on the AASB website: www.aasb.gov.au.

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This AASB Exposure Draft is available on the AASB website: www.aasb.gov.au. Alternatively, printed copies of this AASB Exposure Draft are available by contacting:

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AASB REQUEST FOR COMMENTS

In light of the Australian Accounting Standards Board's (AASB's) policy of incorporating International Financial Reporting Standards (IFRSs) into Australian Accounting Standards, the AASB is inviting comments on:

(a) any of the proposals in the attached International Accounting Standards Board (IASB) Exposure Draft, including the specific questions on the proposals as listed in the Invitation to Comment section of the attached IASB Exposure Draft; and

(b) the 'AASB Specific Matters for Comment' listed below.

The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

Due Date for Comments to the AASB

Comments should be submitted to the AASB by 17 August 2009. This will enable the AASB to consider those comments in the process of formulating its own comments to the IASB. Constituents are also strongly encouraged to send their response to the IASB.

AASB Specific Matters for Comment

The AASB would particularly value comments on whether:

(a) there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

    (i) not-for-profit entities; and

    (ii) public sector entities.

(b) overall, the proposals would result in financial statements that would be useful to users; and

(c) the proposals are in the best interests of the Australian economy.

July 2009

Exposure Draft ED/2009/7

Financial Instruments: Classification and Measurement

Comments to be received by 14 September 2009

International Accounting Standards Board®

Exposure Draft

FINANCIAL INSTRUMENTS: CLASSIFICATION AND MEASUREMENT

Comments to be received by 14 September 2009

ED/2009/7

This exposure draft *Financial Instruments: Classification and Measurement* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued as an International Financial Reporting Standard (IFRS). Comments on the draft IFRS and its accompanying documents (see separate booklets) should be submitted in writing so as to be received by **14 September 2009.** Respondents are asked to send their comments electronically to the IASB website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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Introduction and invitation to comment

Reasons for publishing the exposure draft

IN1 IAS 39 *Financial Instruments: Recognition and Measurement* sets out the requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. The International Accounting Standards Board inherited IAS 39 from its predecessor body, the International Accounting Standards Committee.

IN2 Many users of financial statements and other interested parties have told the Board that the requirements in IAS 39 are difficult to understand, apply and interpret. They have urged the Board to develop a new standard of financial reporting for financial instruments that is principle-based and less complex. Although the Board has amended IAS 39 several times to clarify requirements, add guidance and eliminate internal inconsistencies, it has not previously undertaken a fundamental reconsideration of reporting for financial instruments.

IN3 Since 2005, the Board and the US Financial Accounting Standards Board (FASB) have had a long-term objective to improve and simplify the reporting for financial instruments. In March 2008 the boards published a discussion paper *Reducing Complexity in Reporting Financial Instruments*. That paper discussed the main causes of complexity in reporting financial instruments and possible intermediate and long-term approaches to improving financial reporting and reducing complexity. The boards received 162 comment letters. In the discussions leading to the exposure draft *Financial Instruments: Classification and Measurement*, the Board considered relevant recommendations and suggestions about classification and measurement from those comment letters.

IN4 In October 2008, as part of a joint approach to dealing with the reporting issues arising from the global financial crisis, the boards set up a Financial Crisis Advisory Group (FCAG). The FCAG was asked to consider how improvements in financial reporting could help enhance investor confidence in financial markets. The FCAG expects to publish a report in the third quarter of 2009. However, the exposure draft reflects its discussions to date. The exposure draft also draws on input that the Board obtained from discussions with interested parties, in particular, from three public round tables held to discuss reporting issues that arose from the financial crisis.

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IN5 In April 2009, in response to the input received as a result of their work responding to the financial crisis, and following the conclusions of the G20 leaders and the recommendations of international bodies such as the Financial Stability Board, the boards announced an accelerated timetable for replacing their respective financial instruments standards.

The IASB's approach to replacing IAS 39

IN6 The Board noted requests from interested parties that the accounting for financial instruments should be improved quickly. The G20 leaders recommended that the Board take action by the end of 2009 to improve and simplify the accounting requirements for financial instruments. To achieve this, the Board divided its project to replace IAS 39 into three phases. As the Board completes each phase, it will delete the relevant portions of IAS 39 and, along with its current project on the derecognition of financial instruments, create an IFRS that will eventually replace IAS 39. The Board published an exposure draft on derecognition in March 2009.

IN7 This exposure draft proposes requirements for the classification and measurement of financial assets and financial liabilities. The Board decided to address those aspects first because they form the foundation of a standard on reporting financial instruments. Moreover, many of the concerns that have been expressed during the financial crisis arise from the classification and measurement requirements of IAS 39.

IN8 In its deliberations leading to the exposure draft, the Board discussed alternative approaches for improving the reporting for financial instruments. The exposure draft discusses one alternative approach (and possible variants of that approach) and asks respondents for comments.

Presentation of the contents of this exposure draft

IN9 The proposals in this exposure draft would necessitate extensive consequential amendments to IAS 39 and other IFRSs and to the guidance on those IFRSs. For the convenience of readers, all of those proposed amendments are set out in a separate booklet.

Next steps

IN10 The Board plans to develop an IFRS from the proposals in this exposure draft to be available for early adoption in time for 2009 year-end financial statements. The Board also expects to publish exposure drafts in the

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fourth quarter of 2009 on impairment of financial assets and hedge accounting. The Board will review the effective date of the proposals from the three exposure drafts in due course, but expects that the new requirements will not be mandatorily effective before January 2012, although early application of any finalised requirements on impairment and hedge accounting may also be permitted.

IN11 The Board and the FASB are committed to working together to develop a comprehensive standard to improve the measurement and reporting of financial instruments. The Board has chosen to complete the project in three phases. However, the FASB believes that it will be important to its constituents to be able to comment on a proposed standard including classification, measurement and impairment at the same time. It is not uncommon for the boards to deliberate separately on joint projects and then subsequently to reconcile any differences in their technical decisions. At the time this exposure draft was published, the FASB had not deliberated what the basic classification model for financial instruments should be but planned to do so shortly.

Other relevant IASB activities

Credit risk in liability measurement

IN12 In June 2009 the IASB published a discussion paper on the role of credit risk in liability measurement (commonly referred to as 'own credit risk'), together with a staff paper that described the most common arguments for and against including credit risk in measuring liabilities. The Board acknowledged that the issue of whether profit or loss resulting from changes in 'own credit risk' should be recognised when a financial liability is measured at fair value has generated more comment and controversy than any other issue about the use of fair value, especially during the recent financial crisis. The discussion paper asks whether current measurements of liabilities (including fair value) should incorporate the probability that an entity will fail to perform as required and, if not, what the alternatives are.

IN13 The discussion paper seeks comment on three possible approaches to liability measurement set out in the staff paper. Those approaches identify possible ways to measure liabilities while excluding own credit risk, as follows:

(a) Measure all liabilities using the risk-free rate of interest and expected future cash flows, excluding any expectations about

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default. Any difference between the resulting amount and cash proceeds (if any) should be charged to profit or loss immediately.

(b) Measure all liabilities using the risk-free rate of interest and expected future cash flows, excluding any expectations about default. Any difference between the resulting amount and cash proceeds (if any) should be charged to equity and amortised over the life of the liability.

(c) Measure borrowings and other liabilities that result from an exchange for cash at the amount of the cash proceeds. Measure liabilities that do not have a cash exchange at the present value of expected future cash flows, discounted at market rates that exclude the effect of credit risk. Subsequent current measurements should incorporate changes in market interest rates. Changes arising from the entity's credit quality or the price of its credit should be excluded from the market interest rates. This would have the effect of fixing the credit spread at the original amount and incorporating all changes in the risk-free rate.

IN14 The discussion paper is open for comment until 1 September 2009 and can be accessed free of charge on *e*IFRS or on the 'Open to comment' section on the IASB's website (www.iasb.org). The Board believes that responses to the discussion paper will be relevant to this project and intends to consider them along with the responses to this exposure draft when it reconsiders and finalises the proposals in this exposure draft.

Summary of the proposals and invitation to comment

The Board invites comments on all matters in this exposure draft, and in particular on the questions set out in the following paragraphs. Respondents need not comment on all of the questions. Comments are most helpful if they:

(a) respond to the questions as stated

(b) indicate the specific paragraph or paragraphs to which the comments relate

(c) contain a clear rationale

(d) describe any alternatives the Board should consider.

The Board is not seeking comments on aspects of IAS 39 not addressed in this exposure draft.

Comments should be submitted in writing so as to be received no later than **14 September 2009**.

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Classification approach (paragraphs 3–5)

The exposure draft proposes two primary measurement categories for financial instruments. A financial asset or financial liability would be measured at amortised cost if two conditions are met:

- the instrument has basic loan features, and
- the instrument is managed on a contractual yield basis.

A financial asset or financial liability that does not meet both conditions would be measured at fair value.

The proposed approach would reduce the complexity that results from the many categories and related impairment methods in IAS 39. The proposed approach would also simplify accounting requirements by eliminating the 'tainting' provision in IAS 39, ie the exposure draft contains no proposal to prohibit an entity from measuring a financial asset at amortised cost if the entity has previously sold other financial assets measured at amortised cost before maturity. However, an entity would be required to separately present in the statement of comprehensive income gains or losses arising from the derecognition of a financial asset or financial liability measured at amortised cost and provide additional disclosures.

Question 1

Does amortised cost provide decision-useful information for a financial asset or financial liability that has basic loan features and is managed on a contractual yield basis? If not, why?

Question 2

Do you believe that the exposure draft proposes sufficient, operational guidance on the application of whether an instrument has 'basic loan features' and 'is managed on a contractual yield basis'? If not, why? What additional guidance would you propose and why?

Question 3

Do you believe that other conditions would be more appropriate to identify which financial assets or financial liabilities should be measured at amortised cost? If so,

(a) what alternative conditions would you propose? Why are those conditions more appropriate?

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(b) if additional financial assets or financial liabilities would be measured at amortised cost using those conditions, what are those additional financial assets or financial liabilities? Why does measurement at amortised cost result in information that is more decision-useful than measurement at fair value?

(c) if financial assets or financial liabilities that the exposure draft would measure at amortised cost do not meet your proposed conditions, do you think that those financial assets or financial liabilities should be measured at fair value? If not, what measurement attribute is appropriate and why?

Embedded derivatives (paragraphs 6–8)

The exposure draft proposes that a hybrid contract with a host that is within the scope of the proposed IFRS ('financial host') is classified in its entirety in accordance with the proposed classification approach.

Many consider the accounting requirements in IAS 39 for embedded derivatives complex and rule-based. The exposure draft would simplify those accounting requirements by proposing a single classification approach for all financial instruments including hybrid contracts with financial hosts.

The exposure draft also addresses investments in contractually subordinated interests (ie tranches). The exposure draft proposes to apply the classification criteria to such investments by requiring that any tranche that provides credit protection to other tranches on the basis of any possible outcome (rather than a probability-weighted outcome) must be measured at fair value because provision of such credit protection is a form of leverage and not a basic loan feature.

Question 4

(a) Do you agree that the embedded derivative requirements for a hybrid contract with a financial host should be eliminated? If not, please describe any alternative proposal and explain how it simplifies the accounting requirements and how it would improve the decision-usefulness of information about hybrid contracts.

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(b) Do you agree with the proposed application of the proposed classification approach to contractually subordinated interests (ie tranches)? If not, what approach would you propose for such contractually subordinated interests? How is that approach consistent with the proposed classification approach? How would that approach simplify the accounting requirements and improve the decision-usefulness of information about contractually subordinated interests?

Fair value option (paragraph 9)

The exposure draft retains the fair value option in IAS 39 that permits an entity to elect at initial recognition to measure any financial asset or financial liability within the scope of the exposure draft at fair value through profit or loss if such designation eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch').

IAS 39 also permits designation of financial assets and financial liabilities at fair value through profit or loss:

- when a group of financial assets, financial liabilities or both 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; or
- for some contracts that contain one or more embedded derivatives.

Under the proposed approach, these eligibility conditions are not needed. The proposals would require financial instruments that do not have basic loan features or are not managed on a contractual yield basis to be measured at fair value and would eliminate the requirement to identify and account for embedded derivatives separately.

Question 5

Do you agree that entities should continue to be permitted to designate any financial asset or financial liability at fair value through profit or loss if such designation eliminates or significantly reduces an accounting mismatch? If not, why?

Question 6

Should the fair value option be allowed under any other circumstances? If so, under what other circumstances should it be allowed and why?

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Reclassification (paragraph 10)

The exposure draft proposes to prohibit reclassification of financial assets and financial liabilities between the amortised cost and fair value categories.

This proposal would improve comparability and eliminate the need for complex reclassification requirements.

Question 7

Do you agree that reclassification should be prohibited? If not, in what circumstances do you believe reclassification is appropriate and why do such reclassifications provide understandable and useful information to users of financial statements? How would you account for such reclassifications, and why?

Investments in equity instruments that do not have a quoted market price and whose fair value cannot be reliably measured

IAS 39 requires all investments in equity instruments (and derivatives on those equity instruments) to be measured at fair value, unless they do not have a quoted market price in an active market and their fair value cannot be reliably measured (and, in the case of derivatives, are settled by delivery of those equity instruments). Such instruments are measured at cost.

Moreover, IAS 39 requires the holder to monitor such investments for impairment and recognise a loss if one has been incurred. That requirement has been criticised because it is based on a calculation that is similar to fair value. Some have told the Board that the impairment calculation is not more reliable or less costly than measuring the equity investment at fair value.

The Board recognises that measuring all investments in equity instruments (and derivatives on those equity instruments) at fair value would impose additional costs on preparers. In the Board's view, these costs are justified by improved decision-useful information about equity investments for users of financial statements. Measuring all investments in equity instruments in the same way would also simplify the accounting requirements and improve comparability. Therefore, the exposure draft proposes that all investments in equity instruments (and derivatives on those equity instruments) should be measured at fair value. The Board notes that the relative costs and benefits may vary depending on the size of the entity and the significance of equity investments to its financial position and performance.

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Question 8

Do you believe that more decision-useful information about investments in equity instruments (and derivatives on those equity instruments) results if all such investments are measured at fair value? If not, why?

Question 9

Are there circumstances in which the benefits of improved decision-usefulness do not outweigh the costs of providing this information? What are those circumstances and why? In such circumstances, what impairment test would you require and why?

Investments in equity instruments that are measured at fair value through other comprehensive income (paragraphs 21 and 22)

An investment in equity instruments does not meet the conditions to be measured at amortised cost because it does not have basic loan features.

The Board has been told that some equity instruments are purchased for strategic purposes and are not held with the primary objective of realising a profit from increases in the value of the instrument and dividends. Therefore, the exposure draft proposes to permit an entity, on initial recognition of investments in equity instruments that are not held for trading but are held for purposes other than realising direct investment gains, to make an irrevocable election to present changes in the fair value of those investments in other comprehensive income. Dividends on such investments would also be presented in other comprehensive income. There would be no transfers from other comprehensive income to profit or loss ('recycling') and hence no impairment requirements.

This proposal is intended to assist users of financial statements to identify separately the gains and losses on equity instruments that are held for purposes other than realising direct investment gains and to assess the implications of such fair value changes accordingly.

Question 10

Do you believe that presenting fair value changes (and dividends) for particular investments in equity instruments in other comprehensive income would improve financial reporting? If not, why?

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Question 11

Do you agree that an entity should be permitted to present in other comprehensive income changes in the fair value (and dividends) of any investment in equity instruments (other than those that are held for trading), only if it elects to do so at initial recognition? If not,

(a) how do you propose to identify those investments for which presentation in other comprehensive income is appropriate? Why?

(b) should entities present changes in fair value in other comprehensive income only in the periods in which the investments in equity instruments meet the proposed identification principle in (a)? Why?

Effective date and transition (paragraphs 23–33)

The Board will review the effective date in due course, but expects that the new requirements will not be mandatorily effective before January 2012. The Board expects to permit early application of any finalised requirements.

The exposure draft proposes to amend IFRS 7 *Financial Instruments: Disclosures* to require additional disclosures if an entity decides to adopt the proposed IFRS before its mandated effective date.

The exposure draft also proposes specific requirements in paragraphs 24–33 for transition to the proposed IFRS.

Question 12

Do you agree with the additional disclosure requirements proposed for entities that apply the proposed IFRS before its mandated effective date? If not, what would you propose instead and why?

Question 13

Do you agree with applying the proposals retrospectively and the related proposed transition guidance? If not, why? What transition guidance would you propose instead and why?

An alternative approach

In its deliberations leading to the exposure draft, the Board discussed alternative approaches to classification and measurement.

One alternative approach was that financial assets that meet the two conditions specified in this exposure draft (ie they have basic loan features and are managed on a contractual yield basis) and meet the definition of loans and receivables in

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IAS 39 would be measured at amortised cost in the statement of financial position. All other financial assets would be measured at fair value in the statement of financial position, including assets that meet the conditions specified in this exposure draft to be measured at amortised cost. The fair value changes of such financial assets for each period would be disaggregated, and presented as follows:

(a) changes in recognised value determined on an amortised cost basis (including impairments determined using the incurred loss impairment requirements in IAS 39) would be presented in profit or loss; and

(b) any difference between the amortised cost measure in (a) and the fair value change for the period would be presented in other comprehensive income (OCI).

There would be no recycling between OCI and profit or loss. Any reversals of impairment losses would be recognised in profit or loss.

Some Board members think that this approach might provide decision-useful information to users of financial statements because fair value information is provided in the statement of financial position and changes in fair values are disaggregated (in profit or loss and OCI).

Question 14

Do you believe that this alternative approach provides more decision-useful information than measuring those financial assets at amortised cost, specifically:

(a) in the statement of financial position?

(b) in the statement of comprehensive income?

If so, why?

Possible variants of this alternative approach were also discussed.

One variant would be to present both (a) and (b) in profit or loss, but separately.

Another variant would be to measure all financial instruments (including financial assets that meet the two conditions specified in the exposure draft and meet the definition of loans and receivables in IAS 39) at fair value in the statement of financial position. All financial instruments (including financial liabilities) with basic loan features that are managed on a contractual yield basis would be disaggregated and presented as described in (a) and (b).

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Question 15

Do you believe that either of the possible variants of the alternative approach provides more decision-useful information than the alternative approach and the approach proposed in the exposure draft? If so, which variant and why?

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[Draft] International Financial Reporting Standard X *Financial Instruments: Classification and Measurement* ([draft] IFRS X) is set out in paragraphs 1–33 and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold** type state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the [draft] IFRS. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. [Draft] IFRS X should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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[Draft] International Financial Reporting Standard X *Financial Instruments: Classification and Measurement*

Objective

1 The objective of this [draft] IFRS is to establish principles for the classification and measurement of *financial assets* and *financial liabilities* that will present relevant and decision-useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of future cash flows. The principles in this [draft] IFRS complement the principles for recognising, presenting and providing disclosures about financial assets and financial liabilities in IAS 32 *Financial Instruments: Presentation*, IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures*.

Scope

2 **This [draft] IFRS shall be applied to all items within the scope of IAS 39.**

Classification approach

Two categories of financial assets and financial liabilities

3 **On initial recognition, an entity shall classify financial assets and financial liabilities as subsequently measured at either *amortised cost* or *fair value* in accordance with paragraphs 4 and 5.**

4 **A financial asset or financial liability shall (unless paragraph 9 applies) be measured at amortised cost if both of the following conditions are met:**

(a) the instrument has only basic loan features, and

(b) the instrument is managed on a contractual yield basis.

Paragraphs B1–B13 provide guidance on these conditions.

5 **A financial asset or financial liability that does not meet the conditions in paragraph 4 shall be measured at fair value. Changes in fair value shall be presented in profit or loss or other comprehensive income in accordance with paragraphs 19, 21 and 22.**

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Embedded derivatives

6 An embedded *derivative* is a component of a hybrid contract that also includes a non-derivative host—with the effect that some of the cash flows of the combined instrument vary in a way similar to the cash flows of a stand-alone derivative. If a derivative is attached to a *financial instrument* but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, that derivative is not an embedded derivative, but a separate financial instrument.

7 **If the host is not within the scope of this [draft] IFRS, an entity shall apply the requirements in paragraphs 10–13 and AG28-AG33 of IAS 39 to determine whether an embedded derivative must be separated from the host. If an embedded derivative must be separated from the host, the entity shall account for the derivative in accordance with paragraphs 3–5. The entity shall account for the host in accordance with other appropriate IFRSs.**

8 **An entity shall apply the requirements in paragraphs 3–5 to all other hybrid contracts.**

Option to designate a financial asset or financial liability at fair value through profit or loss

9 **At initial recognition, an entity may designate a financial asset or financial liability that would otherwise be measured subsequently at amortised cost, as measured at fair value through profit or loss if 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 recognising the gains and losses on them on different bases.**

Reclassification

10 **An entity shall not reclassify a financial asset or financial liability between the fair value and amortised cost categories.**

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Measurement

Initial measurement of financial assets and financial liabilities

11 **At initial recognition, an entity shall measure a financial asset or financial liability at its fair value (see paragraphs 48–49 and AG69–AG82 of IAS 39) plus, in the case of a financial asset or financial liability not at fair value through profit or loss, *transaction costs*.**

Subsequent measurement of financial assets and financial liabilities

Financial assets

12 **After initial recognition, an entity shall measure financial assets at fair value (see paragraphs 48–49 and AG69–AG82 of IAS 39) or amortised cost in accordance with paragraphs 3–9.**

13 **An entity shall apply the impairment requirements in paragraphs 58–65 and AG84–AG93 of IAS 39 to all financial assets measured at amortised cost.**

14 **An entity shall apply the hedge accounting requirements in paragraphs 89–102 of IAS 39 to financial assets that are designated as *hedged items* (see paragraphs 78–84 and AG98–AG101 of IAS 39).**

Financial liabilities

15 **After initial recognition, an entity shall measure financial liabilities at fair value (see paragraphs 48–49 and AG69–AG82 of IAS 39) or amortised cost in accordance with paragraphs 3–9 except for:**

(a) those that arise when a transfer of a financial asset does not qualify for *derecognition* or when the continuing involvement approach applies, which shall be measured in accordance with paragraphs 29 and 31 of IAS 39.

