AASB Exposure Draft

ED 230
December 2012

Classification and Measurement: Limited Amendments to AASB 9

(proposed amendments to AASB 9 (2010))

Comments to the AASB by 13 February 2013

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 13 February 2013. 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 28 March 2013. Comments should be addressed to:

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA
E-mail: standard@aasb.gov.au

Respondents to the IASB are asked to send their comments electronically to the IFRS Foundation website (www.ifrs.org), using the 'Comment on a proposal' page.

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chairman of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

Obtaining a Copy of this AASB Exposure Draft

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:

The Customer Service Officer
Australian Accounting Standards Board
Level 7
600 Bourke Street
Melbourne Victoria
AUSTRALIA

Phone: (03) 9617 7637
Fax: (03) 9617 7608
E-mail: publications@aasb.gov.au
Postal address:
PO Box 204
Collins Street West Victoria 8007

Other Enquiries

Phone: (03) 9617 7600
Fax: (03) 9617 7608
E-mail: standard@aasb.gov.au

ISSN 1030-5882

AASB REQUEST FOR COMMENTS

This Exposure Draft proposes limited amendments to AASB 9 *Financial Instruments* (2010) to clarify the existing classification and measurement requirements and to introduce a fair value through other comprehensive income (OCI) measurement category for particular financial assets that contain contractual cash flows that are solely payments of principal and interest. This Exposure Draft also proposes that once all chapters of AASB 9 are completed and the completed version of AASB 9 is issued (the date of which is yet to be determined), only that version of AASB 9 would be available for early application, with one exception. That is, the Exposure Draft proposes to permit early application of the requirements issued in December 2010 for the presentation in OCI of gains or losses attributable to changes in a liability's credit risk for financial liabilities designated under the fair value option.

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.

Submissions play an important role in the decisions that the AASB will make in regard to a Standard. 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 13 February 2013. 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.

Reduced Disclosure Requirements

AASB 1053 *Application of Tiers of Australian Accounting Standards* establishes a differential reporting framework consisting of two tiers of reporting requirements for preparing general purpose financial statements:

(a) Tier 1: Australian Accounting Standards; and

(b) Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

A separate consultative document will be issued for comment shortly after the issue of this Exposure Draft outlining the AASB's Tier 2 disclosure proposals in respect of this Exposure Draft.

AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

1. whether, overall, the proposals would result in financial statements that would be useful to users;

2. whether 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:

   (a) not-for-profit entities; and

   (b) public sector entities, including GAAP/GFS implications;

3. whether the proposals are in the best interests of the Australian economy; and

4. unless already provided in response to specific matters for comment 1 – 3 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative.

November 2012

Exposure Draft ED/2012/4

Classification and Measurement: Limited Amendments to IFRS 9

Proposed amendments to IFRS 9 (2010)

Comments to be received by 28 March 2013

Classification and Measurement: Limited Amendments to IFRS 9

(Proposed amendments to IFRS 9 (2010))

Comments to be received by 28 March 2013

Exposure Draft ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010)) 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 in final form as amendments to IFRSs. Comments on the Exposure Draft and the Basis for Conclusions should be submitted in writing so as to be received by **28 March 2013**. Respondents are asked to send their comments electronically to the IASB website (www.ifrs.org), using the 'Comment on a proposal' 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.

ISBN: 978-1-907877-73-5

IFRS Foundation Publications Department,
1st Floor, 30 Cannon Street, London EC4M 6XH, United Kingdom.
Tel: +44 (0)20 7332 2730 Fax: +44 (0)20 7332 2749
Email: publications@ifrs.org Web: www.ifrs.org

CONTENTS

Introduction

IN1 The International Accounting Standards Board (IASB) has published this Exposure Draft of proposed amendments to IFRS 9 *Financial Instruments* (issued October 2010)—referred to as IFRS 9 (2010)—to:

(a) address specific application questions raised by interested parties;

(b) take into account the interaction of the classification and measurement model for financial assets with the IASB's Insurance Contracts project; and

(c) reduce key differences with the US Financial Accounting Standards Board's (FASB) tentative classification and measurement model for financial instruments.

IN2 Accordingly, this Exposure Draft proposes limited amendments to IFRS 9 (2010) to clarify the existing classification and measurement requirements and to introduce a fair value through other comprehensive income (OCI) measurement category for particular financial assets that contain contractual cash flows that are solely payments of principal and interest. This Exposure Draft also proposes that once all chapters of IFRS 9 are completed and the completed version of IFRS 9 is issued, only that version of IFRS 9 would be available for early application, with one exception. That is, the Exposure Draft proposes to permit early application of the requirements issued in October 2010 for the presentation in other comprehensive income of gains or losses attributable to changes in a liability's credit risk for financial liabilities designated under the fair value option.

IN3 The IASB noted that many interested parties have either already applied IFRS 9 early or dedicated significant resources in preparation for its initial application. The IASB is mindful of the extent of change to IFRS 9 and is seeking to minimise the cost and disruption to interested parties. Accordingly, the IASB proposes limited amendments to IFRS 9. The IASB also proposes that the prohibition to newly apply previous versions of IFRS 9 only becomes effective six months after the completed version of IFRS 9 is issued.

Next steps

IN4 The IASB will consider the comments it receives on the proposals and will decide whether to proceed with amendments to IFRS 9 (2010).

Invitation to comment

The IASB invites comments on the proposals in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

(a) comment on the questions as stated;

(b) indicate the specific paragraph or group of paragraphs to which they relate;

(c) contain a clear rationale; and

(d) include any alternative the IASB should consider, if applicable.

In this Exposure Draft, the IASB is not requesting comments on matters in IFRS 9 (2010) that are not addressed in the Exposure Draft.

Comments should be submitted in writing so as to be received no later than **28 March 2013**.

Contractual cash flow characteristics assessment: a modified economic relationship between principal and consideration for the time value of money and the credit risk

The IASB has received questions about the application of the contractual cash flow characteristics assessment to some financial assets. In particular, questions have been raised about financial assets that contain interest rate mismatch features (ie the interest rate is reset but the frequency of the reset does not match the tenor of the interest rate).

Accordingly, this Exposure Draft proposes an amendment to the application guidance in IFRS 9 to clarify that if contractual cash flows on a financial asset include only payments related to principal and consideration for the time value of money and the credit risk, but the economic relationship between those components is modified due to an interest rate mismatch feature or leverage ('a modified economic relationship'), an entity shall assess that modification to determine whether the contractual cash flows represent solely payments of principal and interest. In assessing a modified economic relationship, an entity considers the cash flows of a financial asset that is identical in all respects (including reset dates) other than not containing the modification in the economic relationship ('benchmark cash flows'). If the modification could result in contractual cash flows that are more than insignificantly different from the benchmark cash flows, the contractual cash flows are not solely payments of principal and interest.

Question 1

Do you agree that a financial asset with a modified economic relationship between principal and consideration for the time value of money and the credit risk could be considered, for the purposes of IFRS 9, to contain cash flows that are solely payments of principal and interest? Do you agree that this should be the case if, and only if, the contractual cash flows could not be more than insignificantly different from the benchmark cash flows? If not, why and what would you propose instead?

Question 2

Do you believe that this Exposure Draft proposes sufficient, operational application guidance on assessing a modified economic relationship? If not, why? What additional guidance would you propose and why?

Question 3

Do you believe that this proposed amendment to IFRS 9 will achieve the IASB's objective of clarifying the application of the contractual cash flow characteristics assessment to financial assets that contain interest rate mismatch features? Will it result in more appropriate identification of financial assets with contractual cash flows that should be considered solely payments of principal and interest? If not, why and what would you propose instead?

Business model assessment: the 'fair value through other comprehensive income' measurement category for financial assets that contain contractual cash flows that are solely payments of principal and interest

The Exposure Draft proposes that some financial assets should be mandatorily measured at fair value through OCI,[1] specifically, financial assets held within a business model in which assets are managed both in order to collect contractual cash flows and for sale (subject to the contractual cash flow characteristics assessment; ie these are debt instruments). Under the proposals, interest revenue, credit impairment and any gain or loss on derecognition would be recognised in profit or loss; all other gains or losses (ie the difference between these items and the total change in fair value) would be recognised in OCI.

Interest income and credit impairment would be computed and recognised in the same manner as for financial assets measured at amortised cost.[2] Cumulative gain or loss recognised in OCI would be reclassified to profit or loss when the financial asset is derecognised. That would result in amortised cost information being provided in profit or loss and fair value information being provided in the statement of financial position.