(b) a *financial guarantee contract* as defined in paragraph 9 of IAS 39 (unless (a) applies), which shall be measured in accordance with paragraphs 16 and 17.

(c) a commitment to provide a loan at below-market interest rates, which shall be measured in accordance with paragraphs 16 and 17.

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16 **A financial guarantee contract or a commitment to provide a loan at a below-market interest rate shall be measured at fair value through profit or loss if either of the following criteria is met:**

(a) it is designated at fair value through profit or loss in accordance with paragraph 9; or

(b) it is *held for trading*.

17 **A financial guarantee contract or a commitment to provide a loan at a below-market interest rate that does not meet either of the criteria in paragraph 16 shall be measured at the higher of:**

(a) the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, and

(b) the amount initially recognised (see paragraph 11) less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

18 **An entity shall apply the hedge accounting requirements in paragraphs 89–102 of IAS 39 to financial liabilities that are designated as hedged items (see paragraphs 78–84 and AG98–AG101 of IAS 39).**

Gains and losses

19 **A gain or loss on a financial asset or financial liability that is measured at fair value and is not part of a hedging relationship (see paragraphs 89–102 of IAS 39) shall be presented in profit or loss unless the financial asset is an investment in an *equity instrument* and the entity elects to present gains and losses on that investment in other comprehensive income in accordance with paragraph 21.**

20 **A gain or loss on a financial asset or financial liability that is measured at amortised cost shall be recognised in profit or loss when the financial asset or financial liability is derecognised and through the amortisation process. However, for financial assets or financial liabilities that are hedged items (see paragraphs 78–84 and AG98–AG101 of IAS 39) the gain or loss shall be recognised in accordance with paragraphs 89–102 of IAS 39.**

Investments in equity instruments

21 **At initial recognition, an entity may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of investments in equity instruments within the scope of this [draft] IFRS that are not held for trading.**

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22 If an entity makes that election, it shall recognise in other comprehensive income dividends from those investments when the entity's right to receive payment is established.

Effective date and transition

Effective date

23 An entity shall apply this [draft] IFRS for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies this [draft] IFRS in its financial statements for a period before [date to be inserted after exposure], it shall disclose that fact and at the same time apply the amendments set out in Appendix C.

Transition

24 An entity shall apply this [draft] IFRS retrospectively, subject to the transitional provisions in paragraphs 25–33, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. For the purposes of the transitional provisions in paragraphs 25–33, the date of initial application is the date when an entity first applies the requirements in this [draft] IFRS.

25 An entity shall assess whether a financial asset or financial liability meets the condition in paragraph 4(b) on the basis of the facts and circumstances that existed at the date of initial application. That classification shall be applied retrospectively.

26 If a hybrid contract is required to be measured at fair value in accordance with paragraph 5 but the fair value of the hybrid contract had not been determined in comparative periods, the entity shall measure the hybrid contract in the comparative periods using the sum of the fair value of the components (ie the host and the embedded derivative) at the end of each comparative period presented. At the date of initial application, the entity shall measure the hybrid contract in its entirety at fair value. Any difference between that measurement at the date of initial application and the sum of the fair values of the components at the date of initial application shall be recognised in the opening retained earnings of the reporting period of initial application if this [draft] IFRS is applied initially at the beginning of a reporting period and in profit or loss if this [draft] IFRS is applied initially during a reporting period.

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27 An entity may designate a financial asset or financial liability as at fair value through profit or loss in accordance with paragraph 9. Such designation shall be made on the basis of the facts and circumstances that existed at the date of initial application. That classification shall be applied retrospectively.

28 An entity may designate an investment in an equity instrument as at fair value through other comprehensive income in accordance with paragraph 21. Such designation shall be made on the basis of the facts and circumstances that existed at the date of initial application. That classification shall be applied retrospectively.

29 An entity may revoke its previous designation of a financial asset or financial liability as at fair value through profit or loss in accordance with paragraph 9 on the basis of the facts and circumstances that existed at the date of initial application (and shall revoke its designation if the eligibility criterion in paragraph 9 is not met). That classification shall be applied retrospectively.

30 If it is impracticable (as defined in IAS 8) for an entity to apply retrospectively the effective interest method or the impairment requirements in paragraphs 58–65 and AG84–AG93 of IAS 39, the entity shall determine the amortised cost of the financial instrument or any impairment on a financial asset in each period presented on the basis of the fair value of the financial instrument at the end of each comparative period. If an impairment loss is recognised using that approach or if it is impracticable for the entity to apply the effective interest method, the fair value of the financial instrument at the date of initial application shall be the new amortised cost of that instrument at the date of initial application of this [draft] IFRS.

31 If an entity previously accounted for an investment in an unquoted equity instrument (or a derivative that is linked to and must be settled by delivery of such unquoted equity instruments) in accordance with paragraphs 46(c), 47(a) and 66 of IAS 39, that instrument shall be measured at fair value at the date of initial application. Any difference shall be recognised in the opening retained earnings of the reporting period of initial application.

32 Any hedge relationship accounted for in accordance with paragraphs 85–101 of IAS 39 that is de-designated as a consequence of the classification approach in this [draft] IFRS shall be accounted for as a discontinuation of hedge accounting in accordance with paragraphs 91 and 101 of IAS 39 from the date of initial application.

33 An entity that prepares interim financial reports in accordance with IAS 34 *Interim Financial Reporting* need not apply the requirements in this [draft] IFRS to prior interim periods if it is impracticable (as defined in IAS 8).

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Appendix A
Defined terms

This appendix is an integral part of the [draft] IFRS.

The following terms are defined in paragraph 11 of IAS 32 or paragraph 9 of IAS 39 and are used in this [draft] IFRS with the meanings specified in IAS 32 or IAS 39:

(a) derecognition

(b) derivative

(c) equity instrument

(d) fair value

(e) financial asset

(f) financial guarantee contract

(g) financial instrument

(h) financial liability

(i) hedged item

(j) hedging instrument.

amortised cost The amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

effective interest method A method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period using the effective interest rate.

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effective interest rate The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (for example, prepayment, call and similar options) but shall not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see IAS 18), transaction costs and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

held for trading A financial asset or financial liability is held for trading if:

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

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

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transaction costs Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

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Appendix B
Application guidance

This appendix is an integral part of the [draft] IFRS.

Classification approach

Two categories of financial assets and financial liabilities

Basic loan features

B1 Basic loan features are contractual terms that give rise on specified dates to cash flows that are payments of principal and interest on the principal outstanding. For the purposes of this [draft] IFRS, interest is consideration for the time value of money and the credit risk associated with the principal amount outstanding during a particular period of time. Contractual terms that change the timing or amount of payments of principal or interest on the principal outstanding are not basic loan features unless they protect the creditor or debtor (see paragraph B3(c)). Other contractual features that result in cash flows that are not payments of principal and interest are not basic loan features.

B2 An entity shall assess whether a contractual term is a basic loan feature in the currency in which the financial asset or financial liability is denominated (see also paragraph B25).

B3 The following are examples of basic loan features:

(a) returns to the holder that are:

(i) a fixed amount (eg a zero coupon bond);

(ii) a fixed return over the life of the instrument;

(iii) a variable return that, throughout the life of the instrument, is equal to a single referenced quoted or observable interest rate (such as LIBOR) and/or an adjustment of the interest rate in accordance with (c) below; or

(iv) some combination of such fixed return and variable return (such as LIBOR plus or minus 50 basis points), including debt instruments issued at a discount or premium and fixed rate debt instruments with one or more interest rate resets at pre-specified rates and pre-specified times. For fixed and

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variable rate interest returns, interest is calculated by multiplying the rate for the applicable period by the principal amount outstanding during the period.

(b) a contractual feature that is a combination of a fixed interest return and a variable interest return (as described in (a)). Such a feature may reduce the cash flow variability by setting a limit on a variable interest rate (eg an interest rate cap or floor) or increase the cash flow variability because a fixed interest rate becomes variable.

(c) contractual provisions that permit the issuer (the debtor) to prepay a debt instrument (eg loans or bonds) or permit the holder (the creditor) to put a debt instrument back to the issuer before maturity and are not contingent on future events. In such a case, the prepayment amount must substantially represent unpaid amounts of principal and interest. For this purpose, terms that protect the lender from credit deterioration of the borrower in cases of defaults, credit downgrades and loan covenant violations, and terms relating to possible future changes in taxation, law and similar factors that protect the lender are not considered to be contingent on future events. Such prepayment provisions may include terms that require the issuer to compensate the holder for the early termination of the instrument.

B4 The following do not violate the conditions for returns in paragraph B3(a):

(a) changes in the return to the holder attributable to changes in the timing of cash flows (including related contractual payments that compensate either party for that change in the timing permitted in accordance with paragraph B3(c)).

(b) pre-specified resets of interest rates in response to changes in the credit quality of the financial asset or financial liability.

B5 Other contractual features that result in cash flows that are not payments of principal and interest on the principal outstanding are not basic loan features. An interest rate swap, or a forward contract or option contract to deliver another financial instrument, does not have basic loan features because the contractual cash flows are not payments of principal and interest on the principal outstanding.

B6 In almost every lending transaction the creditor is ranked relative to an entity's other creditors. An instrument that is subordinated to other instruments may still have basic loan features if the issuer's non-payment is a breach of contract and the holder has a contractual right to unpaid amounts of principal and interest even in the event of the issuer's

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bankruptcy. For example, a trade receivable that ranks as a general creditor has basic loan features even if the debtor has issued loans that are collateralised, which in the event of bankruptcy gives that loan holder priority over the claims of the general creditor in respect of the collateral but does not affect the contractual right of the general creditor to unpaid principal.

B7 In some types of transactions, an entity may prioritise payments to the holders of the financial assets using multiple contractually subordinated interests (ie tranches). Each tranche has a subordination ranking that specifies the order in which any losses that the issuer incurs are allocated to the different tranches. The senior tranche is paid in full before any subordinated tranche is paid.

B8 Any tranche that provides credit protection to other tranches in any situation does not have basic loan features. The cash flows of the tranche are not principal and interest because its holder is compensated for providing that credit protection.

Managed on a contractual yield basis

B9 Financial instruments are managed on a contractual yield basis only if they are managed, and their performance evaluated by the entity's key management personnel (as defined in IAS 24 *Related Party Disclosures*), on the basis of the contractual cash flows that are generated when held or issued (including any adjustment or consideration for prepayment provisions).

B10 Whether financial instruments are managed on a contractual yield basis does not depend on management's intentions for an individual instrument. It depends on how management manages the instruments, which is unlikely to differ for an individual financial asset or financial liability in isolation. Accordingly, this condition is not an instrument-by-instrument approach to classification. However, an entity may have several units that are managed in different ways. Therefore, classification need not be determined at the reporting entity level. For example, a bank with a broad scope of activities may have an investment banking business managed on one basis and a retail banking business managed on another basis. Instruments held in the investment banking business will most likely be managed differently from those in the retail banking business.

B11 An entity shall not reclassify a financial asset or financial liability between the fair value and amortised cost categories under any circumstances.

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B12 The following are examples of financial assets or financial liabilities that are managed on a contractual yield basis:

(a) trade accounts receivable (or payable) that an entity holds to collect (or pay) the cash amounts due.

(b) instruments that an entity manages on the basis of contractual payments of principal and interest that are received during the contract term.

(c) issued bonds that the entity manages on the basis of contractual interest and principal that it pays to investors under the terms of the contract.

B13 The following are examples of financial assets or financial liabilities that are not managed on a contractual yield basis:

(a) a financial asset or financial liability that is held for trading.

(b) a financial asset that is acquired at a discount that reflects incurred credit losses.

Option to designate a financial asset or financial liability at fair value through profit or loss

B14 An entity may designate a financial asset, a financial liability, or a group of financial instruments (financial assets, financial liabilities or both) as at fair value through profit or loss only if such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise.

B15 The decision of an entity to designate a financial asset or financial liability as at fair value through profit or loss is similar to an accounting policy choice (although, unlike an accounting policy choice, it is not required to be applied consistently to all similar transactions). When an entity has such a choice, paragraph 14(b) of IAS 8 requires the chosen policy to result in financial statements that provide reliable and more relevant information about the effects of transactions, other events and conditions on the entity's financial position, financial performance or cash flows.

B16 This [draft] IFRS and IAS 39 determine the way that a financial asset or financial liability is measured, how recognised changes in its value are presented and whether hedge accounting may be applied. In some circumstances, those requirements can create a measurement or recognition inconsistency (sometimes referred to as an 'accounting

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mismatch'). For example, if a financial asset is measured at fair value through profit or loss and a liability the entity considers related is measured at amortised cost (with changes in fair value not recognised), an entity may conclude that its financial statements provide less relevant information than if both the asset and the liability were classified as at fair value through profit or loss.

B17 An entity may designate financial assets or financial liabilities as at fair value through profit or loss only if it meets the principle in paragraph 9. The following examples are circumstances in which the principle may be met:

(a) An entity has liabilities under insurance contracts whose measurement incorporates current information (as permitted by paragraph 24 of IFRS 4 *Insurance Contracts*), and financial assets it considers related that would otherwise be measured at amortised cost.

(b) An 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. However, only some of the instruments would be measured at fair value through profit or loss (ie are derivatives). It may also be the case that the requirements for hedge accounting are not met, for example because the requirements for effectiveness in paragraph 88 of IAS 39 are not met.

(c) An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, and the risk gives rise to opposite changes in fair value that tend to offset each other and the entity does not qualify for hedge accounting because none of the instruments is a derivative. Furthermore, in the absence of hedge accounting there is a significant inconsistency in the recognition of gains and losses. For example:

(i) the entity has financed a portfolio of fixed rate assets with fixed rate debentures whose changes in fair value tend to offset each other. Reporting both the assets and the debentures at fair value through profit or loss corrects the inconsistency that could arise from measuring the assets at fair value and the debentures at amortised cost.

(ii) the entity has financed a specified group of loans by issuing traded bonds whose changes in fair value tend to offset each other. If, in addition, the entity regularly buys and sells the

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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 the loans at amortised cost and the bonds at fair value.

B18 For such examples, the measurement or recognition inconsistency could be eliminated or significantly reduced, and more relevant information produced, if an entity designates, at initial recognition, the financial assets and financial liabilities not otherwise so measured as at fair value through profit or loss. For practical purposes, the entity need not enter into all of the assets and liabilities giving rise to the measurement or recognition inconsistency at exactly the same time. A reasonable delay is permitted provided that each transaction is designated as at fair value through profit or loss at its initial recognition and, at that time, any remaining transactions are expected to take place.

B19 It would not be acceptable to designate only some of the financial assets and financial liabilities giving rise to the inconsistency as at fair value through profit or loss if to do so would not eliminate or significantly reduce the inconsistency and therefore would not result in more relevant information. However, it would be acceptable to designate only some of a number of similar financial assets or similar financial liabilities if doing so achieves a significant reduction (and possibly a greater reduction than other allowable designations) in the inconsistency. For example, assume an entity has a number of similar financial liabilities that sum to CU100[*] and a number of similar financial assets that sum to CU50 but are measured on a different basis. The entity may significantly reduce the measurement inconsistency by designating at initial recognition all of the assets but only some of the liabilities (for example, individual liabilities with a combined total of CU45) as at fair value through profit or loss. However, because designation as at fair value through profit or loss can be applied only to the whole of a financial instrument, the entity in this example must designate one or more liabilities in their entirety. It could not designate either a component of a liability (eg changes in value attributable to only one risk, such as changes in a benchmark interest rate) or a proportion (ie percentage) of a liability.

[*] In this [draft] IFRS, monetary amounts are denominated in ‘currency units (CU)’.

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Measurement

Initial measurement of financial assets and financial liabilities

B20 The fair value of a financial instrument at initial recognition is normally the transaction price (ie the fair value of the consideration given or received, see also paragraph AG76 of IAS 39). However, if part of the consideration given or received is for something other than the financial instrument, the fair value of the financial instrument is estimated, using a valuation technique (see paragraphs AG74–AG79 of IAS 39). For example, the fair value of a long-term loan or receivable that carries no interest can be estimated as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.

B21 If an entity originates a loan that bears an off-market interest rate (eg 5 per cent when the market rate for similar loans is 8 per cent), and receives an up-front fee as compensation, the entity recognises the loan at its fair value, ie net of the fee it receives. The entity accretes the discount to profit or loss using the effective interest method.

Subsequent measurement of financial assets

B22 If a financial instrument that was previously recognised as a financial asset is measured at fair value and its fair value decreases below zero, it is a financial liability measured in accordance with paragraphs 15–18.

B23 The following example illustrates the accounting for transaction costs on the initial and subsequent measurement of a financial asset measured at fair value with changes through other comprehensive income in accordance with paragraph 21. An entity acquires an asset for CU100 plus a purchase commission of CU2. Initially, the entity recognises the asset at CU102. The reporting period ends one day later, when the quoted market price of the asset is CU100. If the asset were sold, a commission of CU3 would be paid. On that date, the entity measures the asset at CU100 (without regard to the possible commission on sale) and recognises a loss of CU2 in other comprehensive income.

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Gains and losses

B24 Paragraph 21 permits an entity to make an irrevocable election to present in other comprehensive income changes in the fair value of particular investments in equity instruments. Amounts recognised in other comprehensive income are not subsequently transferred to profit or loss. However, the entity may transfer the cumulative gain or loss (including any dividends recognised in accordance with paragraph 22) within equity.

B25 An entity applies IAS 21 *The Effects of Changes in Foreign Exchange Rates* to financial assets and financial liabilities that are monetary items in accordance with IAS 21 and denominated in a foreign currency. IAS 21 requires any foreign exchange gains and losses on monetary assets and monetary liabilities to be recognised in profit or loss. An exception is a monetary item that is designated as a *hedging instrument* in either a cash flow hedge (see paragraphs 95–101 of IAS 39) or a hedge of a net investment (see paragraph 102 of IAS 39).

B26 Paragraph 21 permits an entity to make an irrevocable election to present in other comprehensive income changes in the fair value of particular investments in equity instruments. Those investments are not monetary items. Accordingly, the gain or loss that is presented in other comprehensive income under paragraph 21 includes any related foreign exchange component.

B27 If there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component of those financial instruments are recognised in profit or loss.

Defined terms

Effective interest rate

B28 When applying the effective interest method, an entity generally amortises any fees, points paid or received, transaction costs and other premiums or discounts included in the calculation of the effective interest rate over the expected life of the instrument. However, a shorter period is used if this is the period to which the fees, points paid or received, transaction costs, premiums or discounts relate. This will be the case when the variable to which the fees, points paid or received, transaction costs, premiums or discounts relate is repriced to market

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rates before the expected maturity of the instrument. In such a case, the appropriate amortisation period is the period to the next such repricing date. For example, if a premium or discount on a floating rate instrument reflects interest that has accrued on the instrument since interest was last paid, or changes in market rates since the floating interest rate was reset to market rates, it will be amortised to the next date when the floating interest is reset to market rates. This is because the premium or discount relates to the period to the next interest reset date because, at that date, the variable to which the premium or discount relates (ie interest rates) is reset to market rates. If, however, the premium or discount results from a change in the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates, it is amortised over the expected life of the instrument.

B29 For floating rate financial assets and floating rate financial liabilities, periodic re-estimation of cash flows to reflect changes in market rates of interest alters the effective interest rate. If a floating rate financial asset or floating rate financial liability is recognised initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or liability.

B30 If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate or, when applicable, the revised effective interest rate calculated in accordance with paragraph 92 of IAS 39. The adjustment is recognised in profit or loss as income or expense.

Financial assets and financial liabilities held for trading

B31 Trading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margin.

B32 Financial liabilities held for trading include:

(a) derivative liabilities that are not accounted for as hedging instruments in accordance with IAS 39;

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(b) obligations to deliver financial assets borrowed by a short seller (ie an entity that sells financial assets it has borrowed and does not yet own);

(c) financial liabilities that are incurred with an intention to repurchase them in the near term (eg a quoted debt instrument that the issuer may buy back in the near term depending on changes in its fair value); and

(d) financial liabilities that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking.

The fact that a liability is used to fund trading activities does not in itself make that liability one that is held for trading.

Transaction costs

B33 Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.

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Approval by the Board of *Financial Instruments: Classification and Measurement* published in July 2009

The exposure draft *Financial Instruments: Classification and Measurement* was approved for publication by thirteen of the fourteen members of the International Accounting Standards Board. Mr Leisenring voted against publication. His alternative view is set out after the Basis for Conclusions.

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July 2009

Draft amendments to other IFRSs and guidance
Exposure Draft ED/2009/7

Financial Instruments: Classification and Measurement

Comments to be received by 14 September 2009

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Exposure Draft

FINANCIAL INSTRUMENTS: CLASSIFICATION AND MEASUREMENT

Draft amendments to other IFRSs and guidance

Comments to be received by 14 September 2009

ED/2009/7

This booklet contains Appendix C of the proposed International Financial Reporting Standard (IFRS) set out in the exposure draft *Financial Instruments: Classification and Measurement* (see separate booklet). It also contains draft amendments to the guidance on other IFRSs. Comments on the draft IFRS and its accompanying documents should be submitted in writing so as to be received by **14 September 2009.** Respondents are asked to send their comments electronically to the IASB website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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Appendix C
Amendments to other IFRSs

The amendments in this [draft] appendix shall be applied for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies this [draft] IFRS for an earlier period, it shall apply these amendments for that earlier period. Amended paragraphs are shown with new text underlined and deleted text struck through.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

C1 Paragraph 29 is amended and paragraph 39A is added as follows:

Presentation and disclosure

Explanation of transition to IFRSs

Designation of financial assets or financial liabilities

29 An entity is permitted to designate a previously recognised financial asset or financial liability as a financial asset or financial liability at fair value through profit or loss ~~or a financial asset as available for sale~~ in accordance with paragraph ~~D19~~ B9. The entity shall disclose the fair value of financial assets or financial liabilities designated into ~~each~~ this category at the date of designation and their classification and carrying amount in the previous financial statements.

Effective date

39A [Draft] IFRS X *Financial Instruments: Classification and Measurement*, issued in [date to be inserted after exposure] amended paragraphs 29 and B1, added paragraphs B8 and B9 and deleted paragraph D19. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

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C2 In Appendix B, paragraph B1 is amended, and a heading and paragraphs B8 and B9 are added.

Appendix B
Exceptions to the retrospective application of other IFRSs

B1 An entity shall apply the following exceptions:

(a) derecognition of financial assets and financial liabilities (paragraphs B2 and B3);

(b) hedge accounting (paragraphs B4–B6)~~, and~~ ;

(c) non-controlling interests (paragraph B7)~~.~~ ; and

(d) classification and measurement of financial assets and financial liabilities (paragraphs B8 and B9).

Classification and measurement of financial assets and financial liabilities

B8 An entity shall assess whether a financial asset or financial liability meets the condition in paragraph 4(b) of [draft] IFRS X on the basis of the facts and circumstances that exist at the date of transition to IFRSs. The resulting classification shall be applied retrospectively.

B9 An entity may designate a financial asset or financial liability as at fair value through profit or loss in accordance with paragraph 9 of [draft] IFRS X on the basis of the facts and circumstances that exist at the date of transition to IFRSs. That classification shall be applied retrospectively.

C3 In Appendix D (Exemptions from other IFRSs), the heading above paragraph D19 and paragraph D19 are deleted.

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IFRS 3 *Business Combinations*

C4 Paragraphs 16, 42, 53 and 56 are amended and paragraph 64A is added as follows:

The acquisition method

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

Recognition principle

Classifying or designating identifiable assets acquired and liabilities assumed in a business combination

16 In some situations, IFRSs provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the acquirer shall make on the basis of the pertinent conditions as they exist at the acquisition date include but are not limited to:

(a) classification of particular financial assets and liabilities as a financial asset or liability at fair value through profit or loss, or at amortised cost ~~as a financial asset available for sale or held to maturity~~, in accordance with [draft] IFRS X *Financial Instruments: Classification and Measurement* ~~IAS 39 *Financial Instruments: Recognition and Measurement*~~;

(b) designation of a derivative instrument as a hedging instrument in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*; and

(c) assessment of whether an embedded derivative should be separated from the non-financial host contract in accordance with IAS 39 (which is a matter of 'classification' as this IFRS uses that term).

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Additional guidance for applying the acquisition method to particular types of business combinations

A business combination achieved in stages

42 In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income ~~(for example, because the investment was classified as available for sale)~~. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

Determining what is part of the business combination transaction

Acquisition-related costs

53 Acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognised in accordance with IAS 32 and [draft] IFRS X ~~IAS 39~~.

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Subsequent measurement and accounting

Contingent liabilities

56 After initial recognition and until the liability is settled, cancelled or expires, the acquirer shall measure a contingent liability recognised in a business combination at the higher of:

(a) the amount that would be recognised in accordance with IAS 37; and

(b) the amount initially recognised less, if appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

This requirement does not apply to contracts accounted for in accordance with [draft] IFRS X and IAS 39.

Effective date and transition

Effective date

64A [Draft] IFRS X issued in [date to be inserted after exposure], amended paragraphs 16, 42, 53 and 56. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

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IFRS 4 *Insurance Contracts*

C5 Paragraphs 3, 4(d), 12(b) and 35 are amended and paragraph 41C is added as follows:

Scope

3 This IFRS does not address other aspects of accounting by insurers, such as accounting for financial assets held by insurers and financial liabilities issued by insurers (see IAS 32 *Financial Instruments: Presentation*, IAS 39 *Financial Instruments: Recognition and Measurement*, ~~and~~ IFRS 7 and [draft] IFRS X *Financial Instruments: Classification and Measurement*), except in the transitional provisions in paragraph 45.

4 An entity shall not apply this IFRS to:

...

(d) financial guarantee contracts unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, in which case the issuer may elect to apply either IAS 39, IAS 32, ~~and~~ IFRS 7 and [draft] IFRS X or this ~~Standard~~ IFRS to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.

Unbundling of deposit components

12 To unbundle a contract, an insurer shall:

...

(b) apply [draft] IFRS X and IAS 39 to the deposit component.

Recognition and measurement

Discretionary participation features

Discretionary participation features in financial instruments

35 The requirements in paragraph 34 also apply to a financial instrument that contains a discretionary participation feature. In addition:

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(a) if the issuer classifies the entire discretionary participation feature as a liability, it shall apply the liability adequacy test in paragraphs 15–19 to the whole contract (ie both the guaranteed element and the discretionary participation feature). The issuer need not determine the amount that would result from applying [draft] IFRS X and IAS 39 to the guaranteed element.

(b) if the issuer classifies part or all of that feature as a separate component of equity, the liability recognised for the whole contract shall not be less than the amount that would result from applying [draft] IFRS X and IAS 39 to the guaranteed element. That amount shall include the intrinsic value of an option to surrender the contract, but need not include its time value if paragraph 9 exempts that option from measurement at fair value. The issuer need not disclose the amount that would result from applying [draft] IFRS X and IAS 39 to the guaranteed element, nor need it present that amount separately. Furthermore, the issuer need not determine that amount if the total liability recognised is clearly higher.

Effective date and transition

41C [Draft] IFRS X issued in [date to be inserted after exposure], amended paragraphs 3, 4(d), 12(b), 35, B18(g) and the definition of 'deposit component' in Appendix A. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

C6 In Appendix A (Defined terms), the definition of 'deposit component' is amended as follows:

deposit component	A contractual component that is not accounted for as a derivative under [draft] IFRS X and IAS 39 and would be within the scope of IAS 39 if it were a separate instrument.

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C7 In Appendix B (Definition of an insurance contract), paragraph B18(g) is amended as follows:

Examples of insurance contracts

B18 The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:

...

(g) credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. These contracts could have various legal forms, such as that of a guarantee, some types of letter of credit, a credit derivative default contract or an insurance contract. However, although these contracts meet the definition of an insurance contract, they also meet the definition of a financial guarantee contract in IAS 39 and are within the scope of IAS 32 [footnote omitted] and IAS 39, not this IFRS (see paragraph 4(d)). Nevertheless, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either <u>[draft] IFRS X,</u> IAS 39 and IAS 32 [footnote omitted] or this ~~Standard~~ <u>IFRS</u> to such financial guarantee contracts.

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IFRS 7 *Financial Instruments: Disclosures*

C8 A heading and paragraphs 11A, 11B, 20A, 44H and 44I are added, paragraphs 12 and 12A are deleted and paragraphs 2, 3(d), 8, 9, 10, 20, 29 and 30 are amended as follows:

Objective

2 The principles in this IFRS complement the principles for recognising, measuring and presenting financial assets and financial liabilities in IAS 32 *Financial Instruments: Presentation*, ~~and~~ IAS 39 *Financial Instruments: Recognition and Measurement* and [draft] IFRS X *Financial Instruments: Classification and Measurement*.

Scope

3 This IFRS shall be applied by all entities to all types of financial instruments, except:

...

(d) insurance contracts as defined in IFRS 4 *Insurance Contracts*. However, this IFRS applies to derivatives that are embedded in insurance contracts if IAS 39 requires the entity to account for them separately. Moreover, an issuer shall apply this IFRS to *financial guarantee contracts* if the issuer applies IAS 39 and [draft] IFRS X in recognising and measuring the contracts, but shall apply IFRS 4 if the issuer elects, in accordance with paragraph 4(d) of IFRS 4, to apply IFRS 4 in recognising and measuring them.

...

Significance of financial instruments for financial position and performance

Statement of financial position

Categories of financial assets and financial liabilities

8 The carrying amounts of each of the following categories, as specified ~~defined~~ in [draft] IFRS X ~~IAS 39~~, shall be disclosed either in the statement of financial position or in the notes:

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(a) financial assets at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those mandatorily classified as at fair value ~~held for trading~~ in accordance with [draft] IFRS X ~~IAS 39~~;

(b)–(d) [deleted]

~~(b) held-to-maturity investments;~~

~~(c) loans and receivables;~~

~~(d) available-for-sale financial assets;~~

(e) financial liabilities at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those mandatorily classified as at fair value ~~held for trading~~ in accordance with [draft] IFRS X ~~IAS 39~~; ~~and~~

(ea) financial assets measured at fair value through other comprehensive income;

(eb) financial assets measured at amortised cost; and

(f) financial liabilities measured at amortised cost.

Financial assets or financial liabilities at fair value through profit or loss

9 If the entity has designated as at fair value through profit or loss a financial asset (or group of financial assets) that would otherwise be measured at amortised cost ~~a loan or receivable (or group of loans or receivables) as at fair value through profit or loss~~, it shall disclose:

(a) the maximum exposure to *credit risk* (see paragraph 36(a)) of the ~~loan or receivable~~ financial asset (or group of ~~loan or receivables~~ financial assets) at the end of the reporting period.

(b) the amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.

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(c) the amount of change, during the period and cumulatively, in the fair value of the ~~loan or receivable~~ financial asset (or group of ~~loan or receivables~~ financial assets) that is attributable to changes in the credit risk of the financial asset determined either:

(i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to *market risk*; or

(ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset.

Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate or index of prices or rates.

(d) the amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the ~~loan or receivable~~ financial asset was designated.

10 If the entity has designated a financial liability as at fair value through profit or loss in accordance with paragraph 9 of [draft] IFRS X ~~IAS 39~~, it shall disclose:

...

Financial assets at fair value through other comprehensive income

11A If an entity designated investments in equity instruments to be measured at fair value through other comprehensive income, as permitted by paragraph 21 of [draft] IFRS X, it shall disclose:

(a) which investments in equity instruments have been designated to be measured at fair value through other comprehensive income.

(b) the reasons for using this presentation alternative.

(c) the fair value of each such investment at the end of the reporting period.

(d) any transfers of the cumulative gain or loss within equity during the period other than on disposal, including the reason for such transfers.

11B If an entity sold investments in equity instruments measured at fair value through other comprehensive income during the reporting period, it shall disclose:

(a) the reasons for disposing of the investments.

(b) the cumulative gain or loss transferred within equity on disposal, if any.

Statement of comprehensive income

Items of income, expense, gains or losses

20 An entity shall disclose the following items of income, expense, gains or losses either in the statement of comprehensive income or in the notes:

(a) net gains or net losses on:

(i) financial assets or financial liabilities measured at fair value through profit or loss, showing separately those on financial assets or financial liabilities designated as such upon initial recognition, and those on financial assets or financial liabilities that are mandatorily classified as at fair value ~~held for trading~~ in accordance with [draft] IFRS X ~~IAS 39~~;

(ii)-(iv) [deleted]

~~(ii) available for sale financial assets, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount reclassified from equity to profit or loss for the period;~~

~~(iii) held-to-maturity investments;~~

~~(iv) loans and receivables; and~~

(v) financial assets or financial liabilities measured at amortised cost;

(vi) financial assets measured at fair value through other comprehensive income;

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(b) total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are measured at amortised cost ~~not at fair value through profit or loss~~;

(c) fee income and expense (other than amounts included in determining the effective interest rate) arising from:

 (i) financial assets or financial liabilities measured at amortised cost ~~that are not at fair value through profit or loss~~; and

 (ii) trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions;

(d) interest income on impaired financial assets accrued in accordance with paragraph AG93 of IAS 39; and

(e) the amount of any impairment loss for each class of financial asset.

20A An entity shall disclose a reconciliation of the gain or loss recognised in the statement of comprehensive income arising from the derecognition of financial assets and financial liabilities measured at amortised cost.

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Other disclosures

Fair value

29 Disclosures of fair value are not required~~:~~

~~(a)~~ when the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short term trade receivables and payables.

~~(b) for an investment in equity instruments that do not have a quoted market price in an active market, or derivatives linked to such equity instruments, that is measured at cost in accordance with IAS 39 because its fair value cannot be measured reliably; or~~

~~(c) for a contract containing a discretionary participation feature (as described in IFRS 4) if the fair value of that feature cannot be measured reliably.~~

30 ~~In the cases described in paragraphs 29(b) and (c),~~ Disclosures of fair value are not required for a contract containing a discretionary participation feature (as described in IFRS 4) if the fair value of that feature cannot be measured reliably. However, an entity shall disclose information to help users of the financial statements make their own judgements about the extent of possible differences between the carrying amount of those ~~financial assets and financial liabilities~~ contracts and their fair value, including:

(a) ...

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Effective date and transition

44H [Draft] IFRS X issued in [date to be inserted after exposure], amended paragraphs 2, 3(d), 8, 9, 10, 20, 29 and 30, added paragraphs 11A, 11B and 20A and deleted paragraphs 12 and 12A. It also amended the last paragraph of Appendix A (Defined terms) and paragraphs B1, B5, B10, B22 and B27 in Appendix B (Application guidance), and deleted Appendix D (Amendments to IFRS 7 if the Amendments to IAS 39 Financial Instruments: Recognition and Measurement—*The Fair Value Option* have not been applied). An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period and disclose for each class of financial assets and financial liabilities at the date of initial application:

(a) the original measurement category and carrying amount determined in accordance with IAS 39;

(b) the new measurement category and carrying amount determined in accordance with [draft] IFRS X;

(c) the amount of any financial assets or financial liabilities designated as at fair value through profit or loss that have been reclassified in accordance with paragraph 9 of [draft] IFRS X, and their original measurement basis and presentation method;

(d) the amount of any financial assets or financial liabilities that were previously designated as at fair value through profit or loss that are no longer so designated, distinguishing between those that [draft] IFRS X requires to reclassify and those that an entity elects to reclassify.

44I An entity shall present the quantitative disclosures required by paragraph 44H in tabular format unless another format is more appropriate. In addition, an entity shall disclose qualitative information to enable users to understand:

(a) the reasons for how it applied the classification requirements in [draft] IFRS X for those financial assets or financial liabilities whose classification has changed as a result of applying [draft] IFRS X.

(b) the reasons for any designation or revocation of financial assets or financial liabilities at fair value through profit or loss

C9 In Appendix A (Defined terms), the last paragraph is amended as follows:

The following terms are defined in paragraph 11 of IAS 32, ~~or~~ paragraph 9 of IAS 39 or Appendix A of [draft] IFRS X and are used in the IFRS with the meaning specified in IAS 32, ~~and~~ IAS 39 and [draft] IFRS X.

- ~~amortised cost of a financial asset or financial liability~~
- amortised cost
- ~~available-for-sale financial assets~~
- derecognition
- derivative
- effective interest method
- equity instrument
- fair value
- financial asset
- ~~financial asset or financial liability at fair value through profit or loss~~
- ~~financial asset or financial liability held for trading~~
- financial guarantee contract
- financial instrument
- financial liability
- forecast transaction
- hedging instrument

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- <u>held for trading</u>
- ~~held-to-maturity investments~~
- ~~loans and receivables~~
- regular way purchase or sale

C10 In Appendix B (Application guidance), paragraphs B1, B5, B10, B22 and B27 are amended as follows:

Classes of financial instruments and level of disclosure (paragraph 6)

B1 Paragraph 6 requires an entity to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes described in paragraph 6 are determined by the entity and are, thus, distinct from the categories of financial instruments specified in ~~IAS 39~~ <u>[draft] IFRS X</u> (which determine how financial instruments are measured and where changes in fair value are recognised).

Significance of financial instruments for financial position and performance

Other disclosure – accounting policies (paragraph 21)

B5 Paragraph 21 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:

(a) for financial assets or financial liabilities designated as at fair value through profit or loss:

(i) the nature of the financial assets or financial liabilities the entity has designated as at fair value through profit or loss;

(ii) [deleted] ~~the criteria for so designating such financial assets or financial liabilities on initial recognition; and~~

(iii) how the entity has satisfied the conditions in paragraph 9 of [draft] IFRS X ~~9, 11A or 12 of IAS 39~~ for such designation. ~~For instruments designated in accordance with paragraph (b)(i) of the definition of a financial asset or financial liability at fair value through profit or loss in IAS 39, that disclosure includes a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with paragraph (b)(ii) of the definition of a financial asset or financial liability at fair value through profit or loss in IAS 39, that disclosure includes a narrative description of how designation at fair value through profit or loss is consistent with the entity's documented risk management or investment strategy.~~

(b) [deleted] ~~the criteria for designating financial assets as available for sale.~~

(c) ...

Nature and extent of risks arising from financial instruments (paragraphs 31–42)

Maximum credit risk exposure (paragraph 36(a))

B10 Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:

(a) granting loans ~~and receivables~~ to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the related financial assets.

(b) ...

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Market risk – sensitivity analysis (paragraphs 40 and 41)

Interest rate risk

B22 *Interest rate risk* arises on interest-bearing financial instruments recognised in the statement of financial position (eg ~~loans and receivables and~~ fixed rate debt instruments issued) and on some financial instruments not recognised in the statement of financial position (eg some loan commitments).

Other price risk

B27 In accordance with paragraph 40(a), the sensitivity of profit or loss (that arises, for example, from instruments classified as at fair value through profit or loss ~~and impairments of available-for-sale financial assets~~) is disclosed separately from the sensitivity of equity ~~(~~that arises, for example, from equity instruments whose changes in fair value are presented in other comprehensive income ~~classified as available for sale)~~.

C11 Appendix D (Amendments to IFRS 7 if the Amendments to IAS 39 Financial Instruments: Recognition and Measurement—*The Fair Value Option* have not been applied) is deleted.

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IAS 1 *Presentation of Financial Statements*

C12 In paragraph 7, the definition of 'other comprehensive income' and paragraphs 68, 71, 82, 93 and 95 are amended and paragraph 139E is added as follows:

Definitions

7 ...

Other comprehensive income **comprises items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other IFRSs.**

The components of other comprehensive income include:

(a) changes in revaluation surplus (see IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*);

(b) actuarial gains and losses on defined benefit plans recognised in accordance with paragraph 93A of IAS 19 *Employee Benefits*;

(c) gains and losses arising from translating the financial statements of a foreign operation (see IAS 21 *The Effects of Changes in Foreign Exchange Rates*);

(d) gains and losses ~~on remeasuring available-for-sale financial assets (see IAS 39 *Financial Instruments: Recognition and Measurement*);~~ (including dividends) from equity instruments measured at fair value through other comprehensive income in accordance with paragraphs 21 and 22 of [draft] IFRS X *Financial Instruments: Classification and Measurement*;

(e) the effective portion of gains and losses on hedging instruments in a cash flow hedge (see IAS 39 *Financial Instruments: Recognition and Measurement*).

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Structure and content

Statement of financial position

Current assets

68 The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months. Current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period. Current assets also include assets held primarily for the purpose of trading (examples include some financial assets that meet the definition of ~~classified as~~ held for trading in [draft] IFRS X ~~accordance with IAS 39~~) and the current portion of non-current financial assets.

Current liabilities

71 Other current liabilities are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting period or held primarily for the purpose of trading. Examples are some financial liabilities that meet the definition of ~~classified as~~ held for trading in [draft] IFRS X ~~accordance with IAS 39~~, bank overdrafts, and the current portion of non-current financial liabilities, dividends payable, income taxes and other non-trade payables. Financial liabilities that provide financing on a long-term basis (ie are not part of the working capital used in the entity's normal operating cycle) and are not due for settlement within twelve months after the reporting period are non-current liabilities, subject to paragraphs 74 and 75.

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Statement of comprehensive income

Information to be presented in the statement of comprehensive income

82 **As a minimum, the statement of comprehensive income shall include line items that present the following amounts for the period:**

(a) **revenue;**

(b) **finance costs;**

(c) **share of the profit or loss of associates and joint ventures accounted for using the equity method;**

(ca) **gains and losses arising from the derecognition of financial assets and financial liabilities measured at amortised cost;**

(d) **...**

Other comprehensive income for the period

93 Other IFRSs specify whether and when amounts previously recognised in other comprehensive income are reclassified to profit or loss. Such reclassifications are referred to in this Standard as reclassification adjustments. A reclassification adjustment is included with the related component of other comprehensive income in the period that the adjustment is reclassified to profit or loss. ~~For example, gains realised on the disposal of available-for-sale financial assets are included in profit or loss of the current period.~~ These amounts may have been recognised in other comprehensive income as unrealised gains in the current or previous periods. Those unrealised gains must be deducted from other comprehensive income in the period in which the realised gains are reclassified to profit or loss to avoid including them in total comprehensive income twice.