The Exposure Draft proposes application guidance on how to determine whether the business model is to manage assets both to collect contractual cash flows and to sell.

In addition, the Exposure Draft proposes clarifications to the application guidance in IFRS 9 on what is a 'hold to collect' business model.

Question 4

Do you agree that financial assets that are held within a business model in which assets are managed both in order to collect contractual cash flows and for sale should be required to be measured at fair value through OCI (subject to the contractual cash flow characteristics assessment) such that:

(a) interest revenue, credit impairment and any gain or loss on derecognition are recognised in profit or loss in the same manner as for financial assets measured at amortised cost; and

(b) all other gains and losses are recognised in OCI?

If not, why? What do you propose instead and why?

---

1 This is different from the irrevocable option in IFRS 9 to present fair value gains and losses on an equity instrument that is not held for trading in OCI.

2 For the purpose of recognising foreign exchange gains and losses under IAS 21 *The Effect of Changes in Foreign Exchange Rates*, a financial asset classified at the proposed 'fair value through OCI' category is treated as if it were measured at amortised cost in the foreign currency. Accordingly, exchange differences resulting from changes in amortised cost are recognised in profit or loss.

Question 5

Do you believe that the Exposure Draft proposes sufficient, operational application guidance on how to distinguish between the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the guidance provided to describe those business models? If not, why? What additional guidance would you propose and why?

The Exposure Draft proposes that the existing fair value option in IFRS 9 should be available for financial assets that would otherwise be mandatorily measured at fair value through OCI. That is, the Exposure Draft proposes that an entity would be permitted to designate such a financial asset as measured at fair value through profit or loss if, and only if, such a designation eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch'). In accordance with the existing fair value option in IFRS 9 such designation would be performed at initial recognition and would be irrevocable.

Question 6

Do you agree that the existing fair value option in IFRS 9 should be extended to financial assets that would otherwise be mandatorily measured at fair value through OCI? If not, why and what would you propose instead?

Early application

At present, more than one version of IFRS 9 can be applied early: that is, an entity is permitted to apply either the classification and measurement requirements for financial assets only (ie IFRS 9 issued in 2009) or to apply the classification and measurement requirements for both financial liabilities and financial assets (ie IFRS 9 issued in 2010). The Exposure Draft proposes that only the completed version of IFRS 9 (ie including Classification and Measurement, Impairment and General Hedge Accounting chapters) can be newly applied prior to the mandatory effective date (except as described in question 8 below).[3] This proposed amendment would become effective six months after the completed version of IFRS 9 is issued.

Question 7

Do you agree that an entity that chooses to early apply IFRS 9 after the completed version of IFRS 9 is issued should be required to apply the completed version of IFRS 9 (ie including all chapters)? If not, why? Do you believe that the proposed six-month period between the issuance of the completed version of IFRS 9 and when the prohibition on newly applying previous versions of IFRS 9 becomes effective is sufficient? If not, what would be an appropriate period and why?

Presentation of 'own credit' gains or losses on financial liabilities

Notwithstanding the proposed transition requirement above, once IFRS 9 is completed, an entity will be permitted to early apply only the 'own credit' provisions in IFRS 9, which require an entity to present in other comprehensive income fair value gains or losses

3 Entities that have already applied an earlier version of IFRS 9 by the time these proposed transition provisions become effective will be permitted to continue to apply that version until the mandatory effective date of IFRS 9 or until the entity chooses to early apply the completed version of IFRS 9.

attributable to changes in the credit risk of financial liabilities designated as measured at fair value through profit or loss, without otherwise changing the classification and measurement of financial instruments.

Question 8

Do you agree that entities should be permitted to choose to early apply only the 'own credit' provisions in IFRS 9 once the completed version of IFRS 9 is issued? If not, why and what do you propose instead?

First-time adoption

This Exposure Draft does not propose any specific changes to IFRS 1 *First-time Adoption of International Financial Reporting Standards* for first-time adopters of IFRS. However, to make sure that first-time adopters are given sufficient lead time to apply IFRS 9 and are not at a disadvantage in comparison to existing preparers, the IASB intends to consider the transition to IFRS 9 for first-time adopters when these proposals are redeliberated.

Question 9

Do you believe there are considerations unique to first-time adopters that the IASB should consider for the transition to IFRS 9? If so, what are those considerations?

[Draft] Amendments to International Financial Reporting Standard 9 *Financial Instruments* (2010)

[Please note: footnotes are included as context to the proposals and will not be included in the final text.]

Paragraphs 4.1.1 and 4.1.3–4.1.4 are amended. Paragraph 4.1.2A is added. New text is underlined and deleted text is struck through. Paragraph 4.1.2 is shown for reference only and is not proposed for amendment.

4.1 Classification of financial assets

4.1.1 **Unless paragraph 4.1.5 applies, an entity shall classify financial assets as subsequently measured at ~~either~~ amortised cost, fair value through other comprehensive income or fair value through profit or loss on the basis of both:**

(a) the entity's business model for managing the financial assets and

(b) the contractual cash flow characteristics of the financial asset.

4.1.2 **A financial asset shall be measured at amortised cost if both of the following conditions are met:**

(a) The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows.

(b) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs B4.1.1–B4.1.26 provide guidance on how to apply these conditions.

4.1.2A **A financial asset shall be measured at fair value through other comprehensive income if both of the following conditions are met:**

(a) The asset is held in a business model in which assets are managed both in order to collect contractual cash flows and for sale.

(b) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs B4.1.1–B4.1.26 provide guidance on how to apply these conditions.

4.1.3 **For the purpose of applying paragraphs 4.1.2(b) and 4.1.2A(b), interest is consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time.**

4.1.4 A financial asset shall be measured at fair value <u>through profit or loss</u> unless it is measured at amortised cost in accordance with paragraph 4.1.2 <u>or at fair value through other comprehensive income in accordance with paragraph 4.1.2A</u>. <u>However an entity may make an irrevocable election for particular financial assets in this measurement category to present in other comprehensive income subsequent changes in fair value (refer to paragraph 5.7.5).</u>

Paragraphs 5.2.1–5.2.2 are amended. New text is underlined and deleted text is struck through.

5.2 Subsequent measurement of financial assets

5.2.1 After initial recognition, an entity shall measure a financial asset in accordance with paragraphs 4.1.1–4.1.5 at ~~fair value or:~~

<u>(a)</u> amortised cost (see paragraphs 9 and AG5–AG8 of IAS 39[4]);

<u>(b)</u> <u>fair value through other comprehensive income (refer to paragraph 5.7.1A); or</u>

<u>(c)</u> <u>fair value through profit or loss</u>.

5.2.2 An entity shall apply the impairment requirements in paragraphs <u>X-X</u>[5] ~~58–65 and AG84–AG93 of IAS 39~~ to financial assets measured at amortised cost <u>in accordance with paragraph 4.1.2 and financial assets measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A</u>.

Paragraphs 5.6.2–5.6.3 are amended. New text is underlined and deleted text is struck through. Paragraph 5.6.1 is included for reference only and is not proposed for amendment.

5.6 Reclassification of financial assets

5.6.1 If an entity reclassifies financial assets in accordance with paragraph 4.4.1, it shall apply the reclassification prospectively from the *reclassification date*. The entity shall not restate any previously recognised gains, losses or interest.

5.6.2 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset <u>out of the amortised cost measurement category and</u> ~~so that it is~~

4 References to the requirements in IAS 39 will be replaced by references to the relevant paragraphs in this Standard when this Standard is completed.

5 The references in this paragraph will be inserted when the IASB finalises the expected loss impairment model and incorporates those requirements in this Standard. The IASB has tentatively decided that the same impairment model will be applied to both financial assets in the amortised cost measurement category and the fair value through other comprehensive income measurement category.

~~measured at~~ into the fair value through profit or loss measurement category, its fair value is determined at the reclassification date. Any gain or loss arising from a difference between the previous carrying amount and fair value is recognised in profit or loss.

5.6.3 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset out of the fair value through profit or loss measurement category and ~~so that it is measured at~~ into the amortised cost measurement category, its fair value at the reclassification date becomes its new carrying amount.

Paragraphs 5.6.4–5.6.7 are added.

5.6.4 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset out of the amortised cost measurement category and into the fair value through other comprehensive income measurement category, its fair value is determined at the reclassification date. Any gain or loss arising from a difference between the previous carrying amount and fair value is recognised in other comprehensive income. The effective interest rate is not adjusted as a result of the reclassification.