95 Reclassification adjustments arise, for example, on disposal of a foreign operation (see IAS 21), ~~on derecognition of available-for-sale financial assets (see IAS 39)~~ and when a hedged forecast transaction affects profit or loss (see paragraph 100 of IAS 39 in relation to cash flow hedges).

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Transition and effective date

139E [Draft] IFRS X issued in [date to be inserted after exposure], amended the definition of 'other comprehensive income' in paragraph 7 and paragraphs 68, 71, 82, 93 and 95. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

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IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

C13 Paragraph 53 is amended and paragraph 54A is added as follows:

Impracticability in respect of retrospective application and retrospective restatement

53 Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, ~~when an entity corrects a prior period error in measuring financial assets previously classified as held-to-maturity investments in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*, it does not change their basis of measurement for that period if management decided later not to hold them to maturity. In addition,~~ when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with IAS 19 *Employee Benefits*, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were authorised for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

Effective date

54A [Draft] IFRS X *Financial Instruments: Classification and Measurement*, issued in [date to be inserted after exposure], amended paragraph 53. An entity shall apply that amendment for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendment for that earlier period.

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IAS 12 *Income Taxes*

C14 Paragraph 20 is amended and paragraph 96 is added as follows:

Recognition of deferred tax liabilities and deferred tax assets

Taxable temporary differences

Assets carried at fair value

20 IFRSs permit or require certain assets to be carried at fair value or to be revalued (see, for example, IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets*, [draft] IFRS X *Financial Instruments: Classification and Measurement* ~~IAS 39 *Financial Instruments: Recognition and Measurement*~~ and IAS 40 *Investment Property*). In some jurisdictions, the revaluation or other restatement of an asset to fair value affects taxable profit (tax loss) for the current period. As a result, the tax base of the asset is adjusted and no temporary difference arises. In other jurisdictions, the revaluation or restatement of an asset does not affect taxable profit in the period of the revaluation or restatement and, consequently, the tax base of the asset is not adjusted. Nevertheless, the future recovery of the carrying amount will result in a taxable flow of economic benefits to the entity and the amount that will be deductible for tax purposes will differ from the amount of those economic benefits. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability or asset. This is true even if: ...

Effective date

96 [Draft] IFRS X issued in [date to be inserted after exposure], amended paragraph 20. An entity shall apply that amendment for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendment for that earlier period.

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IAS 18 *Revenue*

C15 Paragraphs 6(d), 11 and 30 are amended and paragraph 39 is added as follows:

Scope

6 This Standard does not deal with revenue arising from:

(d) changes in the fair value of financial assets and financial liabilities or their disposal (see [draft] IFRS X *Financial Instruments: Classification and Measurement* and IAS 39 *Financial Instruments: Recognition and Measurement*);

Measurement of revenue

11 In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than the nominal amount of cash received or receivable. For example, an entity may provide interest free credit to the buyer or accept a note receivable bearing a below-market interest rate from the buyer as consideration for the sale of goods. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest. The imputed rate of interest is the more clearly determinable of either:

(a) the prevailing rate for a similar instrument of an issuer with a similar credit rating; or

(b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

The difference between the fair value and the nominal amount of the consideration is recognised as interest revenue in accordance with paragraphs 29 and 30 and in accordance with IAS 39 and [draft] IFRS X.

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Interest, royalties and dividends

30 Revenue shall be recognised on the following bases:

(a) interest shall be recognised using the effective interest method as set out in Appendix A and paragraphs B28–B30 of [draft] IFRS X ~~IAS 39, paragraphs 9 and AG5–AG8~~;

(b) royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement; and

(c) dividends shall be recognised when the shareholder's right to receive payment is established.

Effective date

39 [Draft] IFRS X issued in [date to be inserted after exposure], amended paragraphs 6(d), 11 and 30. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

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IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

C16 Paragraph 10A is amended and paragraph 44 is added as follows:

Government grants

10A The benefit of a government loan at a below-market rate of interest is treated as a government grant. The loan shall be recognised and measured in accordance with [draft] IFRS X *Financial Instruments: Classification and Measurement* and IAS 39 *Financial Instruments: Recognition and Measurement*. The benefit of the below-market rate of interest shall be measured as the difference between the initial carrying value of the loan determined in accordance with [draft] IFRS X ~~IAS 39~~ and the proceeds received. The benefit is accounted for in accordance with this Standard. The entity shall consider the conditions and obligations that have been, or must be, met when identifying the costs for which the benefit of the loan is intended to compensate.

Effective date

44 [Draft] IFRS X issued in [date to be inserted after exposure], amended paragraph 10A. An entity shall apply that amendment for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendment for that earlier period.

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IAS 21 *The Effects of Changes in Foreign Exchange Rates*

C17 Paragraphs 3, 4 and 52(a) are amended and paragraph 60C is added as follows:

Scope

3 This Standard shall be applied: [footnote omitted]

- **(a) in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of IAS 39** ***Financial Instruments: Recognition and Measurement*** **and [draft] IFRS X** ***Financial Instruments: Classification and Measurement*****;**
- **(b) in translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation, proportionate consolidation or the equity method; and**
- **(c) in translating an entity's results and financial position into a presentation currency.**

4 [Draft] IFRS X and IAS 39 apply ~~applies~~ to many foreign currency derivatives and, accordingly, these are excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of [draft] IFRS X and IAS 39 (eg some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.

Disclosure

52 An entity shall disclose:

- **(a) the amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with [draft] IFRS X ~~IAS 39~~; and**

...

Effective date and transition

60C [Draft] IFRS X issued in [date to be inserted after exposure], amended paragraphs 3, 4 and 52(a). An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

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IAS 23 *Borrowing Costs*

C18 Paragraph 6(a) is amended and paragraph 29B is added as follows:

Definitions

6 Borrowing costs may include:

(a) interest expense calculated using the effective interest method as described in [draft] IFRS X *Financial Instruments: Classification and Measurement* ~~IAS 39 *Financial Instruments: Recognition and Measurement*~~;

(b) ...

29B [Draft] IFRS X issued in [date to be inserted after exposure], amended paragraph 6(a). An entity shall apply that amendment for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendment for that earlier period.

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IAS 27 *Consolidated and Separate Financial Statements*

C19 Paragraphs 35, 37, 38 and 40 are amended and paragraph 45D is added as follows:

Loss of control

35 If a parent loses control of a subsidiary, the parent shall account for all amounts recognised in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent reclassifies the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. For example, if a subsidiary has cumulative exchange differences relating to a foreign operation ~~available-for-sale financial assets~~ and the parent loses control of the subsidiary, the parent shall reclassify to profit or loss the gain or loss previously recognised in other comprehensive income in relation to the foreign operation ~~those assets~~. Similarly, if a revaluation surplus previously recognised in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent transfers the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

37 The fair value of any investment retained in the former subsidiary at the date when control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with [draft] IFRS X *Financial Instruments: Classification and Measurement* ~~IAS 39 *Financial Instruments: Recognition and Measurement*~~ or, when appropriate, the cost on initial recognition of an investment in an associate or jointly controlled entity.

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Accounting for investments in subsidiaries, jointly controlled entities and associates in separate financial statements

38 **When an entity prepares separate financial statements, it shall account for investments in subsidiaries, jointly controlled entities and associates either:**

(a) at cost, or

(b) in accordance with [draft] IFRS X and IAS 39.

The entity shall apply the same accounting for each category of investments. Investments accounted for at cost shall be accounted for in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* **when they are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5. The measurement of investments accounted for in accordance with [draft] IFRS X ~~IAS 39~~ is not changed in such circumstances.**

40 **Investments in jointly controlled entities and associates that are accounted for in accordance with [draft] IFRS X and IAS 39 in the consolidated financial statements shall be accounted for in the same way in the investor's separate financial statements.**

Effective date and transition

45D [Draft] IFRS X issued in [date to be inserted after exposure], amended paragraphs 35, 37, 38 and 40. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

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IAS 28 *Investments in Associates*

C20 Paragraphs 1 and 18–19A are amended and paragraph 41D is added as follows:

Scope

1 **This Standard shall be applied in accounting for investments in associates. However, it does not apply to investments in associates held by:**

- **(a) venture capital organisations, or**
- **(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds**

that upon initial recognition are designated as at fair value through profit or loss or are ~~classified as~~ held for trading and accounted for in accordance with [draft] IFRS X *Financial Instruments: Classification and Measurement* ~~IAS 39 *Financial Instruments: Recognition and Measurement*~~. Such investments shall be measured at fair value in accordance with [draft] IFRS X ~~IAS 39~~, with changes in fair value recognised in profit or loss in the period of the change. An entity holding such an investment shall make the disclosures required by paragraph 37(f).

Application of the equity method

18 **An investor shall discontinue the use of the equity method from the date when it ceases to have significant influence over an associate and shall account for the investment in accordance with [draft] IFRS X and IAS 39 from that date, provided the associate does not become a subsidiary or a joint venture as defined in IAS 31. On the loss of significant influence, the investor shall measure at fair value any investment the investor retains in the former associate. The investor shall recognise in profit or loss any difference between:**

- **(a) the fair value of any retained investment and any proceeds from disposing of the part interest in the associate; and**
- **(b) the carrying amount of the investment at the date when significant influence is lost.**

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19 **When an investment ceases to be an associate and is accounted for in accordance with [draft] IFRS X and IAS 39, the fair value of the investment at the date when it ceases to be an associate shall be regarded as its fair value on initial recognition as a financial asset in accordance with [draft] IFRS X ~~IAS 39~~.**

19A If an investor loses significant influence over an associate, the investor shall account for all amounts recognised in other comprehensive income in relation to that associate on the same basis as would be required if the associate had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognised in other comprehensive income by an associate would be reclassified to profit or loss on the disposal of the related assets or liabilities, the investor reclassifies the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses significant influence over the associate. For example, if an associate has cumulative exchange differences relating to a foreign operation ~~available-for-sale financial assets~~ and the investor loses significant influence over the associate, the investor shall reclassify to profit or loss the gain or loss previously recognised in other comprehensive income in relation to the foreign operation ~~those assets~~. If an investor's ownership interest in an associate is reduced, but the investment continues to be an associate, the investor shall reclassify to profit or loss only a proportionate amount of the gain or loss previously recognised in other comprehensive income.

Effective date and transition

41D [Draft] IFRS X, issued in [date to be inserted after exposure], amended paragraphs 1 and 18–19A. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

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IAS 31 *Interests in Joint Ventures*

C21 Paragraphs 1, 45–45B and 51 are amended and paragraph 58C is added as follows:

Scope

1 **This Standard shall be applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place. However, it does not apply to venturers' interests in jointly controlled entities held by:**

- **(a) venture capital organisations, or**
- **(b) mutual funds, unit trusts and similar entities including investment-linked insurance funds**

that upon initial recognition are designated as at fair value through profit or loss or are ~~classified as~~ held for trading and accounted for in accordance with [draft] IFRS X *Financial Instruments: Classification and Measurement* ~~IAS 39 *Financial Instruments: Recognition and Measurement*~~. Such investments shall be measured at fair value in accordance with [draft] IFRS X ~~IAS 39~~, with changes in fair value recognised in profit or loss in the period of the change. A venturer holding such an interest shall make the disclosures required by paragraphs 55 and 56.

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Jointly controlled entities

Financial statements of a venturer

Exceptions to proportionate consolidation and equity method

45 **When an investor ceases to have joint control over an entity, it shall account for any remaining investment in accordance with [draft] IFRS X and IAS 39 *Financial Instruments: Recognition and Measurement* from that date, provided that the former jointly controlled entity does not become a subsidiary or associate. From the date when a jointly controlled entity becomes a subsidiary of an investor, the investor shall account for its interest in accordance with IAS 27 and IFRS 3 *Business Combinations* (as revised in 2008). From the date when a jointly controlled entity becomes an associate of an investor, the investor shall account for its interest in accordance with IAS 28. On the loss of joint control, the investor shall measure at fair value any investment the investor retains in the former jointly controlled entity. The investor shall recognise in profit or loss any difference between:**

- **(a) the fair value of any retained investment and any proceeds from disposing of the part interest in the jointly controlled entity; and**
- **(b) the carrying amount of the investment at the date when joint control is lost.**

45A **When an investment ceases to be a jointly controlled entity and is accounted for in accordance with [draft] IFRS X and IAS 39, the fair value of the investment when it ceases to be a jointly controlled entity shall be regarded as its fair value on initial recognition as a financial asset in accordance with [draft] IFRS X ~~IAS 39~~.**

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45B If an investor loses joint control of an entity, the investor shall account for all amounts recognised in other comprehensive income in relation to that entity on the same basis as would be required if the jointly controlled entity had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the investor reclassifies the gain or loss from equity to profit or loss (as a reclassification adjustment) when the investor loses joint control of the entity. For example, if a jointly controlled entity has cumulative exchange differences relating to a foreign operation ~~available-for-sale financial assets~~ and the investor loses joint control of the entity, the investor shall reclassify to profit or loss the gain or loss previously recognised in other comprehensive income in relation to the foreign operation ~~those assets~~. If an investor's ownership interest in a jointly controlled entity is reduced, but the investment continues to be a jointly controlled entity, the investor shall reclassify to profit or loss only a proportionate amount of the gain or loss previously recognised in other comprehensive income.

Reporting interests in joint ventures in the financial statements of an investor

51 An investor in a joint venture that does not have joint control shall account for that investment in accordance with [draft] IFRS X and IAS 39 or, if it has significant influence in the joint venture, in accordance with IAS 28.

Effective date and transition

58C [Draft] IFRS X issued in [date to be inserted after exposure], amended paragraphs 1, 45–45B and 51. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

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IAS 32 *Financial Instruments: Presentation*

C22 Paragraphs 3, 4, 12, 23 and 31 are amended and paragraph 97E is added as follows:

Objective

3 The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in [draft] IFRS X *Financial Instruments: Classification and Measurement* and IAS 39 *Financial Instruments: Recognition and Measurement*, and for disclosing information about them in IFRS 7 *Financial Instruments: Disclosures*.

Scope

4 This Standard shall be applied by all entities to all types of financial instruments except:

...

(d) insurance contracts as defined in IFRS 4 *Insurance Contracts*. However, this Standard applies to derivatives that are embedded in insurance contracts if IAS 39 requires the entity to account for them separately. Moreover, an issuer shall apply this Standard to financial guarantee contracts if the issuer applies [draft] IFRS X and IAS 39 in recognising and measuring the contracts, but shall apply IFRS 4 if the issuer elects, in accordance with paragraph 4(d) of IFRS 4, to apply IFRS 4 in recognising and measuring them.

(e) ...

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Definitions (see also paragraphs AG3–AG23)

12 The following terms are defined in Appendix A of [draft] IFRS X and paragraph 9 of IAS 39 and are used in this Standard with the meaning specified in [draft] IFRS X and IAS 39.

- ~~amortised cost of a financial asset or financial liability~~
- amortised cost
- ~~available for sale financial assets~~
- derecognition
- derivative
- effective interest method
- effective interest rate
- ~~financial asset or financial liability at fair value through profit or loss~~
- financial guarantee contract
- firm commitment
- forecast transaction
- hedge effectiveness
- hedged item
- hedging instrument
- held for trading
- ~~held to maturity investments~~
- ~~loans and receivables~~
- regular way purchase or sale
- transaction costs.

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Presentation

Liabilities and equity (see also paragraphs AG13–AG14J and AG25–AG29A)

Settlement in the entity's own equity instruments (paragraph 16(b))

23 With the exception of the circumstances described in paragraphs 16A and 16B or paragraphs 16C and 16D, a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (for example, for the present value of the forward repurchase price, option exercise price or other redemption amount). This is the case even if the contract itself is an equity instrument. One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. When the financial liability is recognised and measured initially under [draft] IFRS X and IAS 39, its fair value (the present value of the redemption amount) is reclassified from equity. Subsequently, the financial liability is measured in accordance with [draft] IFRS X ~~IAS 39~~. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem (eg a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price).

31 [Draft] IFRS X and IAS 39 deal~~s~~ with the measurement of financial assets and financial liabilities. Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the

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compound financial instrument other than the equity component (such as an equity conversion option) is included in the liability component. The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately.

Effective date and transition

97E [Draft] IFRS X issued in [date to be inserted after exposure], amended paragraphs 3, 4, 12, 23, 31, AG2 and AG30. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

C23 In the Appendix (Application Guidance), paragraphs AG2 and AG30 are amended as follows:

AG2 The Standard does not deal with the recognition or measurement of financial instruments. Requirements about the recognition and measurement of financial assets and financial liabilities are set out in [draft] IFRS X and IAS 39.

Presentation

Compound financial instruments (paragraphs 28–32)

AG30 Paragraph 28 applies only to issuers of non-derivative compound financial instruments. Paragraph 28 does not deal with compound financial instruments from the perspective of holders. ~~IAS 39 deals with the separation of embedded derivatives from the perspective of holders of compound financial instruments that contain debt and equity features.~~

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IAS 33 *Earnings per Share*

C24 Paragraph 34 is amended and paragraph 74B is added as follows:

Measurement

Diluted earnings per share

Earnings

34 After the potential ordinary shares are converted into ordinary shares, the items identified in paragraph 33(a)–(c) no longer arise. Instead, the new ordinary shares are entitled to participate in profit or loss attributable to ordinary equity holders of the parent entity. Therefore, profit or loss attributable to ordinary equity holders of the parent entity calculated in accordance with paragraph 12 is adjusted for the items identified in paragraph 33(a)–(c) and any related taxes. The expenses associated with potential ordinary shares include transaction costs and discounts accounted for in accordance with the effective interest method (see ~~paragraph 9~~ Appendix A of [draft] IFRS X *Financial Instruments: Classification and Measurement* ~~IAS 39~~ ~~*Financial Instruments: Recognition and Measurement*~~~~, as revised in 2003~~).

Effective date

74B [Draft] IFRS X issued in [date to be inserted after exposure], amended paragraph 34. An entity shall apply that amendment for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendment for that earlier period.

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IAS 39 *Financial instruments: Recognition and Measurement*

C25 Extensive changes are proposed to IAS 39 that are not reproduced here. Some paragraphs have been moved to [draft] IFRS X and others have been amended or deleted. The following table indicates the extent of change.

Paragraph(s) in IAS 39	**Status**
Throughout	The term *hybrid instrument* has been changed throughout IAS 39 to *hybrid contract*.
1–7	Remain in IAS 39
8, 9	The following definitions will be deleted from IAS 39 and inserted into [draft] IFRS X: • amortised cost of a financial asset or financial liability • effective interest method • effective interest rate • transaction costs The portion of the definition of a *financial asset or financial liability at fair value through profit or loss* (FVTPL) that describes *held for trading* will be inserted into [draft] IFRS X. The rest of the definition of FVTPL will be deleted. The following definitions have been deleted: • held-to-maturity investments • loans and receivables • available-for-sale financial assets As a result of some of these changes, paragraph 8 of IAS 39 will be amended to refer to the particular definitions in the [draft] IFRS. All other definitions will remain unchanged.
10, 11	Remain in IAS 39 but amended to refer only to hybrid contracts with non-financial hosts. Portions of paragraph 10 are also inserted as paragraph 6 in [draft] IFRS X.

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11A	Deleted
12, 13	Remain in IAS 39 but amended to refer only to hybrid contracts with non-financial hosts. The guidance related to reclassifications is deleted from paragraph 12.
14–42	Remain in IAS 39 but paragraphs 26(b), 27(b), 31, 33, 34(b) and 35 will be amended to refer to the relevant measurement guidance in [draft] IFRS X.
43	Replaced by the requirements in paragraph 11 of [draft] IFRS X
44	Remains in IAS 39
45–47	Replaced by the requirements in paragraphs 12–18 of [draft] IFRS X
48–49	Remain in IAS 39
50–54	Deleted
55, 56	Replaced by the requirements in paragraphs 19–22 of [draft] IFRS X
57	Remains in IAS 39 but will be amended to refer only to financial assets measured at amortised cost
58	Remains in IAS 39 but will be amended to refer to the relevant measurement guidance in [draft] IFRS X
59, 60	Remain in IAS 39
61	Deleted
62–65	Remain in IAS 39
66–70	Deleted
71–78	Remain in IAS 39
79	Deleted
80–102	Remain in IAS 39 but paragraph 88(d) will be amended to refer to the relevant measurement guidance in [draft] IFRS X and the last two sentences of paragraph 89(b) have been deleted.
103–108C, 109 and 110	Remain in IAS 39
AG1–AG4A	Remain in IAS 39
AG4B–AG4G	Replaced by the requirements in paragraphs B14–B19 in [draft] IFRS X
AG4H–AG4K	Deleted

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AG5–AG8	Replaced by the requirements in paragraphs B28–B30 in [draft] IFRS X
AG9–AG12A	Remain in IAS 39
AG13–AG15	Replaced by the requirements in paragraphs B31–B33 in [draft] IFRS X
AG16–AG27	Deleted
AG28, AG29	Remain in IAS 39
AG30	Remains in IAS 39 but will be amended to refer only to hybrid contracts with non-financial hosts: • the examples in (a)–(c), (f) and (h) are deleted • the examples in (d)–(e) and (g) are amended
AG31, AG32	Deleted
AG33	Remains in IAS 39 will be amended to refer only to hybrid contracts with non-financial hosts: • the examples in (c) and (e) are deleted • the examples in (a), (b), (d) and (g) are amended • the examples in (f) and (h) remain the same
AG33A, AG33B	Deleted
AG34–AG63	Remain in IAS 39
AG64–AG67	Replaced by the requirements in paragraphs B20–B23 in [draft] IFRS X
AG68	Deleted
AG69–AG79	Remain in IAS 39
AG80, AG81	Deleted
AG82	Remains in IAS 39
AG83	Replaced by the requirements in paragraphs B24–B27 in [draft] IFRS X
AG84-AG93	Remain in IAS 39 but paragraph AG84 will be amended to remove references to the categories of 'loans and receivables' and 'held-to-maturity investment'.

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AG94	Remains in IAS 39
AG95, AG96	Deleted
AG97–AG133	Remain in IAS 39 but paragraph AG99F(c) will be amended to assume that the inflation-linked bond is measured at amortised cost in its entirety.

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IFRIC 9 *Reassessment of Embedded Derivatives*

C26 In the 'References' section, a reference to [draft] IFRS X *Financial Instruments: Classification and Measurement* is added. Paragraph 7A is deleted, paragraphs 2, 3, 7 and 8 are amended and paragraph 12 is added as follows:

Background

2 IAS 39 paragraph 11 requires an embedded derivative to be separated from ~~the~~ a non-financial host contract and accounted for as a derivative if, and only if:

(a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the non-financial host ~~contract~~; and

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative.~~; and~~

(c) [deleted] ~~the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in profit or loss (ie a derivative that is embedded in a financial asset or financial liability at fair value through profit or loss is not separated).~~

Scope

3 Subject to paragraphs 4 and 5 below, this Interpretation applies to all embedded derivatives that are separated from a non-financial host and accounted for in accordance with ~~within the scope of~~ IAS 39.

Consensus

7 An entity shall assess whether an embedded derivative is required to be separated from the non-financial host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is ~~either (a)~~ a change in the terms of the contract that significantly modifies the cash flows that otherwise would be

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required under the contract ~~or (b) a reclassification of a financial asset out of the fair value through profit or loss category~~, in which case~~s~~ an assessment is required. An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the non-financial host ~~contract~~ or both have changed and whether the change is significant relative to the previously expected cash flows on the contract.

7A [Deleted] ~~The assessment whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on reclassification of a financial asset out of the fair value through profit or loss category in accordance with paragraph 7 shall be made on the basis of the circumstances that existed on the later date of:~~

~~(a) when the entity first became a party to the contract; and~~

~~(b) a change in the terms of the contract that significantly modified the cash flows that otherwise would have been required under the contract.~~

~~For the purpose of this assessment paragraph 11(c) of IAS 39 shall not be applied (ie the hybrid (combined) contract shall be treated as if it had not been measured at fair value with changes in fair value recognised in profit or loss). If an entity is unable to make this assessment the hybrid (combined) contract shall remain classified as at fair value through profit or loss in its entirety.~~

8 A first-time adopter shall assess whether an embedded derivative is required to be separated from the non-financial host ~~contract~~ and accounted for as a derivative on the basis of the conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required by paragraph 7.

Effective date and transition

12 [Draft] IFRS X, issued in [date to be inserted after exposure], deleted paragraph 7A and amended paragraphs 2, 3, 7 and 8. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

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IFRIC 10 *Interim Financial Reporting and Impairment*

C27 In the 'References' section, a reference to [draft] IFRS X *Financial Instruments: Classification and Measurement* is added. Paragraphs 1, 2, 7 and 8 are amended, paragraph 11 is added and paragraphs 5 and 6 are deleted as follows:

Background

1 An entity is required to assess goodwill for impairment at the end of each reporting period~~, to assess investments in equity instruments and in financial assets carried at cost for impairment at the end of each reporting period~~ and, if required, to recognise an impairment loss at that date in accordance with IAS 36 ~~and IAS 39~~. However, at the end of a subsequent reporting period, conditions may have so changed that the impairment loss would have been reduced or avoided had the impairment assessment been made only at that date. This Interpretation provides guidance on whether such impairment losses should ever be reversed.

2 The Interpretation addresses the interaction between the requirements of IAS 34 and the recognition of impairment losses on goodwill in IAS 36 ~~and certain financial assets in IAS 39~~, and the effect of that interaction on subsequent interim and annual financial statements.

Issue

7 The Interpretation addresses the following issue:

> Should an entity reverse impairment losses recognised in an interim period on goodwill ~~and investments in equity instruments and in financial assets carried at cost~~ if a loss would not have been recognised, or a smaller loss would have been recognised, had an impairment assessment been made only at the end of a subsequent reporting period?

Consensus

8 An entity shall not reverse an impairment loss recognised in a previous interim period in respect of goodwill ~~or an investment in either an equity instrument or a financial asset carried at cost.~~

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Effective date and transition

11 [Draft] IFRS X, issued in [date to be inserted after exposure], amended paragraphs 1, 2, 7 and 8 and deleted paragraphs 5 and 6. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

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IFRIC 12 *Service Concession Arrangements*

C28 In the 'References' section, a reference to [draft] IFRS X *Financial Instruments: Classification and Measurement* is added. Paragraphs 23–25 are amended and paragraph 28A is added as follows:

Consensus

Financial asset

23 IASs 32 and 39 and [draft] IFRS X and IFRS 7 apply to the financial asset recognised under paragraphs 16 and 18.

24 The amount due from or at the direction of the grantor is accounted for in accordance with [draft] IFRS X and IAS 39 as:

(a) at amortised cost ~~a loan or receivable~~;

(b) at fair value through profit or loss ~~an available-for-sale financial asset~~; or

(c) if so designated upon initial recognition, a financial asset at fair value through profit or loss, if the conditions for that classification are met.

25 If the amount due from the grantor is accounted for ~~either as a loan or receivable or as an available-for-sale financial asset~~ at amortised cost, [draft] IFRS X ~~IAS 39~~ requires interest calculated using the effective interest method to be recognised in profit or loss.

Effective date

28A [Draft] IFRS X, issued in [date to be inserted after exposure], amended paragraphs 23–25. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendments for that earlier period.

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SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*

C29 In the 'References' section, a reference to [draft] IFRS X *Financial Instruments: Classification and Measurement* is added. Paragraph 7 is amended and a new paragraph added to the 'Effective date' section as follows:

Consensus

7 Other obligations of an arrangement, including any guarantees provided and obligations incurred upon early termination, shall be accounted for under IAS 37, [draft] IFRS X and IAS 39, or IFRS 4, depending on the terms.

Effective date

This Interpretation becomes effective on 31 December 2001. Changes in accounting policies shall be accounted for in accordance with IAS 8.

[Draft] IFRS X, issued in [date to be inserted after exposure], amended paragraph 7. An entity shall apply that amendment for annual periods beginning on or after [date to be inserted after exposure]. If an entity applies [draft] IFRS X for an earlier period, it shall apply the amendment for that earlier period.

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[Draft] Amendments to guidance on other IFRSs

The following [draft] amendments to guidance on IFRSs are necessary in order to ensure consistency with [draft] IFRS X Financial Instruments: Classification and Measurement *and the related amendments to other IFRSs. In the amended paragraphs, new text is underlined and deleted text is struck through.*

Some guidance on implementing IAS 39 *Financial Instruments: Recognition and Measurement* has been amended to ensure consistency with the proposals in the [draft] IFRS.

For the purpose of the exposure draft, all of that amended guidance remains in IAS 39. The Board will decide at a later date on the location of that guidance.

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

IGA1 In the Implementation Guidance accompanying IFRS 1, paragraphs IG55, IG56, IG58, IG58A and IG59 are amended as follows:

IAS 39 *Financial Instruments: Recognition and Measurement*

Embedded derivatives

IG55 When IAS 39 requires an entity to separate an embedded derivative from a non-financial host contract, the initial carrying amounts of the components at the date when the instrument first satisfies the recognition criteria in IAS 39 reflect circumstances at that date (IAS 39 paragraph 11). If the entity cannot determine the initial carrying amounts of the embedded derivative and non-financial host ~~contract~~ reliably, it treats the entire combined contract as ~~a~~ ~~financial instrument held for trading~~ at fair value through profit or loss (IAS 39 paragraph 12). ~~This results in fair value measurement (except when the entity cannot determine a reliable fair value, see IAS 39 paragraph 46(c)), with changes in fair value recognised in profit or loss.~~

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Measurement

IG56 In preparing its opening IFRS statement of financial position, an entity applies the criteria in ~~IAS 39~~ [draft] IFRS X *Financial Instruments: Classification and Measurement* to identify on the basis of the facts and circumstances that exist at the date of transition to IFRSs those financial assets and financial liabilities that are measured at fair value and those that are measured at amortised cost. The resulting classifications are applied retrospectively. ~~In particular:~~

(a)–(e) [deleted]

IG58 An entity's estimates of ~~loan~~ impairments of financial assets measured at amortised cost at the date of transition to IFRSs are consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 14 of the IFRS). The entity treats the impact of any later revisions to those estimates as impairment losses (or, if the criteria in IAS 39 are met, reversals of impairment losses) of the period in which it makes the revisions.

Transition adjustments

IG58A An entity shall treat an adjustment to the carrying amount of a financial asset or financial liability as a transition adjustment to be recognised in the opening balance of retained earnings at the date of transition to IFRSs only to the extent that it results from adopting ~~IAS 39~~ [draft] IFRS X. Because all derivatives, other than those that are financial guarantee contracts or are designated and effective hedging instruments, are classified as ~~held for trading~~ at fair value through profit or loss, the differences between the previous carrying amount (which may have been zero) and the fair value of the derivatives are recognised as an adjustment of the balance of retained earnings at the beginning of the financial year in which ~~IAS 39~~ [draft] IFRS X is initially applied (other than for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

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IG59 An entity may, in accordance with its previous GAAP, have measured investments at fair value and recognised the revaluation gain outside profit or loss. If an investment is classified as at fair value through profit or loss, the pre-~~IAS 39~~ [draft] IFRS X revaluation gain that had been recognised outside profit or loss is reclassified into retained earnings on initial application of ~~IAS 39~~ [draft] IFRS X. If, on initial application of ~~IAS 39~~ [draft] IFRS X, an investment in an equity instrument is classified as ~~available for sale~~ at fair value through other comprehensive income, then the pre-~~IAS 39~~ [draft] IFRS X revaluation gain is recognised in a separate component of equity. Subsequently, the entity recognises gains, ~~and~~ losses and dividends on the ~~available-for-sale~~ financial asset in other comprehensive income and accumulates the cumulative gains, ~~and~~ losses and dividends in that separate component of equity. ~~until the investment is impaired, sold, collected or otherwise disposed of. On subsequent derecognition or impairment of the available-for-sale financial asset, the entity reclassifies to profit or loss the cumulative gain or loss remaining in equity (IAS 39 paragraph 55(b)).~~ The amounts recognised in that separate component of equity may be transferred within equity.

IGA2 IG Example 11 in paragraph IG63 is amended as follows:

The table 'Reconciliation of equity at 1 January 20X4 (date of transition to IFRSs)' is amended to read as follows:

Reconciliation of equity at 1 January 20X4 (date of transition to IFRSs)

Note		*Previous GAAP* CU	*Effect of transition to IFRSs* CU	*IFRSs* CU
1	Property, plant and equipment	8,299	100	8,399
2	Goodwill	1,220	150	1,370
2	Intangible assets	208	(150)	58
3	Financial assets	3,471	420	3,891
	Total non-current assets	13,198	520	13,718

continued...

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...continued

	Trade and other receivables	3,710	0	3,710
4	Inventories	2,962	400	3,362
5	Other receivables	333	431	764
	Cash and cash equivalents	748	0	748
	Total current assets	7,753	831	8,584
	Total assets	20,951	1,351	22,302
	Interest-bearing loans	9,396	0	9,396
	Trade and other payables	4,124	0	4,124
6	Employee benefits	0	66	66
7	Restructuring provision	250	(250)	0
	Current tax liability	42	0	42
8	Deferred tax liability	579	460	1,039
	Total liabilities	14,391	276	14,667
	Total assets less total liabilities	6,560	1,075	7,635
	Issued capital	1,500	0	1,500
5	Hedging reserve	0	302	302
9	Retained earnings	5,060	773	5,833
	Total equity	6,560	1,075	7,635

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Note 3 to the reconciliation of equity at 1 January 20X4 is amended as follows:

3	Financial assets are all classified as ~~available for sale~~ at fair value through profit or loss in accordance with IFRSs and are carried at their fair value of CU3,891. They were carried at cost of CU3,471 in accordance with previous GAAP. The resulting gains of CU294 (CU420, less related deferred tax of CU126) are included in ~~the revaluation surplus~~ retained earnings.

Note 9 to the reconciliation of equity at 1 January 20X4 is amended to read as follows:

9	The adjustments to retained earnings are as follows:	
		CU
	Depreciation (note 1)	100
	Financial assets	420
	Production overhead (note 4)	400
	Pension liability (note 6)	(66)
	Restructuring provision (note 7)	250
	Tax effect of the above	(331)
	Total adjustment to retained earnings	773

The reconciliation of total comprehensive income for 20X4 is amended to read as follows:

Reconciliation of total comprehensive income for 20X4

Note		*Previous GAAP* CU	*Effect of transition to IFRSs* CU	*IFRSs* CU
	Revenue	20,910	0	20,910
1,2,3	Cost of sales	(15,283)	(97)	(15,380)
	Gross profit	5,627	(97)	5,530
6	Other income	0	180	180

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...continued				
1	Distribution costs	(1,907)	(30)	(1,937)
1,4	Administrative expenses	(2,842)	(300)	(3,142)
	Finance income	1,446	0	1,446
	Finance costs	(1,902)	0	(1,902)
	Profit before tax	422	(247)	175
5	Tax expense	(158)	74	(84)
	Profit (loss) for the year	264	(173)	91
7	Cash flow hedges	0	(40)	(40)
8	Tax relating to other comprehensive income	0	(29)	(29)
	Other comprehensive income	0	(69)	(69)
	Total comprehensive income	264	(242)	22

Note 6 to the reconciliation of total comprehensive income for 20X4 is amended as follows:

6	~~Available-for-sale f~~ Financial assets at fair value through profit or loss ~~carried at fair value in accordance with IFRSs~~ increased in value by CU180 during 20X4. They were carried at cost in accordance with previous GAAP. ~~The entity sold available-for-sale financial assets during the year, recognising a gain of CU40 in profit or loss. Of that realised gain CU30 had been included in the revaluation surplus as at 1 January 20X4 and is reclassified from revaluation surplus to profit or loss (as a reclassification adjustment).~~

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IFRS 7 *Financial Instruments: Disclosures*

IGA3 In the Implementation Guidance accompanying IFRS 7, the table in paragraph IG13A is amended to read as follows:

Assets measured at fair value

		Fair value measurement at end of the reporting period using:		
		Level 1	**Level 2**	**Level 3**
Description	**31 Dec 20X2**	**CU million**	**CU million**	**CU million**
Financial assets at fair value through profit or loss				
Trading securities	100	40	55	5
Trading derivatives	39	17	20	2
Financial assets at fair value through other comprehensive income				
Equity investments	75	30	40	5
Total	214	87	115	12

(Note: For liabilities, a similar table might be presented.)

IGA4 The table in paragraph IG13B is amended to read as follows:

Assets measured at fair value based on Level 3

	Fair value measurement at the end of the reporting period			
	Financial assets at fair value			**Total**
	Trading securities	Trading derivatives	Equity investments	
	CU million	CU million	CU million	CU million
Opening balance	6	5	3	14
Total gains or losses				
in profit or loss	(2)	(2)	-	(4)
in other comprehensive income	-	-	1	1
Purchases	1	2	1	4

continued...

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...continued

Issues	-	-	-	-
Settlement	-	(1)	-	(1)
Transfers out of Level 3	-	(2)	-	(2)
Closing balance	5	2	5	12
Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period	(1)	(1)	-	(2)
Gains or losses included in profit or loss for the period (above) are presented in trading income and in other income as follows:				
				Trading Income
Total gains or losses included in profit or loss for the period				(4)
Total gains or losses for the period included in profit or loss for assets held at the end of the reporting period				(2)

(Note: For liabilities, a similar table might be presented.)

IGA5 Paragraph IG36 is amended as follows:

IG36 The following example illustrates the application of the disclosure requirement in paragraph 40(a):

Interest rate risk

At 31 December 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, post-tax profit for the year would have been CU1.7 million (20X1—CU2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings~~, and other comprehensive income would have been CU2.8 million (20X1—CU3.2 million) higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as available for sale~~. If interest rates had been 10 basis points higher, with all other variables held constant, post-tax profit would have been CU1.5 million (20X1—CU2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings~~, and other comprehensive income would have been CU3.0 million (20X1—CU3.4 million) lower, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as available for sale~~. Profit is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X). [footnote omitted] ...

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IAS 1 *Presentation of Financial Statements*

IGA6 In the guidance on implementing IAS 1, the heading above paragraph IG7 and paragraphs IG7–IG9 are deleted. Paragraph IG2 is amended as follows:

Illustrative financial statement structure

IG2 The guidance is in three sections. Paragraphs IG3–IG6 provide examples of the presentation of financial statements. Paragraphs IG7–IG9 have been deleted.~~provide an example of the determination of reclassification adjustments for available-for-sale financial assets in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.~~ Paragraphs IG10 and IG11 provide examples of capital disclosures.

IGA7 In the illustrative financial statements, references to 'Available-for-sale financial assets' are replaced by 'Investments in equity instruments'. The heading and table 'Disclosure of components of other comprehensive income' are amended to read as follows:

Part I: Illustrative presentation of financial statements

Disclosure of components of other comprehensive income
[footnote omitted]

Notes

Year ended 31 December 20X7

(in thousands of currency units)

		20X7		**20X6**
Other comprehensive income:				
Exchange differences on translating foreign operations		5,334		10,667
Investments in equity instruments		(24,000)		26,667
Cash flow hedges:				
Gains (losses) arising during the year	(4,667)		(4,000)	
Less: Reclassification adjustments for gains (losses) included in profit or loss	3,333		–	

continued...

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...continued

Less: Adjustments for amounts transferred to initial carrying amount of hedged items	667	(667)	–	(4,000)
Gains on property revaluation		933		3,367
Actuarial gains (losses) on defined benefit pension plans		(667)		1,333
Share of other comprehensive income of associates		400		(700)
Other comprehensive income		(18,667)		37,334
Income tax relating to components of other comprehensive income		4,667		(9,334)
Other comprehensive income for the year		(14,000)		28,000

IGA8 The second paragraph in footnote (k) to the illustrative financial statements is amended as follows:

(k) The amount included in the translation, <u>investments in equity instruments</u> ~~available-for-sale~~ and cash flow hedge reserves represent other comprehensive income for each component, net of tax and non-controlling interests, eg other comprehensive income related to <u>investments in equity instruments</u> ~~available-for-sale financial assets~~ for 20X6 of 16,000 is 26,667, less tax 6,667, less non-controlling interests 4,000.

IGA9 The second paragraph in footnote (l) to the illustrative financial statements is amended as follows:

(l) The amount included in the translation, <u>investment in equity instruments</u> ~~available-for-sale~~ and cash flow hedge reserves represent other comprehensive income for each component, net of tax and non-controlling interests, eg other comprehensive income related to the translation of foreign operations for 20X7 of 3,200 is 5,334, less tax 1,334, less non-controlling interests 800.

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IAS 18 *Revenue*

IGA10 In the appendix to IAS 18, paragraphs 5 and 14 are amended as follows:

Sale of goods

5 ...

For a sale and repurchase agreement on an asset other than a financial asset, the terms of the agreement need to be analysed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the buyer and hence revenue is recognised. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue. For a sale and repurchase agreement on a financial asset, [draft] IFRS X *Financial Instruments: Classification and Measurement* and IAS 39 *Financial Instruments: Recognition and Measurement* apply ~~applies~~.

Rendering of services

14 *Financial service fees*

(a) *Fees that are an integral part of the effective interest rate of a financial instrument.*

...

(i) *Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under [draft] IFRS X ~~IAS 39~~ is classified as a financial asset 'at fair value through profit or loss'.*

Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related transaction costs [footnote omitted] (as defined in [draft] IFRS X ~~IAS 39~~), are deferred and recognised as an adjustment to the effective interest rate.

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(ii) *Commitment fees received by the entity to originate a loan when the loan commitment is outside the scope of IAS 39.*

If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of IAS 39, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related transaction costs (as defined in [draft] IFRS X ~~IAS 39~~), is deferred and recognised as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry. Loan commitments that are within the scope of IAS 39 are accounted for as derivatives and measured at fair value.

(iii) *Origination fees received on issuing financial liabilities measured at amortised cost.*

These fees are an integral part of generating an involvement with a financial liability. When a financial liability is not classified as 'at fair value through profit or loss', the origination fees received are included, with the related transaction costs (as defined in [draft] IFRS X ~~IAS 39~~) incurred, in the initial carrying amount of the financial liability and recognised as an adjustment to the effective interest rate. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

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(b) *Fees earned as services are provided.*

...

(iii) *Investment management fees.*

Fees charged for managing investments are recognised as revenue as the services are provided.