5.6.5 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset out of the fair value through other comprehensive income measurement category and into the amortised cost measurement category, the financial asset is reclassified at its fair value at the reclassification date. However, the cumulative gain or loss previously recognised in other comprehensive income is removed from equity and adjusted against the fair value of the financial asset at the reclassification date. This adjustment affects other comprehensive income but does not affect profit or loss and is therefore not a reclassification adjustment (see IAS 1 *Presentation of Financial Statements*). The effective interest rate is not adjusted as a result of the reclassification.

5.6.6 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset out of the fair value through profit or loss measurement category and into the fair value through other comprehensive income measurement category, its fair value at the reclassification date becomes its new carrying amount.

5.6.7 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset out of the fair value through other comprehensive income measurement category and into the fair value through profit or loss measurement category, its fair value at the reclassification date becomes its new carrying amount. The cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment (see IAS 1) at the reclassification date.

Paragraphs 5.7.1 and 5.7.4 are amended. Paragraph 5.7.1A is added. New text is underlined and deleted text is struck through.

5.7 Gains and losses

5.7.1 **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)[6] shall be recognised in profit or loss unless:**

(a) **~~it is part of a hedging relationship (see paragraphs 89–102 of IAS 39);~~ [deleted]**

(b) **it is an investment in an *equity instrument* and the entity has elected to present gains and losses on that investment in other comprehensive income in accordance with paragraph 5.7.5; ~~or~~**

(c) **it is a financial liability designated as at fair value through profit or loss and the entity is required to present the effects of changes in the liability's *credit risk* in other comprehensive income in accordance with paragraph 5.7.7; or~~.~~**

(d) **it is a financial asset classified at fair value through other comprehensive income in accordance with paragraph 4.1.2A and the entity is required to recognise particular changes in fair value in other comprehensive income in accordance with paragraph 5.7.1A.**

5.7.1A **A gain or loss on a financial asset measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A shall be recognised in other comprehensive income, except for impairment losses (see paragraph 5.2.2) and foreign exchange gains and losses (see paragraphs B5.7.2–B5.7.3), until the financial asset is derecognised or reclassified out of the fair value through other comprehensive income measurement category (see paragraph 4.4.1). When the financial asset is derecognised the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment (see IAS 1). If the financial asset is reclassified out of the fair value through other comprehensive income measurement category the entity shall account for the cumulative gain or loss previously recognised in other comprehensive income in accordance with paragraphs 5.6.5 and 5.6.7. Interest calculated using the effective interest method (see paragraphs 9 and AG5–AG8 of IAS 39[7]) is recognised in profit or loss (see IAS 18).**

...

6 The references will ultimately be updated be updated to reflect [draft] Chapter 6 Hedge Accounting.

7 References to the requirements in IAS 39 will be replaced by references to the relevant paragraphs in this Standard when this Standard is completed.

5.7.4 If an entity recognises financial assets using settlement date accounting (see paragraph 3.1.2 and paragraphs B3.1.3 and B3.1.6), any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not recognised for assets measured at amortised cost (other than impairment losses). For assets measured at fair value, however, the change in fair value shall be recognised in profit or loss or in other comprehensive income, as appropriate under paragraphs 5.7.1–5.7.1A.

Paragraph 7.1.1 is amended and paragraphs 7.1.1A–7.1.1B are added. New text is underlined and deleted text is struck through.

7.1 Effective date

7.1.1 An entity shall apply this IFRS for annual periods beginning on or after 1 January 2015. Earlier application is permitted. ~~However, if an entity elects to apply this IFRS early and has not already applied IFRS 9 issued in 2009, it must apply all of the requirements in this IFRS at the same time (but see also paragraph 7.3.2).~~ If an entity applies this IFRS in its financial statements for a period beginning before 1 January 2015, it shall disclose that fact and must apply all of the requirements in this IFRS.[8] A~~a~~t the same time it shall apply the amendments in Appendix C (but see also paragraphs 7.1.1A–7.1.1B).

7.1.1A *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010)) issued on [date to be inserted after exposure]:

(a) amended paragraphs 4.1.1 and 4.1.3–4.1.4, 5.2.1–5.2.2, 5.6.2–5.6.3, 5.7.1 and 5.7.4, 7.1.1, 7.2.1–7.2.2, 7.2.4, 7.2.5–7.2.6, 7.2.14, 7.2.16, 7.3.2, B3.1.6, B4.1.1, B4.1.3–B4.1.4, B4.1.5–B4.1.7, B4.1.9, B4.1.12–B4.1.13, B4.1.26, B4.1.29–B4.1.30, B4.1.36, B4.3.1, the heading before paragraph B4.4.1, B5.1.1, B5.2.1–B5.2.2, B5.7.3 and B7.2.1;

(b) added paragraphs 4.1.2A, 5.6.4–5.6.7, 5.7.1A, 7.1.1A–7.1.1B, 7.2.4A, 7.2.17, B4.1.2A–B4.1.2B, B4.1.4A–B4.1.4B, B4.1.8A, B4.1.9A–B4.1.9E, B4.1.21A, B5.6.1–B5.6.2, B5.7.1A and B5.7.2A; and

(c) deleted paragraph 7.2.3

of IFRS 9 (2010) effective [date to be inserted after exposure].[9] If an entity applied IFRS 9 (issued in 2009), IFRS 9 (issued in 2010) or IFRS 9 incorporating [draft] Chapter 6 Hedge Accounting before [date to be inserted after exposure],[10] the entity is not required to apply these amendments until the first annual period beginning on or after 1 January 2015.

7.1.1B Notwithstanding the requirements in paragraph 7.1.1, an entity may elect to early apply the requirements for the presentation in other comprehensive

8 This includes the requirements for impairment and general hedge accounting, which will be added to this Standard when they are finalised.

9 The date that is six months after the completed version of IFRS 9 is issued.

10 The date that is six months after the completed version of IFRS 9 is issued.

income of gains or losses attributable to changes in a liability's credit risk for financial liabilities designated under the fair value option (paragraphs 5.7.1(c), 5.7.7–5.7.9, 7.2.13 and B5.7.5–B5.7.20) without early applying the other requirements of this IFRS. If an entity has elected to early apply these paragraphs, it shall disclose that fact and apply paragraphs 10 and 10A of IFRS 7 at the same time.

Paragraphs 7.2.1–7.2.2, 7.2.4, 7.2.5–7.2.6, 7.2.14 and 7.2.16 are amended. Paragraphs 7.2.4A and 7.2.17 are added. Paragraph 7.2.3 is deleted. New text is underlined and deleted text is struck through.

7.2 Transition

7.2.1 An entity shall apply this IFRS retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs 7.2.4–~~7.2.15~~7.2.17. This IFRS shall not be applied to items that have already been derecognised at the date of initial application.

7.2.2 For the purposes of the transition provisions in paragraphs 7.2.1 and ~~7.2.3–7.2.16~~ 7.2.4–7.2.17, the date of initial application is the date when an entity first applies the requirements of this IFRS. The date of initial application shall ~~may~~ be~~:~~

~~(a) any date between the issue of this IFRS and 31 December 2010, for entities initially applying this IFRS before 1 January 2011; or~~

~~(b)~~ the beginning of the first reporting period in which the entity adopts this IFRS~~, for entities initially applying this IFRS on or after 1 January 2011~~.

7.2.3 ~~If the date of initial application is not at the beginning of a reporting period, the entity shall disclose that fact and the reasons for using that date of initial application.~~ [Deleted]

7.2.4 At the date of initial application, an entity shall assess whether a financial asset meets the conditions in paragraph 4.1.2(a) or in paragraph 4.1.2A(a) on the basis of the facts and circumstances that exist at the date of initial application. The resulting classification shall be applied retrospectively irrespective of the entity's business model in prior reporting periods.

7.2.4A If it is impracticable (as defined in IAS 8) for an entity to retrospectively assess a modified economic relationship between the principal and the consideration for the time value of money and the credit risk as required by paragraphs B4.1.9A–B4.1.9E of this IFRS, an entity shall retrospectively assess the contractual cash flow characteristics of the relevant financial assets notwithstanding the requirements listed in paragraphs B4.1.9A–B4.1.9E.

7.2.5 If an entity measures a hybrid contract at fair value in accordance with paragraph 4.1.2A, paragraph 4.1.4 or paragraph 4.1.5 but the fair value of the hybrid contract had not been measured in comparative reporting periods, the fair value of the hybrid contract in the comparative reporting periods shall be

the sum of the fair values of the components (ie the non-derivative host and the embedded derivative) at the end of each comparative reporting period if the entity restates prior periods (see paragraph 7.2.14).