Incremental costs that are directly attributable to securing an investment management contract are recognised as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. As in [draft] IFRS X ~~IAS 39~~, an incremental cost is one that would not have been incurred if the entity had not secured the investment management contract. The asset represents the entity's contractual right to benefit from providing investment management services, and is amortised as the entity recognises the related revenue. If the entity has a portfolio of investment management contracts, it may assess their recoverability on a portfolio basis.

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

IGA11 In Appendix C (Examples: Recognition), Example 9 is amended as follows:

Example 9 A single guarantee

On 31 December 20X0, Entity A gives a guarantee of certain borrowings of Entity B, whose financial condition at that time is sound. During 20X1, the financial condition of Entity B deteriorates and at 30 June 20X1 Entity B files for protection from its creditors.

This contract meets the definition of an insurance contract in IFRS 4 *Insurance Contracts*, but is within the scope of [draft] IFRS X *Financial Instruments: Classification and Measurement* and IAS 39 *Financial Instruments: Recognition and Measurement*, because it also meets the definition of a financial guarantee contract in IAS 39. If an issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either IAS 39 and [draft] IFRS X or IFRS 4 to such financial guarantee contracts. IFRS 4 permits the issuer to continue its existing accounting policies for insurance contracts if specified minimum requirements are satisfied. IFRS 4 also permits changes in accounting policies that meet specified criteria. The following is an example of an accounting policy that IFRS 4 permits and that also complies with the requirements in IAS 39 and [draft] IFRS X for financial guarantee contracts within the scope of IAS 39 and [draft] IFRS X.

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IAS 39 *Financial Instruments: Recognition and Measurement*

IGA12 In the guidance on implementing IAS 39 the following Questions and Answers (Q&A) are deleted:

- Section B: Definitions B.12–B.23
- Section C: Embedded Derivatives C.1–C.5, C.10, C.11
- Section E: Measurement E.3.1, E.3.2, E.4.9, E.4.10
- Section F: Hedging F.2.9–F.2.11, F.2.19, F.2.20

IGA13 In Q&A B.4, the last paragraph of the answer is amended as follows:

B.4 Definition of a derivative: prepaid interest rate swap (fixed rate payment obligation prepaid at inception or subsequently)

If the fixed leg is prepaid during the term, that would be regarded as a termination of the old swap and an origination of a new instrument that is evaluated under IAS 39 and [draft] IFRS X.

IGA14 In Q&A B.11, the answer is amended as follows:

B.11 Definition of held for trading: portfolio with a recent actual pattern of short-term profit-taking

Although the term 'portfolio' is not explicitly defined in [draft] IFRS X ~~IAS 39~~, the context in which it is used suggests that a portfolio is a group of financial assets or financial liabilities that are managed as part of that group (~~IAS 39.9~~ [draft] IFRS X Appendix A). If there is evidence of a recent actual pattern of short-term profit-taking on financial instruments included in such a portfolio, those financial instruments ~~qualify as~~ meet the definition of held for trading ([draft] IFRS X Appendix A) and are measured at fair value through profit or loss even though an individual financial instrument may in fact be held for a longer period of time.

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IGA15 In Q&A B.24, the answer is amended as follows:

B.24 Definition of amortised cost: perpetual debt instruments with fixed or market-based variable rate

No. Since there are no repayments of principal, there is no amortisation of the difference between the initial amount and the maturity amount if the rate of interest is fixed or specified as a market-based variable rate. Because interest payments are fixed or market-based and will be paid in perpetuity, the amortised cost (the present value of the stream of future cash payments discounted at the effective interest rate) equals the principal amount in each period (~~IAS 39.9~~ [draft] IFRS X Appendix A).

IGA16 In Q&A B.26, the answer is amended as follows:

B.26 Example of calculating amortised cost: financial asset

Under ~~IAS 39~~ [draft] IFRS X, amortised cost is calculated using the effective interest method. The effective interest rate inherent in a financial instrument is the rate that exactly discounts the estimated cash flows associated with the financial instrument through the expected life of the instrument or, where appropriate, a shorter period to the net carrying amount at initial recognition. The computation includes all fees and points paid or received that are an integral part of the effective interest rate, directly attributable transaction costs and all other premiums or discounts.

IGA17 In Q&A B.27, the answer is amended as follows:

B.27 Example of calculating amortised cost: debt instruments with stepped interest payments

No. Although there is no difference between the initial amount and maturity amount, an entity uses the effective interest method to allocate interest payments over the term of the debt instrument to achieve a constant rate on the carrying amount (~~IAS 39.9~~ [draft] IFRS X Appendix A).

...

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IGA18 Q&A C.6 is amended as follows:

C.6 ~~Embedded derivatives: s~~<u>S</u>ynthetic instruments

Entity A acquires a five-year floating rate debt instrument issued by Entity B. At the same time, it enters into a five-year pay-variable, receive-fixed interest rate swap with Entity C. Entity A regards the combination of the debt instrument and swap as a synthetic fixed rate instrument and <u>measures</u> ~~classifies~~ the instrument <u>at amortised cost.</u> ~~as a held-to-maturity investment, since it has the positive intention and ability to hold it to maturity. Entity A contends that separate accounting for the swap is inappropriate since IAS 39.AG33(a) requires an embedded derivative to be classified together with its host instrument if the derivative is linked to an interest rate that can change the amount of interest that would otherwise be paid or received on the host debt contract. Is the entity's analysis correct~~ <u>Is it appropriate that Entity A accounts for the two financial instruments as a single combined instrument</u>?

No. ~~Embedded derivative instruments are terms and conditions that are included in non-derivative host contracts.~~ It is generally inappropriate to treat two or more separate financial instruments as a single combined instrument ('synthetic instrument' accounting) for the purpose of applying IAS 39 <u>and [draft] IFRS X</u>. Each of the financial instruments has its own terms and conditions and each may be transferred or settled separately. Therefore, the debt instrument and the swap are classified separately. The transactions described here differ from the transactions discussed in Question B.6, which had no substance apart from the resulting interest rate swap.

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IGA19 The tables in Q&A D.2.1 are amended to read as follows:

Settlement date accounting			
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value with changes presented in other comprehensive income**	**Financial assets measured at fair value through profit or loss**
29 December 20X1			
Financial asset	–	–	–
Financial liability	–	–	–
31 December 20X1			
Receivable	–	2	2
Financial asset	–	–	–
Financial liability	–	–	–
Other comprehensive income (fair value adjustment)	–	(2)	–
Retained earnings (through profit or loss)	–	–	(2)
4 January 20X2			
Receivable	–	–	–
Financial asset	1,000	1,003	1,003
Financial liability	–	–	–
Other comprehensive income (fair value adjustment)	–	(3)	–
Retained earnings (through profit or loss)	–	–	(3)

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Trade date accounting			
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value with changes presented in other comprehensive income**	**Financial assets measured at fair value through profit or loss**
29 December 20X1			
Financial asset	1,000	1,000	1,000
Financial liability	(1,000)	(1,000)	(1,000)
31 December 20X1			
Receivable	–	–	–
Financial asset	1,000	1,002	1,002
Financial liability	(1,000)	(1,000)	(1,000)
Other comprehensive income (fair value adjustment)	–	(2)	–
Retained earnings (through profit or loss)	–	–	(2)
4 January 20X2			
Receivable	–	–	–
Financial asset	1,000	1,003	1,003
Financial liability	–	–	–
Other comprehensive income (fair value adjustment)	–	(3)	–
Retained earnings (through profit or loss)	–	–	(3)

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IGA20 The tables in Q&A D.2.2 are amended to read as follows:

Settlement date accounting		
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value through profit or loss**
29 December 20X2		
Receivable	–	–
Financial asset	1,000	1,010
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	–	10
31 December 20X2		
Receivable	–	–
Financial asset	1,000	1,010
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	–	10
4 January 20X3		
Equity (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10

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Trade date accounting		
Balances	**Financial assets measured at amortised cost**	**Financial assets measured at fair value through profit or loss**
29 December 20X2		
Receivable	1,010	1,010
Financial asset	–	–
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10
31 December 20X2		
Receivable	1,010	1,010
Financial asset	–	–
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10
4 January 20X3		
Other comprehensive income (fair value adjustment)	–	–
Retained earnings (through profit or loss)	10	10

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IGA21 Q&A E.1.1 is amended as follows:

E.1.1 Initial measurement: transaction costs

Transaction costs should be included in the initial measurement of financial assets and financial liabilities other than those at fair value through profit or loss. How should this requirement be applied in practice?

For financial assets, incremental costs that are directly attributable to the acquisition of the asset, for example fees and commissions, are added to the amount originally recognised. For financial liabilities, directly related costs of issuing debt are deducted from the amount of debt originally recognised. For financial instruments that are measured at fair value through profit or loss, transaction costs are not added to the fair value measurement at initial recognition.

For financial instruments that are carried at amortised cost, ~~such as held-to-maturity investments, loans and receivables, and financial liabilities that are not at fair value through profit or loss,~~ transaction costs are included in the calculation of amortised cost using the effective interest method and, in effect, amortised through profit or loss over the life of the instrument.

For ~~available-for-sale~~ financial assets with fair value changes presented in other comprehensive income, transaction costs are recognised in other comprehensive income as part of a change in fair value at the next remeasurement. ~~If an available-for-sale financial asset has fixed or determinable payments and does not have an indefinite life, the transaction costs are amortised to profit or loss using the effective interest method. If an available-for-sale financial asset does not have fixed or determinable payments and has an indefinite life, the transaction costsare recognised in profit or loss when the asset is derecognised or becomes impaired.~~

Transaction costs expected to be incurred on transfer or disposal of a financial instrument are not included in the measurement of the financial instrument.

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IGA22 Q&A E.3.3 is amended as follows:

E.3.3 ~~IAS 39~~ [Draft] IFRS X and IAS 21 Exchange differences arising on translation of foreign entities: other comprehensive income or profit or loss?

IAS 21.32 and IAS 21.48 state~~s~~ that all exchange differences resulting from translating the financial statements of a foreign operation should be recognised in other comprehensive income until disposal of the net investment. This would include exchange differences arising from financial instruments carried at fair value through profit or loss.~~, which would include both financial assets classified as at fair value through profit or loss and financial assets that are available for sale.~~

~~IAS 39.55~~ [Draft] IFRS X requires that changes in fair value of financial assets ~~classified as~~ measured at fair value through profit or loss should be recognised in profit or loss ~~and changes in fair value of available-for-sale investments should be recognised in other comprehensive income~~.

If the foreign operation is a subsidiary whose financial statements are consolidated with those of its parent, in the consolidated financial statements how are ~~IAS 39.55~~ [draft] IFRS X.19 and IAS 21.39 applied?

IAS 39 and [draft] IFRS X apply ~~applies~~ in the accounting for financial instruments in the financial statements of a foreign operation and IAS 21 applies in translating the financial statements of a foreign operation for incorporation in the financial statements of the reporting entity.

To illustrate: Entity A is domiciled in Country X and its functional currency and presentation currency are the local currency of Country X (LCX). A has a foreign subsidiary (Entity B) in Country Y whose functional currency is the local currency of Country Y (LCY). B is the owner of a debt instrument, which is held for trading and therefore carried at fair value under [draft] IFRS X ~~IAS 39~~.

...

IGA23 Question E.3.4 is amended as follows:

E.3.4 ~~IAS 39~~ [Draft] IFRS X and IAS 21 Interaction between ~~IAS 39~~ [draft] IFRS X and IAS 21

~~IAS 39~~ [Draft] IFRS X includes requirements about the measurement of financial assets and financial liabilities and the recognition of gains and losses on remeasurement in profit or loss. IAS 21 includes rules about the reporting of foreign currency items and the recognition of exchange differences in profit or loss. In what order are IAS 21 and ~~IAS 39~~ [draft] IFRS X applied?

Statement of financial position

Generally, the measurement of a financial asset or financial liability at fair value~~, cost~~ or amortised cost is first determined in the foreign currency in which the item is denominated in accordance with ~~IAS 39~~ [draft] IFRS X. Then, the foreign currency amount is translated into the functional currency using the closing rate or a historical rate in accordance with IAS 21 (~~IAS 39.AG83~~ [draft] IFRS X.B25). For example, if a monetary financial asset (such as a debt instrument) is carried at amortised cost under ~~IAS 39~~ [draft] IFRS X, amortised cost is calculated in the currency of denomination of that financial asset. Then, the foreign currency amount is recognised using the closing rate in the entity's financial statements (IAS 21.23). That applies regardless of whether a monetary item is measured at cost, amortised cost or fair value in the foreign currency (IAS 21.24). A non-monetary financial asset (such as an investment in an equity instrument) is translated using the closing rate if it is carried at fair value in the foreign currency (IAS 21.23(c)) ~~and at a historical rate if it is not carried at fair value under IAS 39 because its fair value cannot be reliably measured (IAS 21.23(b) and IAS 39.46(c))~~.

~~As an exception, if the financial asset or financial liability is designated as a hedged item in a fair value hedge of the exposure to changes in foreign currency rates under IAS 39, the hedged item is remeasured for changes in foreign currency rates even if it would otherwise have been recognised using a historical rate under IAS 21 (IAS 39.89), ie the foreign currency amount is recognised using the closing rate. This exception applies to non monetary items that are carried in terms of historical cost in the foreign currency and are hedged against exposure to foreign currency rates (IAS 21.23(b)).~~

Profit or loss

...

Any exchange difference arising on recognising a *monetary item* at a rate different from that at which it was initially recognised during the period, or recognised in previous financial statements, is recognised in profit or loss ~~or in other comprehensive income~~ in accordance with IAS 21 (~~IAS 39.AG83~~ [draft] IFRS X.B25, IAS 21.28 and IAS 21.32), unless the monetary item is designated as a cash flow hedge of a highly probable forecast transaction in foreign currency, in which case the requirements for recognition of gains and losses on cash flow hedges in IAS 39 apply (IAS 39.95). Differences arising from recognising a monetary item at

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a foreign currency amount different from that at which it was previously recognised are accounted for in a similar manner, since all changes in the carrying amount relating to foreign currency movements should be treated consistently. All other changes in the statement of financial position measurement of a monetary item are recognised in profit or loss ~~or in other comprehensive income~~ in accordance with ~~IAS 39~~ [draft] IFRS X. ~~For example, although an entity recognises gains and losses on available-for-sale monetary financial assets in other comprehensive income (IAS 39.55(b)), the entity nevertheless recognises the changes in the carrying amount relating to changes in foreign exchange rates in profit or loss (IAS 21.23(a)).~~

Any changes in the carrying amount of a *non-monetary item* are recognised in profit or loss or in other comprehensive income in accordance with ~~IAS 39 (IAS 39.AG83~~ [draft] IFRS X.B25~~)~~. For example, for ~~available-for-sale financial assets~~ financial instruments classified as at fair value through other comprehensive income the entire change in the carrying amount, including the effect of changes in foreign currency rates, is recognised in other comprehensive income. ~~If the non monetary item is designated as a cash flow hedge of an unrecognised firm commitment or a highly probable forecast transaction in foreign currency, the requirements for recognition of gains and losses on cash flow hedges in IAS 39 apply (IAS 39.95).~~

~~When some portion of the change in carrying amount is recognised in other comprehensive income and some portion is recognised in profit or loss, for example, if the amortised cost of a foreign currency bond classified as available for sale has increased in foreign currency (resulting in a gain in profit or loss) but its fair value has decreased in the functional currency (resulting in a loss recognised in other comprehensive income), an entity cannot offset those two components for the purposes of determining gains or losses that should be recognised in profit or loss or in other comprehensive income.~~

IGA24 The last sentence of the answer to Question F.1.4 is deleted.

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IGA25 Q&A F.2.1 is amended as follows:

F.2.1 Whether a derivative can be designated as a hedged item

Does IAS 39 permit designating a derivative instrument (whether a stand-alone or separately recognised embedded derivative) as a hedged item either individually or as part of a hedged group in a fair value or cash flow hedge, for example, by designating a pay-variable, receive-fixed Forward Rate Agreement (FRA) as a cash flow hedge of a pay-fixed, receive-variable FRA?

No. Derivative instruments are always deemed held for trading and measured at fair value with gains and losses recognised in profit or loss unless they are designated and effective hedging instruments (IAS 39.9 and [draft] IFRS X Appendix A). As an exception, IAS 39.AG94 permits the designation of a purchased option as the hedged item in a fair value hedge.

IGA26 Q&A F.2.5 is amended as follows:

F.2.5 Cash flow hedges: 'all in one' hedge

If a derivative instrument is expected to be settled gross by delivery of the underlying asset in exchange for the payment of a fixed price, can the derivative instrument be designated as the hedging instrument in a cash flow hedge of that gross settlement assuming the other cash flow hedge accounting criteria are met?

Yes. A derivative instrument that will be settled gross can be designated as the hedging instrument in a cash flow hedge of the variability of the consideration to be paid or received in the future transaction that will occur on gross settlement of the derivative contract itself because there would be an exposure to variability in the purchase or sale price without the derivative. This applies to all fixed price contracts that are accounted for as derivatives under IAS 39 and [draft] IFRS X.

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For example, if an entity enters into a fixed price contract to sell a commodity and that contract is accounted for as a derivative under IAS 39 and [draft] IFRS X (for example, because the entity has a practice of settling such contracts net in cash or of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin), the entity may designate the fixed price contract as a cash flow hedge of the variability of the consideration to be received on the sale of the asset (a future transaction) even though the fixed price contract is the contract under which the asset will be sold. Also, if an entity enters into a forward contract to purchase a debt instrument that will be settled by delivery, but the forward contract is a derivative because its term exceeds the regular way delivery period in the marketplace, the entity may designate the forward as a cash flow hedge of the variability of the consideration to be paid to acquire the debt instrument (a future transaction), even though the derivative is the contract under which the debt instrument will be acquired.

IGA27 Q&A F.2.13 is amended as follows:

F.2.13 Fair value hedge: risk that could affect profit or loss

Is fair value hedge accounting permitted for exposure to interest rate risk in fixed rate loans that are ~~classified as loans and receivables~~ measured at amortised cost?

Yes. Under [draft] IFRS X, ~~IAS 39, loans and receivables~~ some fixed rate loans are carried at amortised cost. Banking institutions in many countries hold the bulk of their fixed rate loans ~~and receivables~~ until maturity. Thus, changes in the fair value of such fixed rate loans ~~and receivables~~ that are due to changes in market interest rates will not affect profit or loss. IAS 39.86 specifies that a fair value hedge is a hedge of the exposure to changes in fair value that is attributable to a particular risk and that can affect profit or loss. Therefore, IAS 39.86 may appear to preclude fair value hedge accounting for fixed rate loans ~~and receivables~~. However, ~~it follows from IAS 39.79 that loans and receivables can be hedged items with respect to interest rate risk since they are not designated as held-to-maturity investments. T~~the entity could sell them and the change in fair values would affect profit or loss. Thus, fair value hedge accounting is permitted for fixed rate loans ~~and receivables~~.

IGA28 The last paragraph of the answer to Question F.2.17 is amended as follows:

F.2.17 Partial term hedging

To illustrate: Entity A acquires a 10 per cent fixed rate government bond with a remaining term to maturity of ten years. Entity A classifies the bond as ~~available for sale~~ measured at amortised cost. To hedge itself against fair value exposure on the bond associated with the present value of the interest rate payments until year 5, Entity A acquires a five-year pay-fixed, receive-floating swap. The swap may be designated as hedging the fair value exposure of the interest rate payments on the government bond until year 5 and the change in value of the principal payment due at maturity to the extent affected by changes in the yield curve relating to the five years of the swap.

IGA29 Q&A F.5.1 is amended as follows:

F.5.1 Hedge accounting: non-derivative monetary asset or non-derivative monetary liability used as a hedging instrument

If an entity designates a non-derivative monetary asset as a foreign currency cash flow hedge of the repayment of the principal of a non-derivative monetary liability, would the exchange differences on the hedged item be recognised in profit or loss (IAS 21.28) and the exchange differences on the hedging instrument be recognised in other comprehensive income until the repayment of the liability (IAS 39.95)?

No. Exchange differences on the monetary asset and the monetary liability are both recognised in profit or loss in the period in which they arise (IAS 21.28). ~~IAS 39.AG83~~ [Draft] IFRS X.B25 specifies that if there is a hedge relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in fair values of those financial instruments are recognised in profit or loss.

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IGA30 Q&A G.1 is amended as follows:

G.1 Disclosure of changes in fair value

~~IAS 39~~ [Draft] IFRS X requires financial assets ~~classified as available for sale (AFS)~~ designated at fair value through other comprehensive income and financial assets and financial liabilities at fair value through profit or loss to be remeasured to fair value. Unless a financial asset or a financial liability is designated as a cash flow hedging instrument, fair value changes for financial assets and financial liabilities at fair value through profit or loss are recognised in profit or loss, and fair value changes for ~~AFS assets~~ financial assets designated at fair value through other comprehensive income are recognised in other comprehensive income. What disclosures are required regarding the amounts of the fair value changes during a reporting period?