7.2.6 At the date of initial application an entity shall recognise any difference between the fair value of the entire hybrid contract at the date of initial application and the sum of the fair values of the components of the hybrid contract at the date of initial application:

(a) in the opening retained earnings (or other component of equity, as appropriate) of the reporting period of initial application. if the entity initially applies this IFRS at the beginning of a reporting period, or

(b) in profit or loss if the entity initially applies this IFRS during a reporting period.

...

7.2.14 Despite the requirement in paragraph 7.2.1, an entity that adopts the classification and measurement requirements of this IFRS for reporting periods:

(a) beginning before 1 January 2012 need not restate prior periods and is not required to provide the disclosures set out in paragraphs 44S–44W of IFRS 7;

(b) beginning on or after 1 January 2012 and before 1 January 2013 shall elect either to provide the disclosures set out in paragraphs 44S–44W of IFRS 7 or to restate prior periods; and

(c) beginning on or after 1 January 2013 shall provide the disclosures set out in paragraphs 44S–44W of IFRS 7 but. The entity need not restate prior periods. The entity may restate prior periods if, and only if, this is possible without the use of hindsight.

If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application. However, if an entity restates prior periods, the restated financial statements must reflect all of the requirements in this IFRS.

...

Entities that have applied ~~early~~ IFRS 9 issued in 2009, IFRS 9 issued in 2010 or [draft] IFRS 9 incorporating Chapter 6 Hedge Accounting issued in [year] before [date to be inserted after exposure][11]

7.2.16 An entity shall apply the transition requirements in paragraphs 7.2.1–7.2.15 at the relevant date of initial application. In other words, an entity shall apply paragraphs 7.2.4–7.2.11 if it applies IFRS 9 (issued in 2009) or, not having done so, when it applies IFRS 9 (issued in 2010) in its entirety or, not having done so,

11 The date that is six months after the completed version of IFRS 9 is issued.

when it applies [draft] IFRS 9 incorporating Chapter 6 Hedge Accounting. An entity is not permitted to apply those paragraphs more than once except as specified in paragraph 7.2.17.

7.2.17 An entity that applied IFRS 9 (issued in 2009), IFRS 9 (issued in 2010) or [draft] IFRS 9 incorporating Chapter 6 Hedge Accounting before [date to be inserted after exposure][12] and subsequently applies the amendments to IFRS 9 (2010) listed in paragraph 7.1.1A:

(a) shall revoke its previous designation of a financial asset as measured at fair value through profit or loss if such a designation was previously made in accordance with the condition in paragraph 4.1.5 but that condition is no longer satisfied as a result of the application of those amendments;

(b) may designate a financial asset as measured at fair value through profit or loss if such a designation would not have previously satisfied the condition in paragraph 4.1.5 but that condition is now satisfied as a result of the application of those amendments;

(c) shall revoke its previous designation of a financial liability as measured at fair value through profit or loss if such a designation was previously made in accordance with the condition in paragraph 4.2.2(a) but that condition is no longer satisfied as a result of the application of those amendments; and

(d) may designate a financial liability as measured at fair value through profit or loss if such a designation would not have previously satisfied the condition in paragraph 4.2.2(a) but that condition is now satisfied as a result of the application of those amendments.

Such a designation and revocation shall be made on initial application of the amendments to IFRS 9 (2010) listed in paragraph 7.1.1A. That classification shall be applied retrospectively.

Paragraph 7.3.2 is amended. Deleted text is struck through.

7.3 Withdrawal of IFRIC 9 and IFRS 9 (2009)

...

7.3.2 This IFRS supersedes IFRS 9 issued in 2009. ~~However, for annual periods beginning before 1 January 2015, an entity may elect to apply IFRS 9 issued in 2009 instead of applying this IFRS.~~

12 The date that is six months after the completed version of IFRS 9 is issued.

Appendix B
Application guidance

This appendix is an integral part of the IFRS.

Paragraph B3.1.6 is amended. New text is underlined.

Recognition and derecognition (chapter 3)

Regular way purchase or sale of financial assets

...

B3.1.6 The settlement date is the date that an asset is delivered to or by an entity. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by the entity, and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the entity. When settlement date accounting is applied, an entity accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset. In other words, the change in value is not recognised for assets measured at amortised cost; it is recognised in profit or loss for assets classified as financial assets measured at fair value through profit or loss; and it is recognised in other comprehensive income for assets classified as financial assets measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A and investments in equity instruments accounted for in accordance with paragraph 5.7.5.

Paragraphs B4.1.1 and B4.1.3–B4.1.4 are amended. Paragraphs B4.1.2A–B4.1.2B are added. Paragraph B4.1.2 is included for reference only and is not proposed for change. New text is underlined and deleted text is struck through.

Classification (chapter 4)

Classification of financial assets (section 4.1)

The entity's business model for managing financial assets

B4.1.1 Paragraph 4.1.1(a) requires an entity (unless paragraph 4.1.5 applies) to classify financial assets ~~as subsequently measured at amortised cost or fair value~~ on the basis of the entity's business model for managing the financial assets. An entity assesses whether its financial assets meet ~~this~~ the condition in paragraph 4.1.2(a) or in paragraph 4.1.2A(a) on the basis of the objective of the business model as determined by the entity's key management personnel (as defined in IAS 24).

B4.1.2 The entity's business model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by-instrument approach to classification and should be determined

on a higher level of aggregation. However, a single entity may have more than one business model for managing its financial instruments. Therefore, classification need not be determined at the reporting entity level. For example, an entity may hold a portfolio of investments that it manages in order to collect contractual cash flows and another portfolio of investments that it manages in order to trade to realise fair value changes.

B4.1.2A The entity's business model for managing the financial assets is a matter of fact that can be observed by the way the business is managed and its performance is evaluated by the entity's key management personnel. The entity's business model for managing the financial assets determines the entity's likely future cash flows from the financial assets.

B4.1.2B The determination of the business model for managing the financial assets is not driven by a single factor. Rather, all objective evidence that is relevant to assessing the entity's business model must be considered. Such evidence includes, but is not limited to:

(a) how the performance of the business is reported to the entity's key management personnel;

(b) how managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed); and

(c) the frequency, timing and volume of sales in prior periods, why such sales have occurred and expectations about the sales activity in the future.

B4.1.3 In determining whether cash flows are expected to be collected from contractual cash flows, the level of sales activity, as well as the reason for any sales, must be considered. Although the objective of an entity's business model may be to hold financial assets in order to collect contractual cash flows, the entity need not hold all of those instruments until maturity. ~~Thus an entity's business model can be to hold financial assets to collect contractual cash flows even when sales of financial assets occur.~~ For example, the entity may sell a financial asset if~~:~~

~~(a)~~ ~~the financial asset~~ the credit quality of the financial asset has deteriorated such that it no longer meets the entity's documented investment policy~~.~~ ~~(eg the credit rating of the asset declines below that required by the entity's investment policy);~~

~~(b) an insurer adjusts its investment portfolio to reflect a change in expected duration (ie the expected timing of payouts); or~~

~~(c) an entity needs to fund capital expenditures.~~ Such sales are not inconsistent with the objective to hold financial assets to collect contractual cash flows because the credit quality of financial assets is relevant to the entity's ability to collect contractual cash flows. No longer meeting the entity's documented investment policy is not the only evidence that the credit quality of the financial asset has deteriorated such that a sale is necessary. However, in the absence of such a policy, it may be difficult for an entity to demonstrate that the sale is necessary as a result of the deterioration in the asset's credit quality.

Sales that occur for other reasons may also be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows if such sales are infrequent (even if significant) or insignificant both individually and in aggregate (even if frequent). ~~However, if more than an infrequent number of sales are made out of a portfolio, the entity needs to assess whether and how such sales are consistent with an objective of collecting contractual cash flows.~~ Sales of financial assets may be consistent with the objective of collecting contractual cash flows if the sales are made close to the maturity of the financial assets and the proceeds from the sales approximate the collection of the remaining contractual cash flows.

B4.1.4 The following are examples of when the objective of an entity's business model may be to hold financial assets to collect the contractual cash flows. This list of examples is not exhaustive. The examples are not intended to discuss all factors that may be relevant to the assessment of the entity's business model nor specify the relative importance of the factors.

Example	Analysis
Example 1 A~~n~~ non-financial entity holds investments to collect their contractual cash flows ~~but would sell an investment in particular circumstances~~. The funding needs of the entity are predictable and the maturity of its financial assets is matched to its estimated funding needs. In the past, sales have typically occurred when the credit quality of the financial assets has deteriorated such that the assets no longer meet the entity's documented investment policy. In addition, infrequent sales have occurred as a result of unanticipated funding needs. Reports to key management personnel focus on the credit quality of the financial assets. The entity also monitors fair values of the financial assets, among other information.	Although an entity may consider, among other information, the financial assets' fair values from a liquidity perspective (ie the cash amount that would be realised if the entity needs to sell assets), the entity's objective is to hold the financial assets and collect the contractual cash flows. ~~Some sales~~ Sales in response to deterioration in the assets' credit quality such that they no longer meet the entity's documented investment policy or infrequent sales resulting from unanticipated funding needs, even if such sales are significant, would not contradict that objective.

continued...

...continued

Example	Analysis
Example 2 An entity's business model is to purchase portfolios of financial assets, such as loans. Those portfolios may or may not include financial assets with incurred credit losses. If payment on the loans is not made on a timely basis, the entity attempts to extract the contractual cash flows through various means—for example, by making contact with the debtor by mail, telephone or other methods. In some cases, the entity enters into interest rate swaps to change the interest rate on particular financial assets in a portfolio from a floating interest rate to a fixed interest rate.	The objective of the entity's business model is to hold the financial assets and collect the contractual cash flows. ~~The entity does not purchase the portfolio to make a profit by selling them.~~ The same analysis would apply even if the entity does not expect to receive all of the contractual cash flows (eg some of the financial assets have incurred credit losses). Moreover, the fact that the entity has entered into derivatives to modify the cash flows of the portfolio does not in itself change the entity's business model. Consequently, ~~If the portfolio is not managed on a fair value basis~~, the objective of the business model could be to hold the assets to collect the contractual cash flows.
...	...
Example 4 A financial institution holds financial assets to meet liquidity needs in a 'stress case' scenario (for example, a run on the bank's deposits). The entity does not anticipate selling these assets except in such scenarios. The entity monitors the credit quality of the financial assets and its objective in managing the financial assets is to collect contractual cash flows.	The objective of the entity's business model is to hold the financial assets to collect contractual cash flows. The analysis would not change even if during a previous stress case scenario the entity had significant sales of these financial assets in order to meet its liquidity needs. Similarly, recurring insignificant sales activity (for example, to maintain the desired maturity profile of these financial assets) is not inconsistent with holding financial assets to collect contractual cash flows.

continued...

...continued

Example	Analysis
However, the entity also monitors the fair value of the financial assets from a liquidity perspective to ensure that the cash amount that would be realised if the entity needed to sell the assets would be sufficient to meet the entity's liquidity needs in a stress case scenario.	In contrast, if an entity holds financial assets to meet its everyday liquidity needs and that involves recurring and significant sales activity, the objective of the entity's business model is not to hold the financial assets to collect contractual cash flows. Similarly, if the entity is required by its regulator to routinely sell significant volumes of financial assets to demonstrate that the assets are liquid, the entity's business model is not to hold financial assets to collect contractual cash flows. The fact that the requirement to sell the financial assets is imposed by a third party rather than being at the discretion of the entity is not relevant to the analysis.

Paragraphs B4.1.4A–B4.1.4B are added.

B4.1.4A The entity's business model for managing the financial assets may be to manage assets both to collect contractual cash flows and to sell. In other words, the entity's key management personnel has made a decision that both collecting contractual cash flows and selling are fundamental to achieving the objective of the business model within which the financial assets are held. Compared to the business model whose objective is to hold financial assets to collect contractual cash flows, this business model will typically involve greater frequency and volume of sales. This is because selling financial assets is integral to achieving the business model's objective rather than only incidental to it.

B4.1.4B The following are examples of when the entity's business model may be to manage assets both to collect contractual cash flows and to sell. This list of examples is not exhaustive. The examples are not intended to describe all factors that may be relevant to the assessment of the entity's business model nor specify the relative importance of the factors.

Example	Analysis
Example 1 A non-financial entity anticipates capital expenditure in a few years. The entity invests its excess cash in financial assets in order to fund the expenditure when the need arises. The entity's objective for managing the financial assets is to maximise the return on those financial assets. Accordingly, the entity will sell financial assets and re-invest the cash in financial assets with a higher yield when an opportunity arises. The managers responsible for the portfolio are remunerated based on the return generated by the financial assets.	The entity's business model is to manage assets both to collect contractual cash flows and to sell. The entity will make decisions on an ongoing basis about whether collecting contractual cash flows or selling financial assets will maximise the return on the financial assets until the need for the invested cash arises. In contrast, consider an entity that anticipates a cash outflow in five years to fund capital expenditure and invests excess cash in short-term financial assets with the objective of holding them to collect contractual cash flows. When the investments mature, the entity will reinvest the cash into new short-term financial assets. The entity follows this strategy until the funds are needed, at which time it uses the proceeds from the maturing financial assets to fund most of the capital expenditure. Only insignificant sales occur before maturity. Such a business model is consistent with the objective of holding financial assets to collect contractual cash flows.

continued...

...continued

Example	Analysis
Example 2 A financial institution holds financial assets to meet its everyday liquidity needs. The entity seeks to minimise the costs of managing its liquidity needs and therefore actively manages the contractual yield on the financial assets. The entity monitors the contractual yield and would hold some financial assets to collect contractual cash flows and sell other financial assets to reinvest in higher yielding financial assets or to better match the duration of liabilities. This strategy has resulted in significant recurring sales activity in the past, which is expected to continue.	The entity's business model is to manage assets both to collect contractual cash flows and to sell. Both holding and selling the financial assets are integral to the objective of maximising the yield on the financial assets while meeting the everyday liquidity needs.
Example 3 An insurer holds financial assets in order to fund insurance contracts liabilities. The insurer uses the proceeds from the contractual cash flows on the financial assets to settle insurance contracts liabilities as they come due. The insurer also undertakes significant buying and selling activity to rebalance the portfolio of financial assets on a regular basis as estimates of the expected cash flows needed to fulfil the insurance contracts liabilities change to ensure that the contractual cash flows from the financial assets are sufficient to settle those liabilities.	The insurer's objective is to fund insurance contracts liabilities. Both collecting contractual cash flows to fund liabilities as they come due and selling financial assets to maintain the desired profile of the asset portfolio are integral to achieving this objective. Accordingly, the insurer's business model is to manage financial assets both to collect contractual cash flows and to sell.

Paragraphs B4.1.5–B4.1.7 and B4.1.9 are amended. Paragraph B4.1.8A is added. Paragraph B4.1.8 is included for reference only and is not proposed for amendment. New text is underlined and deleted text is struck through.

B4.1.5 Financial assets must be measured at fair value through profit or loss if they are not held within a business model whose objective is to hold assets to collect contractual cash flows or a business model in which assets are managed both in

order to collect contractual cash flows and for sale. ~~One business model in which the objective is not to hold instruments to collect the contractual cash flows is if an entity~~ One such business model is if an entity manages the ~~performance of a portfolio of~~ financial assets with the objective of ~~realising~~ maximising cash flows through the sale of the assets. ~~For example, if an entity actively manages a portfolio of assets in order to realise fair value changes arising from changes in credit spreads and yield curves, its business model is not to hold those assets to collect the contractual cash flows~~. In this case, the entity's objective will typically result~~s~~ in active buying and selling and the entity is managing the instruments to realise fair value gains ~~rather than to collect the contractual cash flows~~. Even though the entity will collect contractual cash flows while it holds the financial assets, such a business model is not to manage assets both to collect contractual cash flows and to sell. This is because the collection of contractual cash flows is not integral to achieving the business model's objective but rather is only incidental to it.

B4.1.6 A portfolio of financial assets that is managed and whose performance is evaluated on a fair value basis (as described in paragraph 4.2.2(b)) is neither ~~not~~ held to collect contractual cash flows nor managed both to collect contractual cash flows and to sell assets. Also, a portfolio of financial assets that meets the definition of held for trading is not held to collect contractual cash flows nor is it managed both to collect contractual cash flows and to sell assets. For such portfolios, the collection of contractual cash flows is only incidental to achieving the business model's objective. Such portfolios of instruments must be measured at fair value through profit or loss.

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding

B4.1.7 Paragraph 4.1.1(b) requires an entity (unless paragraph 4.1.5 applies) to classify a financial asset ~~as subsequently measured at amortised cost or fair value~~ on the basis of its ~~the~~ contractual cash flow characteristics ~~of the financial asset that is in a group of financial assets managed for the collection of the contractual cash flows~~.