IFRS 7.20 requires items of income, expense and gains and losses to be disclosed. This disclosure requirement encompasses items of income, expense and gains and losses that arise on remeasurement to fair value. Therefore, an entity provides disclosures of fair value changes, distinguishing between changes that are recognised in profit or loss and changes that are recognised in other comprehensive income. Further breakdown is provided of changes that relate to:

~~(a)~~ ~~AFS assets, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount that was reclassified from equity to profit or loss for the period as a reclassification adjustment;~~

(~~b~~a) financial assets or financial liabilities at fair value through profit or loss, showing separately those fair value changes on financial assets or financial liabilities (i) designated as such upon initial recognition and (ii) mandatorily classified as such ~~as held for trading~~ in accordance with ~~IAS 39~~ [draft] IFRS X; and

(~~c~~b) hedging instruments.

In addition, IFRS 7.20A requires an entity to disclose the amount of gain or loss recognised in other comprehensive income for financial assets measured at fair value through other comprehensive income, including any amount transferred within equity.

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IFRS 7 neither requires nor prohibits disclosure of components of the change in fair value by the way items are classified for internal purposes. For example, an entity may choose to disclose separately the change in fair value of those derivatives that in accordance with ~~IAS 39~~ [draft] IFRS X it categorises as held for trading, but the entity classifies as part of risk management activities outside the trading portfolio.

In addition, IFRS 7.8 requires disclosure of the carrying amounts of financial assets or financial liabilities at fair value through profit or loss, showing separately: (i) those designated as such upon initial recognition and (ii) those mandatorily classified as such ~~held for trading~~ in accordance with ~~IAS 39~~ [draft] IFRS X.

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IFRIC 12 *Service Concession Arrangements*

IGA31 In the illustrative examples accompanying IFRIC 12, paragraphs IE7 and IE28 are amended as follows:

Example 1: The grantor gives the operator a financial asset

Financial asset

IE7 The amounts due from the grantor qualify for amortised cost measurement ~~meet the definition of a receivable~~ in [draft] IFRS X *Financial Instruments: Classification and Measurement* ~~IAS 39 *Financial Instruments: Recognition and Measurement*~~. The receivable is measured initially at fair value. It is subsequently measured at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount calculated using the effective interest method minus repayments.

Example 3: The grantor gives the operator a financial asset and an intangible asset

Financial asset

IE28 The amount due from or at the direction of the grantor in exchange for the construction services qualifies for amortised cost measurement ~~meets the definition of a receivable~~ in [draft] IFRS X *Financial Instruments: Classification and Measurement* ~~IAS 39 *Financial Instruments: Recognition and Measurement*~~. The receivable is measured initially at fair value. It is subsequently measured at amortised cost, ie the amount initially recognised plus the cumulative interest on that amount minus repayments.

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Basis for Conclusions
Exposure Draft ED/2009/7

Financial Instruments: Classification and Measurement

Comments to be received by 14 September 2009

International Accounting Standards Board®

Basis for Conclusions on
Exposure Draft

FINANCIAL INSTRUMENTS: CLASSIFICATION AND MEASUREMENT

Comments to be received by 14 September 2009

ED/2009/7

This Basis for Conclusions accompanies the proposed International Financial Reporting Standard (IFRS) set out in the exposure draft *Financial Instruments: Classification and Measurement* (see separate booklet). Comments on the draft IFRS and its accompanying documents should be submitted in writing so as to be received by **14 September 2009.** Respondents are asked to send their comments electronically to the IASB website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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Basis for Conclusions on the exposure draft *Financial Instruments: Classification and Measurement*

This Basis for Conclusions accompanies, but is not part of, the draft IFRS.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in developing the proposals in the exposure draft *Financial Instruments: Classification and Measurement*. Individual Board members gave greater weight to some factors than to others.

BC2 The Board has long acknowledged the need to improve the accounting requirements for financial instruments. In the light of the financial crisis and the urgent need to improve the accounting for financial instruments and to make it easier for users of financial statements to understand the financial reporting information, the Board proposes to replace IAS 39 *Financial Instruments: Recognition and Measurement* in several phases. In pursuing such an approach, the Board acknowledged the difficulties that might be created by differences in timing between this project and other projects, in particular phase II of the project on insurance contracts.

BC3 The exposure draft proposes requirements for the classification and measurement of financial instruments and related items. In the Board's view, classification and measurement requirements are the foundation for any financial reporting standard, and associated requirements (for example, impairment and hedging) have to reflect those classification and measurement requirements. In addition, the Board has noted that many of the application issues that have arisen in the financial crisis are related to the classification and measurement requirements of IAS 39.

BC4 The Board plans to develop an IFRS from the proposals in this exposure draft in time to permit (but not require) its application for 2009 year-end financial statements. This is consistent with the recommendation from the G20 leaders that the Board should take action to improve and simplify the accounting requirements for financial instruments by the end of 2009.

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BC5 The Board plans to publish exposure drafts later in 2009 on the impairment of financial assets measured at amortised cost, and on improving and simplifying hedge accounting. The proposals contained in those exposure drafts will build on the classification and measurement proposals in this exposure draft and, to the extent possible, the effects of any redeliberations by the Board of the proposals in this exposure draft in light of the responses.

BC6 The Board is also committed to the convergence of IFRSs and US GAAP requirements for financial instruments. There are many detailed differences between them, making it impossible to achieve convergence on the basis of existing requirements. The Board will consider publishing for comment any proposals that the US Financial Accounting Standards Board (FASB) may publish, to the extent that they are different from the proposals contained in the exposure draft. The Board also believes that the proposals contained in the exposure draft form a common foundation with the approaches currently being considered by the FASB and, to the extent that any FASB proposals differ, will facilitate convergence in the accounting requirements for financial instruments.

Proposals

Scope

BC7 The Board has not yet reconsidered the scope of IAS 39. The scope of IAS 39 and its interaction with other standards have resulted in some application and interpretation issues. However, the Board believes that the issue of scope should be addressed comprehensively rather than only in the context of classification and measurement. Moreover, the scope of IAS 39 has not been raised as a matter of concern during the financial crisis and, hence, the Board believes that the scope of IAS 39 should be considered during a later phase of the project to replace IAS 39.

Classification approach

BC8 Many have told the Board that the number of categories of financial instruments in IAS 39, including the various impairment models associated with those categories, creates much complexity in financial reporting. The Board decided that proposing two measurement

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categories and providing a better rationale for those categories would make it easier for users of financial statements to understand the financial reporting for financial instruments and improve the decision-usefulness of the reported information.

BC9 The objective of the proposed classification approach is to present information that is useful to users for their assessment of the amounts, timing and uncertainty of future cash flows.

A single measurement category for all financial assets and financial liabilities

BC10 Many users of financial statements support a single measurement category for all financial assets and financial liabilities. They note that fair value is more relevant than other measurements in helping them to assess the effect of current economic events on an entity. They assert that one measurement attribute for all financial instruments promotes consistency in valuation, presentation and disclosure and the usefulness of financial statements.

BC11 However, many others, including many preparers and auditors of financial statements and regulators and some users, do not support requiring fair value for all financial assets and financial liabilities, although some agree that reducing the number of measurement categories would reduce complexity. They generally reason that it is not appropriate to measure financial instruments at fair value if the instrument is not held for trading or not managed on a fair value basis. They also note that it is difficult to value financial instruments that are not actively traded. In addition, they believe that moving to a full fair value method would add volatility to profit or loss.

BC12 Some, including some of those who generally support the broad application of fair value for financial instruments, raise concerns about the use of fair value when fair value cannot be reliably determined. Many also agree that other issues, including financial statement presentation, need to be addressed before a comprehensive fair value measurement requirement would be feasible.

BC13 In response to those views, as well as the general concerns raised during the financial crisis and acknowledging that there are issues to be resolved before a comprehensive fair value measurement requirement for most financial instruments is feasible, the Board decided that measuring all financial assets and financial liabilities at fair value is not the most appropriate approach to improving the financial reporting for financial instruments.

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BC14 Some suggested a discounted cash flow remeasurement method as a possible method to complement, but not replace, fair value. The method would use current estimates of cash flows (including expectations about possible variations in the amount and timing of those cash flows) and current interest rates (including risk margins reflecting the price for bearing the uncertainty inherent in the instrument) but would not reflect other factors such as illiquidity risk and market imperfections. However, the Board decided that the method did not have a well-specified measurement objective, and would require significant further work before the Board was able to assess whether such an approach represented an improvement to financial reporting.

BC15 The Board therefore decided to propose a classification approach that requires financial instruments to be measured at fair value or amortised cost. The Board believes that both of these measurement methods can provide useful information to users of financial statements for particular types of financial instruments in particular circumstances. In proposing such an approach, the Board acknowledged that it would not eliminate some of the complexity associated with the existing financial reporting requirements for financial instruments. However, the Board believes that the classification approach proposed should make it easier for users to understand the information about financial instruments that is presented in the financial statements compared with existing requirements, and hence, represents an improvement in financial reporting for financial instruments. Existing requirements include many categories of financial instruments that, when combined with impairment requirements, result in many different ways of determining the carrying amount of a financial instrument. Existing requirements do not have a clear rationale for why a particular instrument is classified in a particular category. Additionally, any particular category can include instruments with different characteristics, eg the loans and receivables category can include originated loans, purchased loans, some investments in first loss tranches issued by structured investment vehicles and investment securities. The Board decided that reducing the number of categories and providing a better rationale for those categories would improve the decision-usefulness of the reported information.

BC16 In developing an approach to distinguish between financial assets measured at fair value and amortised cost the Board considered a model in which only loans originated by the entity would qualify for amortised cost measurement. The Board acknowledged that for originated instruments the entity potentially has better information about the future contractual cash flows and credit risk than for purchased loans. However, the Board decided not to pursue that approach, mainly because

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some entities manage originated and purchased loans in the same portfolio. Distinguishing between originated and purchased loans, which would be done mainly for accounting purposes, would involve systems challenges. In addition, the Board notes that 'originated loans' might easily be created by way of placing purchased loans into an investment vehicle.

The proposed approach

BC17 The proposed approach has two primary measurement categories—fair value and amortised cost. The Board believes that amortised cost can provide useful information only when the instrument produces predictable returns based on its contractual terms and is managed on the basis of the contractual cash flows generated if it is held rather than sold or transferred. Accordingly, a financial asset or financial liability would be measured at amortised cost if two conditions are met:

(a) the instrument has only basic loan features; and

(b) the instrument is managed on a contractual yield basis.

BC18 Under the proposed approach, a financial asset or financial liability that does not meet both conditions would be measured at fair value. The Board also considered developing conditions that specified when an instrument must be measured at fair value, with the requirement that all other instruments would be measured at amortised cost. The Board rejected that approach because it believes that new conditions would have to be developed in the future to address innovative financial products.

Basic loan features

BC19 The Board used as a starting point the requirements for 'basic financial instruments' in Section 11 of the *IFRS for Small and Medium-sized Entities* (SMEs). Those requirements identify particular debt instruments that have basic lending characteristics and should be measured at amortised cost. However, the Board proposes to expand those requirements to address particular contractual features that are common in instruments held or issued by entities that are typically outside the scope of the *IFRS for SMEs*.

BC20 The Board noted that an instrument has basic loan features only if the contractual cash flows are principal and interest on the principal outstanding, which is consistent with the objective of amortised cost accounting and the effective interest method. The objective of the effective

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interest method is to allocate interest revenue or expense to the relevant period. Cash flows that are interest always have a close relation to the amount advanced to the debtor (the 'funded' amount) because interest is compensation for the time value of money and the credit risk associated with the issuer of the instrument and the instrument. The Board noted that the effective interest method is not an appropriate method to allocate cash flows that are not principal or interest on the principal outstanding. The Board concluded that if a financial instrument contains contractual cash flows that are not principal or interest on the principal outstanding then a valuation overlay to contractual cash flows (such as fair value) is required to ensure that the reported financial information provides useful information.

BC21 The Board noted that leverage is not a basic loan feature. Indeed, leverage (a common characteristic of many financial options, forward contracts and swap contracts) amplifies the variability of cash flows, with the result that those cash flows do not have the economic characteristics of interest.

BC22 Sometimes an instrument has a feature that combines a fixed interest return and a variable interest return, and both of those returns would be a basic loan feature on a stand-alone basis. The Board proposes that an instrument with such features should qualify for amortised cost measurement because those features are basic loan features. An example is an investment in a debt instrument with embedded interest rate caps, collars and floors.

BC23 A debt instrument may have pre-specified resets of its interest rate in response to changes in the credit quality of the instrument. The Board believes this is a basic loan feature because its purpose is to reflect the credit quality of the financial instrument over its term, which is consistent with the notion of interest.

BC24 Many financial instruments allow the debtor to repay a debt instrument early, sometimes in exchange for compensation to the creditor. The Board decided that provisions that require the debtor to compensate the creditor for that prepayment are basic loan features as long as the compensation substantially reflects the change in the creditor's economic position (because of the change in the timing of cash flows) rather than other factors.

BC25 The Board also considered different types of credit risk associated with financial assets and the effects of subordination. The Board noted that subordination can arise in different ways.

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BC26 The ranking of an entity's creditors is a common form of subordination that affects almost all lending transactions. The Board noted that commercial law (including bankruptcy law) typically sets out a basic ranking for creditors. This is required because not all creditors' claims are contractual (eg claims regarding damages for unlawful behaviour but also for tax liabilities or social insurance contributions). Although it is often difficult to determine exactly the degree of leverage resulting from this subordination the Board believes that it is reasonable to assume that commercial law does not intend to create leveraged credit exposure for general creditors such as trade creditors. Thus, the Board believes that the credit risk associated with general creditors is consistent with the notion of a basic loan feature. Consequently, the credit risk associated with any secured or senior liabilities ranking above general creditors would also be consistent with the notion of a basic loan feature.

BC27 Alternatively, a structured investment vehicle may issue different tranches to create a 'waterfall' structure that prioritises the payments by the issuer to the holders of the different tranches and, thus, specifies the order in which any losses that the issuer incurs are allocated to the different tranches. The Board noted that some tranches receive a higher return because they provide credit protection to other tranches. A tranche that provides credit protection to other tranches in any situation is leveraged and, therefore, does not have basic loan features. The Board also noted that in many structures, only the most senior tranche will receive credit protection in any situation. As a result, only that tranche will have basic loan features and be eligible for amortised cost measurement. The Board believed that the classification principle should be applied on the basis of the possible outcomes rather than the probability-weighted outcomes because it provides a clear application. Determining the probability-weighted outcomes is often difficult and highly judgemental (if not arbitrary). The Board also noted that writing credit protection reflects risk taking (albeit on a contingent basis) in addition to a proportionate tranche even if the probability of the credit protection being called on is low.

BC28 In reaching this decision the Board also considered other ways of applying the classification principle to concentration of credit risk. One possible alternative considered was to look through to the underlying assets of a structured investment vehicle. However, that approach would not work for debtors other than structured investment vehicles with a narrow investment scope. It would also give rise to the issue of how far to look through the investments held by a series of investment vehicles that invest into each other. This makes it difficult, if not impossible, to identify the 'underlying assets' in a non-arbitrary way

and would no longer reflect the characteristics of the instrument to be classified. Another possible alternative considered was to determine the credit risk at initial recognition. However, that requires setting a threshold for the investment risk at that point in time, which is difficult to implement. For example, it would require some rating or other credit grading process that is consistent for all entities. For many instruments such information may not be readily available (in particular for non-financial institutions) and it also could result in trade receivables of the same debtor incurred at the same time being determined to be an instrument with only basic loan features by one creditor but not by another creditor owing to different rating or grading results.

BC29 If a financial asset is acquired at a discount that reflects incurred credit losses, it does not have basic loan features. An investor acquiring an instrument at such a discount believes that the actual losses will be less than the losses that are reflected in the purchase price. Thus, that instrument creates exposure to significant variability in actual cash flows and such variability is not interest.

BC30 The Board noted that the proposed approach will require an entity to use judgement to determine whether a contractual feature of an instrument is a basic loan feature. The Board noted that many IFRSs require the use of such judgement.

Managed on a contractual yield basis

BC31 The Board decided that the contractual characteristics of a financial asset or financial liability by themselves do not provide sufficient information about the instrument's expected cash flows. The Board noted that the objective of the proposed classification approach is to classify financial assets and financial liabilities in such a way that the measurement reflects the predictive quality of the contractual cash flows and hence provides decision-useful information to users of financial statements in predicting future likely cash flows. The Board concluded that an entity's business model affects the predictive quality of contractual cash flows—ie whether actual cash flows will result from the collection or payment of cash flows arising from the instrument's contractual terms or from transferring the instrument before maturity to realise fair value changes.

BC32 The Board notes that an entity's business model does not relate to a choice (ie it is not a voluntary designation) but rather it is a matter of fact that can be observed by the way that an entity is managed, and information is provided to the management of the entity.

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BC33 For example, if an investment bank uses a trading business model, it could not easily become a savings bank that uses an 'originate and hold' business model. Therefore, a business model is very different from 'management intentions', which can relate to a single instrument and may change with circumstances. Consistently with this observation, the Board also determined that sales or transfers of financial instruments with basic loan features before maturity would not change the business model of an entity, as long as such transactions were consistent with managing the collection or payment of contractual cash flows rather than realising changes in fair values.

BC34 The notion of looking to an entity's business model for classification purposes is used in IAS 39. An entity is allowed to designate a financial asset or financial liability as at fair value through profit or loss if:

> ... a group of financial assets, financial liabilities or both 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 ...

BC35 However, the guidance in IAS 39 would need to be modified in order to be used as a condition for mandatory classification (rather than for voluntary designation). Therefore, the Board proposes a classification requirement that a financial instrument is managed on a contractual yield basis. The Board also proposes not to refer to a 'documented risk management or investment strategy' because an entity should not be able to circumvent the classification requirements simply by failing the documentation requirement.

BC36 The Board considered whether all financial assets and financial liabilities that are not held for trading purposes should be eligible for measurement at amortised cost. The Board rejected that alternative because the notion of 'held for trading' is too narrow and cannot appropriately reflect all situations in which amortised cost does not provide useful information. Being held for trading reflects only one type of financial instrument management that should require fair value measurement.

An alternative approach

BC37 In its deliberations leading to the exposure draft, the Board discussed alternative approaches to classification and measurement.

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BC38 One alternative approach considered was that financial assets that meet the two conditions specified in this exposure draft (ie they have basic loan features and are managed on a contractual yield basis) and meet the definition of loans and receivables in IAS 39 would be measured at amortised cost in the statement of financial position. All other financial assets would be measured at fair value in the statement of financial position, including assets that meet the conditions specified in this exposure draft to be measured at amortised cost. The fair values changes for each period of such financial assets would be disaggregated and presented as follows:

(a) changes in recognised value determined on an amortised cost basis (including impairments determined using the incurred loss impairment requirements in IAS 39) would be presented in profit or loss; and

(b) any difference between the amortised cost measure in (a) and the fair value change for the period would be presented in other comprehensive income.

BC39 Some Board members think that this approach might provide decision-useful information to users of financial statements because fair value information is provided in the statement of financial position and changes in fair values are disaggregated (in profit or loss and other comprehensive income).

BC40 Possible variants of this alternative approach were also discussed.

BC41 The Board decided to ask respondents for comments on the alternative approach and variants of the alternative approach (Questions 14 and 15).

Embedded derivatives

BC42 An embedded derivative is a component of a hybrid (combined) contract that also includes a non-derivative host, with the effect that some of the cash flows of the combined contract vary in a way similar to the cash flows of a stand-alone derivative contract. IAS 39 requires an entity to assess all contracts to determine whether they contain one or more embedded derivatives that are required to be separated from the host and accounted for as stand-alone derivatives.

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BC43 Many respondents to the discussion paper *Reducing Complexity in Reporting Financial Instruments* noted that the requirements and guidance of IAS 39 are complex, rule-based and internally inconsistent. Respondents, and others, have also noted the many application problems that arise from requirements to assess all contracts for embedded derivatives and, if required, to account for and measure those embedded derivative features separately as stand-alone derivatives.

BC44 The Board discussed three approaches for embedded derivatives. The approaches were

(a) to maintain the requirements in IAS 39;

(b) to propose using 'closely related' (used in IAS 39 to determine whether an embedded derivative is required to be separated from the host) as the classification criterion for the contract in its entirety; and

(c) to propose the same classification approach for all financial assets and financial liabilities (including hybrid contracts).

BC45 The Board rejected the first two approaches. The Board noted that both approaches would rely on the assessment of whether an embedded derivative is 'closely related' to the host. The 'closely related' assessment in IAS 39 is based on a list of examples that are inconsistent and unclear. That assessment is also a significant source of complexity. Both approaches would result in hybrid contracts being classified using conditions different from those that would be applied to all non-hybrid financial instruments. Consequently, some hybrid contracts that do not have only basic loan features might be measured at amortised cost. The Board also believes that neither approach would make it easier for users of financial statements to understand the information that financial statements present about financial instruments.

BC46 Therefore, the Board proposes to use the same classification approach for all financial instruments, including hybrid contracts with hosts that are within the scope of the proposed IFRS ('financial hosts'). The Board concluded that a single classification approach for all financial instruments and hybrid contracts with financial hosts is the only approach that responds adequately to the criticisms described above. The Board noted that using a single classification approach improves comparability by ensuring consistency in classification, and hence makes it easier for users to understand the information that financial statements present about financial instruments.

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BC47 The Board decided not to consider proposing changes to the requirements in IAS 39 for embedded derivatives in hybrid contracts with non-financial hosts. The Board noted that those requirements are also complex and have resulted in some application problems, including the question of whether particular types of non-financial contracts are within the scope of the financial instruments standard. The Board noted the importance of ensuring that any proposals for hybrid contracts with non-financial hosts also address which non-financial contracts should be within the scope of the financial instruments standard. The Board also noted the importance for many non-financial entities of hedge accounting for non-financial items, and the relationship to both scope and embedded derivative requirements. Therefore, the Board concluded that the requirements for hybrid contracts with non-financial hosts should be addressed in a later phase of the project to replace IAS 39.