B4.1.8 An entity shall assess whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding for the currency in which the financial asset is denominated (see also paragraph B5.7.2).

B4.1.8A If the contractual cash flows include payments that are unrelated to principal, the time value of money and the credit risk, the contractual cash flows do not represent solely payments of principal and interest. Accordingly, such financial assets must be measured at fair value through profit or loss.

B4.1.9 Leverage is a contractual cash flow characteristic of some financial assets. Leverage modifies the economic relationship between principal and the consideration for the time value of money and the credit risk. More than insignificant leverage ~~Leverage~~ increases the variability of the contractual cash flows with the result that they do not have the economic characteristics of interest. Stand-alone option, forward and swap contracts are examples of financial assets that include such leverage. Thus such contracts do not meet the

condition in paragraphs 4.1.2(b) and 4.1.2A(b) and cannot be subsequently measured at amortised cost or at fair value through other comprehensive income.

Paragraphs B4.1.9A–B4.1.9E are added.

B4.1.9A In other cases, the economic relationship between principal and the consideration for the time value of money and the credit risk in a financial asset may be modified by an interest rate reset feature (ie an interest rate that is reset where the frequency of the reset does not match the tenor of the interest rate). In such cases and in the case of leverage (collectively referred to as 'a modified economic relationship'), an entity shall assess the modification to determine whether the contractual cash flows represent solely payments of principal and interest on the principal amount outstanding.

B4.1.9B Unless paragraph B4.1.9E applies, when assessing a modified economic relationship, an entity shall consider cash flows on a comparable financial asset that does not contain the modification (benchmark cash flows). The appropriate comparable financial asset is a contract of the same credit quality and with the same contractual terms (including, when relevant, the same reset periods), except for the contractual term under evaluation. For example, if the financial asset under assessment contains a variable interest rate that is reset monthly to a three-month interest rate, the appropriate benchmark would be a financial asset with the identical contractual terms and the identical credit quality except that the variable interest rate is reset monthly to a monthly interest rate. An entity may consider either an actual or a hypothetical financial asset as the basis for the assessment.

B4.1.9C If the modification could result in cash flows that are more than insignificantly different from the benchmark cash flows, the financial asset does not meet the condition in paragraphs 4.1.2(b) and 4.1.2A(b). The reason for the rate being set in this way is not relevant to the analysis. For example, the conclusion would be unchanged whether the rate is required to be set in this way to provide consumer protection or is included in a bespoke structured product to achieve a particular economic outcome.

B4.1.9D When assessing a modified economic relationship in a financial asset, an entity shall consider variables that could affect future cash flows. For example, if an entity is assessing a constant maturity bond with a five-year term and a variable rate that is reset semi-annually to a five-year rate, and the interest rate curve at the time of the assessment is such that the difference between a five-year rate and a semi-annual rate is not more than insignificant, that in itself does not enable the entity to conclude that the contractual cash flows are solely payments of principal and interest. The entity shall also consider whether the relationship between the five-year rate and the semi-annual rate could change over the life of the instrument such that the contractual cash flows over the life of the instrument could be more than insignificantly different from the benchmark cash flows. However, an entity shall only consider reasonably possible scenarios rather than every possible scenario. If an entity is unable to conclude that

contractual cash flows could not be more than insignificantly different from the benchmark cash flows, the financial asset shall be measured at fair value through profit or loss.

B4.1.9E If it is clear, with little or no analysis, whether the cash flows on the financial asset under the assessment could or could not be more than insignificantly different from the benchmark cash flows, an entity need not perform a detailed assessment.

Paragraphs B4.1.12–B4.1.13 are amended. New text is underlined and deleted text is struck through.

B4.1.12 A contractual term that changes the timing or amount of payments of principal or interest does not result in contractual cash flows that are solely principal and interest on the principal amount outstanding unless it:

(a) is a variable interest rate that is consideration for the time value of money and the credit risk (~~which~~ the consideration for credit risk may be determined at initial recognition only, and so may be fixed) associated with the principal amount outstanding; and

(b) if the contractual term is a prepayment option, meets the conditions in paragraph B4.1.10; or

(c) if the contractual term is an extension option, meets the conditions in paragraph B4.1.11.

B4.1.13 The following examples illustrate contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. This list of examples is not exhaustive.

Instrument	Analysis
Instrument A Instrument A is a bond with a stated maturity date. Payments of principal and interest on the principal amount outstanding are linked to an inflation index of the currency in which the instrument is issued. The inflation link is not leveraged and the principal is protected.	The contractual cash flows are solely payments of principal and interest on the principal amount outstanding. Linking payments of principal and interest on the principal amount outstanding to an unleveraged inflation index resets the time value of money to a current level. In other words, the interest rate on the instrument reflects 'real' interest. Thus, the interest amounts are consideration for the time value of money on the principal amount outstanding.

continued...

...continued

Instrument	Analysis
	However, if the interest payments were indexed to another variable such as the debtor's performance (eg the debtor's net income) or an equity index, the contractual cash flows are not payments of principal and interest on the principal amount outstanding (unless the indexing to the debtor's performance results in an adjustment that only compensates for changes in the credit quality of the instrument, such that contractual cash flows will only represent payments for principal and interest). That is because the interest payments are not consideration for the time value of money and for credit risk associated with the principal amount outstanding. There is variability in the contractual interest payments that is inconsistent with market interest rates.
Instrument B Instrument B is a variable interest rate instrument with a stated maturity date that permits the borrower to choose the market interest rate on an ongoing basis. For example, at each interest rate reset date, the borrower can choose to pay three-month LIBOR for a three-month term or one-month LIBOR for a one-month term	The contractual cash flows are solely payments of principal and interest on the principal amount outstanding as long as the interest paid over the life of the instrument reflects consideration for the time value of money and for the credit risk associated with the instrument. The fact that the LIBOR interest rate is reset during the life of the instrument does not in itself disqualify the instrument.

continued...

...continued

Instrument	Analysis
	~~However, if the borrower is able to choose to pay one-month LIBOR for three months and that one-month LIBOR is not reset each month, the contractual cash flows are not payments of principal and interest.~~ The same analysis would apply if the borrower is able to choose between the lender's published one-month variable interest rate and the lender's published three-month variable interest rate.
	However, if the borrower is able to choose to pay a one-month interest rate that is reset every three months, the interest rate is reset with a frequency that does not match the tenor of the interest rate and this is therefore a modified economic relationship. Likewise, if ~~the~~ an instrument has a contractual interest rate that is based on a term that exceeds the instrument's remaining life (such as where an instrument with a five-year maturity pays a variable rate that is reset periodically but always reflects a five year maturity), ~~its contractual cash flows~~ the economic relationship is modified. That is because the interest payable in each period is disconnected from both the term of the instrument (except at origination in the latter case) and the time value of money over that period.

continued...

...continued

Instrument	Analysis
	In such cases, the entity must assess the contractual cash flows against the cash flows on an instrument that is identical in all respects except for the tenor of the interest rate to determine if the ~~are not~~ payments represent solely ~~of~~ principal and interest on the principal amount outstanding. For example, in assessing a constant maturity bond with a five-year term that pays a variable rate that is reset semi-annually ~~periodically~~ but always reflects a five-year maturity ~~does not result in contractual cash flows that are payments of principal and interest on the principal amount outstanding. That is because the interest payable in each period is disconnected from the term of the instrument (except at origination).~~, an entity considers the contractual cash flows on an instrument that resets semi-annually to a semi-annual interest rate but is otherwise identical.

Paragraph B4.1.21A is added. Paragraph B4.1.26 is amended. New text is underlined.

Contractually linked instruments

...

B4.1.21A A tranche is deemed to satisfy B4.1.21(a) if it would otherwise have payments that are solely principal and interest but is prevented from meeting this requirement solely because it is prepayable contingent on a prepayment occurring in the underlying pool.

...

B4.1.26 If the holder cannot assess the conditions in paragraph B4.1.21 at initial recognition, the tranche must be measured at fair value through profit or loss. If the underlying pool of instruments can change after initial recognition in such a way that the pool may not meet the conditions in paragraphs B4.1.23 and B4.1.24, the tranche does not meet the conditions in paragraph B4.1.21 and must be measured at fair value through profit or loss. However, if the underlying pool includes instruments that are collateralised by assets that do

not meet the conditions in paragraphs B4.1.23–B4.1.24, the collateral shall be disregarded for the purposes of applying this paragraph.