Option to designate a financial asset or financial liability at fair value

BC48 IAS 39 permits entities the option to designate on initial recognition any financial asset or financial liability as measured at fair value through profit or loss if one (or more) of the following three conditions is met:

(a) It 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 recognising the gains and losses on them on different bases.

(b) A group of financial assets, financial liabilities or both 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.

(c) The financial asset or financial liability contains one or more embedded derivatives (and particular other conditions described in paragraph 11A of IAS 39 are met) and the entity elects to account for the hybrid (combined) contract in its entirety.

BC49 However, the Board noted:

(a) the proposals in the exposure draft would require any financial asset or financial liability that is managed on a fair value basis to be measured at fair value; and

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(b) the exposure draft proposes that hybrid contracts with financial hosts should be classified in their entirety, hence eliminating the requirement to identify and account for embedded derivatives separately.

Accordingly, the Board concluded that under the proposed classification approach the conditions in paragraph BC48(b) and (c) are unnecessary.

BC50 The Board agreed that the eligibility condition in paragraph BC48(a) should be retained in the exposure draft. The Board acknowledges that the condition mitigates some anomalies that result from the different measurement attributes used for financial instruments. In particular, it eliminates the need for fair value hedge accounting of fair value exposures when there are natural offsets and problems arising from a mixed measurement model when some financial assets are measured at fair value and related financial liabilities are measured at amortised cost. The Board also noted that particular sectors believe it is important to be able to mitigate such anomalies until other current IASB projects are completed (eg insurance). Therefore, the Board decided not to consider proposing in the exposure draft changes to the eligibility condition set out in paragraph BC48(a), but to consider whether to propose any changes as part of the future exposure draft on hedge accounting.

Elimination of the 'tainting' provision

BC51 IAS 39 generally prohibits an entity from classifying any financial asset as held to maturity if the entity had, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity.

BC52 Many respondents to the discussion paper *Reducing Complexity in Reporting Financial Instruments* criticised that provision as being an anti-abuse rule. Such respondents also noted that the held-to-maturity category in IAS 39 is not widely used because of the risk of having to recategorise all instruments out of the category if more than an insignificant amount of held-to-maturity investments are sold before maturity.

BC53 The exposure draft proposes to eliminate the held-to-maturity category and the tainting provision. The Board considered whether it should retain a notion of tainting for financial instruments measured at amortised cost. However, the Board believes that the proposed classification approach based on basic loan features and management on a contractual yield basis provides a clear rationale for measurement and that a tainting provision increases the complexity of application and is unduly prohibitive in the context of the proposed classification approach.

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As noted previously, the Board also determined that sales or transfers of financial instruments with basic loan features before maturity would not change how an entity manages its financial instruments, as long as such transactions were consistent with managing the collection or payment of contractual cash flows rather than realising changes in fair values.

BC54 Instead, the Board proposes to amend IAS 1 *Presentation of Financial Statements* to require an entity to present separately in the statement of comprehensive income all gains and losses on derecognition of financial assets and financial liabilities measured at amortised cost. The Board concluded that such a presentation requirement will allow users of financial statements to understand the effects of the derecognition before maturity of instruments measured at amortised cost.

Reclassification between fair value and amortised cost categories

BC55 In October 2008 the Board amended IAS 39 to permit an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances. The amendment also required significant disclosures if an entity decided to reclassify any financial assets. (IAS 39 had always required reclassifications between the held-to-maturity and available-for-sale categories in particular circumstances.)

BC56 The purpose of that amendment to IAS 39 was to provide short-term relief for some entities in the financial crisis and was a short-term response to requests for such relief. The amendment also aimed to align the accounting requirements for reclassifications in IAS 39 with US GAAP.

BC57 Following the amendment to IAS 39, the Board received comments from many users of financial statements that the amendment reduced their ability to understand the information about financial instruments in the financial statements and that the required disclosures have not been widely or consistently applied. Those users believe that the amendment impaired comparability among different entities as well as for financial instruments held by the same entity. Some users have also stated that allowing reclassifications has enabled some entities to manage profit or loss by managing the timing of when future fair value gains and losses will affect profit or loss.

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BC58 The Board considered whether the exposure draft should require or allow reclassifications between the fair value and amortised cost categories. The Board noted that the elimination of the held-to-maturity category and the associated tainting provision would render the associated reclassification requirements unnecessary.

BC59 The Board also noted that allowing or requiring reclassifications would not make it easier for users of financial statements to understand the information that financial statements provide about financial instruments, which is a desired outcome of the proposals in the exposure draft. The Board noted that requiring or permitting reclassifications would also increase complexity because detailed guidance would be required to specify when reclassifications would be permitted (or required), and the subsequent accounting for any reclassified financial instruments.

BC60 IFRS 4 *Insurance Contracts* permits an insurer to reclassify financial assets to prevent an accounting mismatch arising when it introduces a new accounting policy for its insurance contracts. In phase II of its project on insurance contracts, the Board will consider whether to provide a similar option for use on transition to the phase II standard.

Measurement

Exemption in IAS 39 for investments in equity instruments whose fair value cannot be reliably measured (and some derivatives on those investments)

BC61 IAS 39 contains an exemption from fair value measurement for investments in equity instruments that do not have a quoted price in an active market and whose fair value cannot be reliably measured. Those equity investments are required to be measured at cost less impairment, measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. The exemption is extended to derivatives that are linked to and must be settled by delivery of such unquoted equity instruments.

BC62 The exposure draft proposes that all investments in equity instruments should be measured at fair value. Measurement at amortised cost is not applicable to equity investments because such instruments have no contractual cash flows.

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BC63 The Board proposes to eliminate the exemption because measuring investments in equity instruments (and derivatives linked to those investments) at fair value provides the most relevant information to users. Measurement at initial cost provides no predictive value for users of financial statements, because cost information will reflect only the maximum loss exposure from the investment, not possible appreciation in value. In many cases fair value will be significantly different from the cost information reported.

BC64 In addition, IAS 39 requires the holder to monitor the investments for impairment and recognise a loss if one has been incurred. That requirement has been criticised because it is based on a calculation that is similar to a fair value determination and is no more reliable than measuring the equity investment at fair value.

BC65 Removing this exemption would also reduce complexity. Although there might be increased complexity in determining the fair value of the equity investment, that complexity would be offset by eliminating the requirement to monitor it for impairment.

BC66 The Board considered the costs of requiring such equity investments to be measured at fair value from the perspectives of valuation methodology and expertise, as well as the ability to obtain the information required for a fair value measurement. The Board noted that valuation methodologies for equity investments are well-developed and are often far less complex than those required for other financial instruments that are required to be measured at fair value, including many complex derivative products. However, some expressed concerns that smaller entities applying IFRSs may not have internal systems or expertise to determine easily the fair value of equity investments held, and so could face considerable costs. The Board also discussed the ability to obtain the information required to make a fair value measurement and noted that basic shareholder rights generally enable an entity to obtain the necessary information to perform a valuation.

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Gains and losses

Investments in equity instruments

BC67 The proposed approach distinguishes basic lending instruments from all other financial instruments. Therefore, as discussed previously, all equity investments would be measured at fair value because those instruments do not have basic loan features. The Board believes that fair value provides the most useful information to users for investments in equity instruments.

BC68 However, reporting fair value gains and losses in profit or loss for some equity investments may not be indicative of the performance of the entity. For example, an entity may make what it views as a 'strategic investment' in equity instruments issued by another entity with the intention of establishing or maintaining a long-term operating relationship with the entity. Such investments are held not primarily to generate dividends and increases in the value of the investment, but because of the non-contractual benefits associated with holding such an investment. For example, by holding such an investment an entity may be permitted to sell its products in a particular country.

BC69 The Board also noted that when valuing an entity users of financial statements often differentiate between fair value changes arising from equity investments held for purposes other than generating investment returns and equity investments held for trading. For those reasons, the Board proposes to permit entities to irrevocably elect at initial recognition to present fair value changes of some equity instruments in other comprehensive income.

BC70 The Board considered developing a principle to identify other equity investments whose fair value changes should be presented in profit or loss (or other comprehensive income). If such a principle was used to identify such investments, the investment would be reclassified into or out of the presentation requirement according to whether it met or ceased to meet the identification principle. However, the Board decided that it would be difficult, and perhaps impossible, to develop a clear and robust principle that would identify investments that are different enough in nature to justify a different presentation requirement. The Board considered whether a list of indicators could be used to support the principle but decided that such a list would inevitably be

rule-based and could not be comprehensive enough to address all possible situations and factors. Moreover, the Board noted that such an approach would create complexity in application without necessarily increasing the usefulness of information to users of financial statements.

BC71 Accordingly, the Board proposes to permit an entity to make an irrevocable election to present in other comprehensive income changes in the value of any investment in equity instruments that is not held for trading purposes. As discussed previously, the Board believes that separate presentation in other comprehensive income of gains and losses for some investments could provide useful information to users of financial statements because it would allow them to identify easily, and value accordingly, the associated fair value changes.

BC72 For investments in equity instruments that are measured at fair value through other comprehensive income, the Board decided to propose that fair value changes should not be subsequently transferred ('recycled') to profit or loss (on derecognition of the financial asset or otherwise). The Board noted that a gain or loss associated with these investments should be recognised once; therefore, recognising a gain or loss in other comprehensive income and subsequently transferring it to profit or loss is inappropriate. The Board also noted that this proposal eliminates the need for impairment requirements, which have created application problems for equity investments classified as available for sale in accordance with IAS 39.

BC73 An entity may transfer the cumulative gain or loss (including any dividends recognised) within equity. In the light of jurisdiction-specific restrictions on components of equity, the Board proposes not to provide specific requirements related to that transfer.

BC74 The Board proposes to require additional disclosures about investments in equity instruments that are measured at fair value through other comprehensive income. The Board believes those disclosures will provide useful information to users of financial statements about which instruments have been presented in that manner and the effect of that presentation.

BC75 This presentation option will add complexity to the proposed approach. Moreover, all options result in decreased comparability. However, the Board believes that the proposals that accompany this option—that the election is irrevocable and additional disclosures are required—address some of those concerns.

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Effective date and transition

Effective date

BC76 The Board will set the effective date for the proposed requirements when it approves the IFRS. The Board recognises that many countries require time for translation and that the introduction of mandatory requirements of IFRSs is legally binding. In addition, entities will require time to implement new standards. The Board normally sets an effective date of between six and eighteen months after issuing an IFRS.

BC77 The Board considered the implications for transition of the phased approach being taken to replace IAS 39. In the light of the financial crisis, the Board considered that some improvements to current requirements are required as soon as possible and that the phased approach allows the Board to be responsive to such requests for improvement. However, the Board also noted the interaction between the different phases of the project to replace IAS 39 (notably, the proposals in this exposure draft and the future exposure draft on hedging). The Board accepted that some entities or jurisdictions may wish to apply all of the new requirements for financial instruments at the same time. These are expected to be completed during 2010. Accordingly, the Board expects that the new requirements will not be mandatorily effective before January 2012.

BC78 The exposure draft proposes permitting earlier application of the IFRS to allow an entity to apply the enhanced guidance on classification and measurement of financial instruments. However, although the Board believes that the proposals in this exposure draft will result in more decision-useful information, the Board acknowledges that the effect of transition will be significant for some entities. As a result, there will be less comparability between entities that apply the IFRS early and those that do not. Accordingly, the Board proposes additional disclosures for an entity that elects to apply the IFRS early.

Transition

BC79 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that retrospective application results in the most useful information to users because the information presented for all periods is comparable. However, the Board considered the difficulties and associated costs of full retrospective application of the proposals in the exposure draft. The Board considered whether to require prospective application, but noted that such an approach does not provide comparable information for users of financial statements. In addition, the Board noted that any transition

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approach (such as prospective application) that requires resetting the effective interest rate for financial instruments measured at amortised cost reduces the usefulness of information about interest that is presented in profit or loss.

BC80 Therefore, the Board proposes retrospective application and transition relief to address particular difficulties that might arise from retrospective application. The Board also noted that IAS 8 sets out transition requirements if retrospective application is impracticable and prohibits the use of hindsight when applying a new accounting policy to a prior period.

BC81 The Board proposes requiring an entity to assess whether a financial asset or financial liability is managed on a contractual yield basis in the light of circumstances at the date of initial application. The Board believes it would be difficult, and perhaps impossible, to assess that condition on the basis of circumstances when the instrument first satisfied the recognition criterion in IAS 39.

BC82 The Board also decided to propose that the assessment of whether a financial asset or financial liability meets the eligibility criterion for designation under the fair value option should be based on the circumstances at the date of initial application. The proposed approach would change the classification of some financial instruments, including eliminating two of the three eligibility criteria in IAS 39 for the fair value option. Therefore, the Board believes that an entity should reconsider at transition its original assessment of whether to designate a financial asset or financial liability as at fair value through profit or loss.

BC83 The Board acknowledged that it may be impracticable for an entity to apply the impairment requirements in IAS 39 retrospectively in some situations. The process would be cumbersome, in particular for an entity with a large number of financial assets that were previously measured at fair value but are measured at amortised cost in accordance with the proposed approach. Several loss events and reversals might have occurred between the date that the asset was initially recognised and the date of initial application of the proposed IFRS. The Board proposes that if applying the impairment requirements is impracticable or requires the use of hindsight, an entity should use previously determined fair value information to determine whether a financial asset is impaired in comparative periods. If such an approach is used, the Board also decided to propose that the fair value at the date of initial application of the new requirements should be deemed to be the new amortised cost of that financial asset.

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BC84 An entity would not have previously determined the fair value of an investment in an unquoted equity instrument (or a derivative on such an investment) that was previously accounted for in accordance with paragraphs 46(c), 47(a) and 66 of IAS 39. Moreover, an entity will not have the necessary information to determine fair value retrospectively without using hindsight. Accordingly, the Board proposes to require such instruments to be measured at fair value at the date of initial application.

BC85 An entity may not have previously determined the fair value of a hybrid contract in its entirety. Moreover, an entity will not have the necessary information to determine fair value retrospectively without using hindsight. However, an entity would have been required to measure both the embedded derivative and host separately at fair value to apply the disclosure requirements in IFRS 7. Therefore, in comparative periods, the Board proposes that the sum of the fair value of the embedded derivative and the host should be used as an approximation of the fair value of the entire hybrid contract.

BC86 The Board proposes that any hedge relationship that has to be de-designated under the new classification approach should be accounted for as a discontinuation of hedge accounting. The Board believes that the benefits of full retrospective application do not justify the costs that preparers would incur to generate the necessary information.

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Alternative view on exposure draft

Alternative view of James J Leisenring

AV1 Mr Leisenring voted against publication of the exposure draft *Financial Instruments: Classification and Measurement*, for the reasons set out below.

AV2 Mr Leisenring supports efforts to reduce the complexity of accounting for financial instruments. The exposure draft minimally does this, but much more could be done. In that regard, he supports requiring that all financial instruments be measured at fair value with the result of that measurement being recognised in profit or loss. He finds no compelling reason related to improving financial reporting to reject this approach. Mr Leisenring's approach maximises comparability and absolutely minimises complexity.

AV3 It maximises comparability because all financial instruments would be at one attribute within any entity and across entities. No measurement or presentation would change based on either arbitrary distinctions or management behaviour or intentions. The exposure draft emphasises management intentions and behaviour, which substantially undermines comparability.

AV4 Complexity of accounting would be dramatically reduced with all financial instruments measured at fair value. The approach favoured by Mr Leisenring provides at least the following simplifications:

(a) no impairment model is necessary.

(b) criteria for when a given instrument must or can be measured with a given attribute are unnecessary.

(c) there is no need to bifurcate embedded derivatives or to identify financial derivatives.

(d) it eliminates the need for fair value hedge accounting for financial instruments.

(e) it eliminates the disparity in the measure of derivatives in and outside the scope of IAS 39.

(f) it minimises the incentives for structuring transactions to achieve a particular accounting outcome.

(g) no fair value option would be needed to eliminate accounting mismatches.

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(h) it provides a superior foundation for developing a comprehensive standard for the derecognition of financial instruments that is not present in a mixed-attribute model.

AV5 Mr Leisenring accepts that measuring more instruments at fair value increases measurement complexity, but that increase is minimal compared with the reductions in complexity that would be otherwise achieved. There is no disagreement that derivatives must be measured at fair value. Those instruments raise the most difficult measurement issues, as cash instruments have much fewer problems. Indeed, some suggestions for an impairment model would measure at fair value the credit loss component of cash instruments. If that were to be the conclusion on impairment (an expected loss approach), it would minimise the incremental fair value measurement complexity of recording at fair value instruments now at amortised cost.

AV6 Mr Leisenring recognises that measuring all instruments at fair value through profit and loss raises presentation issues about disaggregation of fair value changes. He does not believe, however, that these issues are insurmountable.

AV7 Investors have consistently told both the IASB and the FASB that fair value of financial instruments recorded in profit or loss provides the most decision-useful information for their purposes. There is a worldwide demand for an improved and converged solution to accounting for financial instruments. Mr Leisenring is disappointed the Board will not take this opportunity to make, with other standard-setters, truly substantive changes rather than these minimal changes that perpetuate all the legitimate concerns that have been expressed about the mixed-attribute model.

AV8 Fundamental to the exposure draft is the distinction between financial instruments measured at amortised cost and at fair value. Mr Leisenring is concerned that neither of the two conditions necessary for that determination is operational. What constitutes basic loan features will produce significant implementation issues. The conclusion of paragraph BC29 illustrates this potential for confusion. This paragraph suggests variability of cash flows precludes an instrument from having basic loan features even when the variance is exclusively from credit. Variability of cash flows is certainly not prohibited by paragraphs B1–B8 if the variability is the result of credit. Mr Leisenring also questions how many sales can be observed and still conclude the instrument is managed on a contractual yield basis.

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AV9 Mr Leisenring questions why, given the conclusion in paragraph B9, there is any need for a fair value option. To measure at fair value all one must do is assert they do not manage on a contractual yield basis and the conditions in paragraphs B14 and B15 would not have to be met.

AV10 He is also concerned that, in the current crisis, instruments that have provided some of the most significant losses when measured at fair value would be eligible for amortised cost. That conclusion is not responsive to the present environment. The approach also allows actively traded debt instruments, including treasury securities, be at amortised cost. These results are unacceptable to him and reduce the usefulness of reported information for investors.

AV11 The Board is required by its framework to be neutral in its decision making and to strive to produce neutral information to maximise the usefulness of financial information. The exposure draft fails in that regard as it produces information based on free choice, management intention, and management behaviour. Reporting that will result from this approach will not produce neutral information and diminishes the usefulness of financial reporting.

AV12 The Board is insistent in paragraph BC32 that accounting based on a business model is not free choice but never explains why selection of a business model is not a management choice. The existence of a trading account, a fair value option and the management of interest rate risk on a contractual yield basis are all free choices in the exposure draft.

AV13 The classification of selected equity instruments at fair value with the result of the remeasurement reported outside of profit or loss is also a free choice allowed in the exposure draft. The Board concludes that reporting fair value changes in profit and loss may not reflect the operating performance of an entity when an entity views their investments in equity securities as 'strategic'. Mr Leisenring questions why an investment that results in significant influence and requires IAS 28 accounting cannot also be 'strategic'. He also wonders how many sales of strategic investments can occur before the entity is seen to be trading.

AV14 Mr Leisenring could accept accounting for changes in fair value of some instruments outside profit or loss in other comprehensive income. That accounting, however, should not be a free choice and why that presentation is superior in defined circumstances should be developed. In addition, conditions for accepting such a presentation should be to require a single statement of comprehensive income and require comprehensive income per share.

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AV15 The document is also inherently contradictory because it is based on choices by management but those classifications may not be changed. The business model of the entity may well change. When that occurs instruments will not be accounted for consistently with the objectives of the proposal. If accounting is to be based on intentions or on actual behaviour, reclassifications seem to be a natural consequence to avoid internal inconsistency within the model. It is also curious that the Board has prohibited reclassifications when even the irrevocable election of accounting for an instrument at fair value through profit and loss may result in reclassification at transition based on changed circumstances.

AV16 The credit crisis has provided confirmation that a dramatic change in accounting for financial instruments is desirable. However, many have said that while they agree that the approach suggested by Mr Leisenring would be superior, and a significant improvement, the world is not ready to embrace such change. It is unclear to Mr Leisenring what factors need to be present for the optimal solution to be acceptable. He has concluded that it is hard to envisage circumstances that would make the case any more compelling for fundamental change and improvement than the present circumstances. Therefore, this exposure draft approach will inevitably preserve a mixed-attribute model and the resulting complexity for a significant period of time.

AV17 Mr Leisenring would accept that if, for reasons other than the desire to provide useful information to investors, his approach is politically unattainable, an alternative could be developed that would be operational. That approach would require that all financial assets and financial liabilities be recorded at fair value through profit or loss except originated loans retained by the originator, trade receivables and accounts payable. This approach reduces the improvements that could be made, but it is far more operational than the approach in the exposure draft and minimises the items at amortised cost. While suboptimal, this approach would much better meet the needs of investors and improve the usefulness of reported financial information than what has been proposed.

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