Paragraphs B4.1.29–B4.1.30 are amended. New text is underlined and deleted text is struck through.

Designation eliminates or significantly reduces an accounting mismatch

B4.1.29 Measurement of a financial asset or financial liability and classification of recognised changes in its value are determined by the item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') when, for example, in the absence of designation as at fair value through profit or loss, a financial asset would be classified as subsequently measured at fair value through profit or loss and a liability the entity considers related would be subsequently measured at amortised cost (with changes in fair value not recognised). In such circumstances, an entity may conclude that its financial statements would provide more relevant information if both the asset and the liability were measured as at fair value through profit or loss.

B4.1.30 The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through profit or loss only if it meets the principle in paragraph 4.1.5 or 4.2.2(a).

(a) An entity has liabilities under insurance contracts whose measurement incorporates current information (as permitted by IFRS 4, paragraph 24), and financial assets it considers related that would otherwise be measured at ~~amortised cost~~ fair value through other comprehensive income.

...

Paragraphs B4.1.36 is amended. New text is underlined and deleted text is struck through.

A group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis

...

B4.1.36 Documentation of the entity's strategy need not be extensive but should be sufficient to demonstrate compliance with paragraph 4.2.2(b). Such documentation is not required for each individual item, but may be on a portfolio basis. For example, if the performance management system for a department—as approved by the entity's key management personnel—clearly

demonstrates that its performance is evaluated on a fair value basis ~~a total return basis~~, no further documentation is required to demonstrate compliance with paragraph 4.2.2(b).

Paragraph B4.3.1 is amended. New text is underlined.

Embedded derivatives (section 4.3)

B4.3.1 When an entity becomes a party to a hybrid contract with a host that is not an asset within the scope of this IFRS, paragraph 4.3.3 requires the entity to identify any embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently at fair value through profit or loss.

The heading before paragraph B4.4.1 is amended. Deleted text is struck through. Paragraph B4.4.1 is included for reference only and is not proposed for amendment.

Reclassification ~~of financial assets~~ (section 4.4)

B4.4.1 Paragraph 4.4.1 requires an entity to reclassify financial assets if the objective of the entity's business model for managing those financial assets changes. Such changes are expected to be very infrequent. Such changes must be determined by the entity's senior management as a result of external or internal changes and must be significant to the entity's operations and demonstrable to external parties. Examples of a change in business model include the following:

Paragraph B5.1.1 is amended. New text is underlined.

Measurement (chapter 5)

Initial measurement (section 5.1)

B5.1.1 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 B5.1.2A and IFRS 13). However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument and classify the financial instrument in accordance with paragraph 4.1.1. For example, the fair value of a long-term loan or receivable that carries no interest can be measured 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.

Paragraphs B5.2.1–B5.2.2 are amended. New text is underlined and deleted text is struck through.

Subsequent measurement of financial assets (section 5.2)

B5.2.1 If a financial instrument that was previously recognised as a financial asset is measured at fair value through profit or loss and its fair value decreases below zero, it is a financial liability measured in accordance with paragraph 4.2.1. However, hybrid contracts with hosts that are assets within the scope of this IFRS are always measured in accordance with paragraph 4.3.2.

B5.2.2 The following example illustrates the accounting for transaction costs on the initial and subsequent measurement of an equity investment ~~financial asset~~ that is elected to be measured at fair value ~~with changes~~ through other comprehensive income in accordance with paragraph 5.7.5. 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.

Paragraphs B5.6.1–B5.6.2 and heading are added.

Reclassification of financial assets (section 5.6)

B5.6.1 Paragraph 5.6.1 requires the reclassification of financial assets to be applied prospectively from the reclassification date. Both the amortised cost and fair value through other comprehensive income categories require the effective interest rate to be determined at initial recognition. When reclassifying a financial asset between amortised cost and fair value through other comprehensive income, the recognition of interest income will therefore not change and an entity shall continue to use the effective interest rate determined at initial recognition of the financial asset. Financial assets that are reclassified out of the fair value through other comprehensive income category to the amortised cost category shall be measured at amortised cost as if they had always been classified as such by transferring the cumulative gain or loss previously recognised in other comprehensive income out of equity with the offsetting entry against the fair value of the financial assets at the reclassification date.

B5.6.2 However, for financial assets measured at fair value through profit or loss, an entity is not required to separately recognise interest income. When reclassifying financial assets out of the fair value through profit or loss category, the fair value at the date of the reclassification becomes the carrying amount and the effective interest rate is determined based on that carrying amount.

Paragraphs B5.7.1A and B5.7.2A are added.

Gains and losses (section 5.7)

...

B5.7.1A Paragraph 4.1.2A requires instruments with contractual terms that give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding, and that are held in a business model in which the assets are managed both in order to collect contractual cash flows and for sale, to be measured at fair value through other comprehensive income. This measurement presents information in profit or loss as if the financial assets are measured at amortised cost, while measurement in the statement of financial position will reflect the fair value of the financial assets. Gains or losses, other than those recognised in profit or loss in accordance with paragraph 5.7.1A, shall be recognised in other comprehensive income. When these financial assets are derecognised, cumulative gains or losses previously recognised in other comprehensive income shall be reclassified to profit or loss. This will reflect the gain or loss that would have been recognised in profit or loss upon derecognition if the financial asset was measured on an amortised cost basis.

...

B5.7.2A For the purpose of recognising foreign exchange gains and losses under IAS 21, a financial asset measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A is treated as a monetary item. Accordingly, such a financial asset is treated as if it were carried at amortised cost in the foreign currency. Exchange differences resulting from changes in amortised cost are recognised in profit or loss and other changes in the carrying amount are recognised in accordance with paragraph 5.7.1A.

Paragraph B5.7.3 is amended. New text is underlined and deleted text is struck through.

B5.7.3 ~~Paragraph~~ An equity investment measured at fair value through other comprehensive income in accordance with paragraph 5.7.5 ~~permits an entity to make an irrevocable election to present in other comprehensive income changes in the fair value of an investment in an equity instrument that is not held for trading. Such an investment~~ is not a monetary item. Accordingly, the gain or loss that is presented in other comprehensive income in accordance with paragraph 5.7.5 includes any related foreign exchange component.

Paragraph B7.2.1 is amended. New text is underlined.

Effective date and transition (chapter 7)

Transition (section 7.2)

Financial assets held for trading

B7.2.1 At the date of initial application of this IFRS, an entity must determine whether the objective of the entity's business model for managing any of its financial assets meets the condition in paragraph 4.1.2(a) or in paragraph 4.1.2A(a) or if a financial asset is eligible for the election in paragraph 5.7.5. For that purpose, an entity shall determine whether financial assets meet the definition of held for trading as if the entity had acquired the assets at the date of initial application.

Appendix C
Amendments to other IFRSs

Except where otherwise stated, an entity shall apply the amendments outlined in this [draft] appendix when it applies Classification and Measurement: Limited Amendments to IFRS 9 *(Proposed amendments to IFRS 9 (2010)) issued on [date to be inserted after exposure].*

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

Paragraphs B4 and B8 are amended. New text is underlined.

Hedge accounting

B4 As required by IFRS 9, at the date of transition to IFRSs an entity shall:

(a) measure all derivatives at fair value through profit or loss; and

(b) eliminate all deferred losses and gains arising on derivatives that were reported in accordance with previous GAAP as if they were assets or liabilities.

Classification and measurement of financial assets

B8 An entity shall assess whether a financial asset meets the conditions in paragraphs 4.1.2 or 4.1.2A of IFRS 9 on the basis of the facts and circumstances that exist at the date of transition to IFRSs.

IFRS 3 *Business Combinations*

Paragraph 16 is amended. New text is underlined.

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 measured at fair value through profit or loss, or at amortised cost, as financial assets mandatorily measured at fair value through other comprehensive

income or equity investments designated to be measured as such upon initial recognition in accordance with IFRS 9 *Financial Instruments*;

(b) designation of a derivative instrument as a hedging instrument in accordance with IAS 39; and

(c) assessment of whether an embedded derivative should be separated from a host contract in accordance with IFRS 9 (which is a matter of 'classification' as this IFRS uses that term).

IFRS 4 *Insurance Contracts*

Paragraph 45 is amended. New text is underlined.

Redesignation of financial assets

45 Notwithstanding paragraph 4.4.1 of IFRS 9, when an insurer changes its accounting policies for insurance liabilities, it is permitted, but not required, to reclassify some or all of its financial assets so that they are measured at fair value through profit or loss. This reclassification is permitted if an insurer changes accounting policies when it first applies this IFRS and if it makes a subsequent policy change permitted by paragraph 22. The reclassification is a change in accounting policy and IAS 8 applies.

IFRS 7 *Financial Instruments: Disclosures*

Paragraphs 8 is amended. New text is underlined.

Categories of financial assets and financial liabilities

8 The carrying amounts of each of the following categories, as specified in IFRS 9, shall be disclosed either in the statement of financial position or in the notes:

(a) financial assets measured at fair value through profit or loss, showing separately (i) those designated as such upon initial recognition and (ii) those mandatorily measured at fair value through profit or loss in accordance with IFRS 9.

...

(h) financial assets measured at fair value through other comprehensive income, showing separately (i) financial assets that are mandatorily measured at fair value through other comprehensive income in accordance with IFRS 9; and (ii) equity investments designated to be measured as such upon initial recognition.

Paragraph 9 is amended. New text is underlined.

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

9 If the entity has designated as measured at fair value <u>through profit or loss</u> a financial asset (or group of financial assets) that would otherwise be measured at <u>fair value through other comprehensive income or</u> amortised cost, it shall disclose:

...

The heading before paragraph 11A is amended. New text is underlined and deleted text is struck through. Paragraph 11A is included for reference only and is not proposed for amendment.

Financial assets <u>designated</u> ~~measured~~ at fair value through other comprehensive income

11A If an entity has designated investments in equity instruments to be measured at fair value through other comprehensive income, as permitted by paragraph 5.7.5 of IFRS 9, 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) dividends recognised during the period, showing separately those related to investments derecognised during the reporting period and those related to investments held at the end of the reporting period.

(e) any transfers of the cumulative gain or loss within equity during the period including the reason for such transfers.

Paragraphs 12C–2D are amended. New text is underlined and deleted text is struck through.

Reclassification

12C For each reporting period following reclassification until derecognition, an entity shall disclose for assets reclassified <u>out of the fair value through profit or loss category</u> ~~so that they are measured at amortised cost~~ in accordance with paragraph 4.4.1 of IFRS 9:

(a) the effective interest rate determined on the date of reclassification; and

(b) the interest income or expense recognised.

12D If an entity has reclassified financial assets out of the fair value through profit or loss category ~~so that they are measured at amortised cost~~ since its last annual reporting date, it shall disclose:

(a) the fair value of the financial assets at the end of the reporting period; and

(b) the fair value gain or loss that would have been recognised in profit or loss during the reporting period if the financial assets had not been reclassified.

Paragraph 16A is added. New text is underlined. Paragraph 16 is included for reference but is not proposed for amendment.

Allowance account for credit losses

16 When financial assets are impaired by credit losses and the entity records the impairment in a separate account (eg an allowance account used to record individual impairments or a similar account used to record a collective impairment of assets) rather than directly reducing the carrying amount of the asset, it shall disclose a reconciliation of changes in that account during the period for each class of financial assets.

16A The carrying amount of financial assets measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A of IFRS 9 is not directly reduced by an accumulated impairment amount and an entity is prohibited from presenting the accumulated impairment amount in the statement of financial position. However, an entity shall disclose the accumulated impairment amount in the notes to the financial statements.

Paragraph 20 is amended. New text is underlined and deleted text is struck through.

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) ...

(vii) financial assets designated ~~measured~~ at fair value through other comprehensive income.

(viii) financial assets mandatorily measured at fair value through other comprehensive income, showing separately the amount of gain or loss recognised in other comprehensive income during the period and the amount reclassified upon derecognition from accumulated other comprehensive income to profit or loss for the period.

(b) total interest income and total interest expense (calculated using the effective interest method) for financial assets that are measured at amortised cost or that are mandatorily measured at fair value through

other comprehensive income or financial liabilities that are not measured at fair value through profit or loss.

Paragraphs 44N, 44S, 44U and 44V are amended. Paragraphs 44UA and 44X are added. New text is underlined and deleted text is struck through.

Effective date and transition

...

44N IFRS 9, issued in October 2010, amended paragraphs 2–5, 8–10, 11, 14, 20, 28, 30 and 42C–42E, Appendix A, and paragraphs B1, B5, B10(a), B22 and B27, added paragraphs 10A, 11A, 11B, 12B–12D, 20A, 44I and 44J, and deleted paragraphs 12, 12A, 29(b), 44E, 44F, 44H and B4 and Appendix D. An entity shall apply those amendments when it first applies IFRS 9 ~~as issued in October 2010~~ subject to the requirements in paragraphs 7.1.1 and 7.1.1A–7.1.1B of IFRS 9 (2010).

...

44S When an entity first applies the classification and measurement requirements of IFRS 9, it shall present the disclosures set out in paragraphs 44T–44W of this IFRS ~~if it elects to, or is~~ as required ~~to, provide these disclosures~~ in accordance with ~~IFRS 9 (see paragraph 8.2.12 of IFRS 9 (2009) and~~ paragraph 7.2.14 of IFRS 9 (2010).

...

44U In the reporting period in which IFRS 9 is initially applied, an entity shall disclose the following for financial assets and financial liabilities that have been reclassified so that they are measured at amortised cost or, in case of financial assets, mandatorily measured at fair value through other comprehensive income as a result of the transition to IFRS 9:

(a) the fair value of the financial assets or financial liabilities at the end of the reporting period;

(b) the fair value gain or loss that would have been recognised in profit or loss or other comprehensive income during the reporting period if the financial assets or financial liabilities had not been reclassified;

(c) the effective interest rate determined on the date of reclassification; and

(d) the interest income or expense recognised.

If an entity treats the fair value of a financial asset or a financial liability as its amortised cost at the date of initial application (see ~~paragraph 8.2.10 of IFRS 9 (2009) and~~ paragraph 7.2.10 of IFRS 9 (2010)), the disclosures in (c) and (d) of this paragraph shall be made for each reporting period following reclassification until derecognition. Otherwise, the disclosures in this paragraph need not be made after the reporting period containing the date of initial application.

44UA If an entity applies paragraph 7.2.4A of IFRS 9 (2010) because retrospective assessment of a modified economic relationship between the principal and the consideration for time value of money and credit risk is impracticable, an entity

shall disclose the carrying value of the financial assets whose contractual cash flow characteristics have been assessed in accordance with IFRS 9 (2010), notwithstanding the amendments listed in paragraph 7.1.1A of that IFRS until those financial assets are derecognised.

44V ~~If an entity presents the disclosures set out in paragraphs 44S–44U at the date of initial application of IFRS 9, those disclosures, and the disclosures in paragraph 28 of IAS 8 during the reporting period containing the date of initial application, must permit reconciliation between:~~

~~(a) the measurement categories in accordance with IAS 39 and IFRS 9; and~~

~~(b) the line items presented in the statements of financial position.~~

In the reporting period in which IFRS 9 is initially applied, an entity is not required to disclose the line item amounts that would have been reported in accordance with the classification and measurement requirements of:

(a) IFRS 9 for prior periods; and

(b) IAS 39 for the current period.

44X An entity that has designated a financial liability as at fair value through profit or loss in accordance with paragraph 9 of IAS 39 and has elected to early apply paragraphs 5.7.1(c), 5.7.7–5.7.9, 7.2.13 and B5.7.5–B5.7.20 of IFRS 9 (2010) shall apply paragraphs 10 and 10A of this IFRS at the same time.

IAS 1 *Presentation of Financial Statements*

The definition of 'other comprehensive income' in paragraph 7 is amended. New text is underlined.

Definitions

7 **The following terms are used in this Standard with the meanings specified:**

...

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:

...

(d) gains and losses from investments in equity instruments ~~measured~~ designated at fair value through other comprehensive income in accordance with paragraph 5.7.5 of IFRS 9 *Financial Instruments*;

(da) gains and losses on financial assets measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A of IFRS 9;

(e) ...

Paragraph 82 is amended. New text is underlined and deleted text is struck through.

Information to be presented in the profit or loss section or the statement of profit or loss

82 In addition to items required by other IFRSs, the profit or loss section or the statement of profit or loss shall include line items that present the following amounts for the period:

...

(ca) if a financial asset is reclassified out of the amortised cost measurement category so that it is measured at fair value through profit or loss, any gain or loss arising from a difference between the previous carrying amount and its fair value at the reclassification date (as defined in IFRS 9);

(cb) if a financial asset is reclassified out of the fair value through other comprehensive income measurement category so that it is measured at fair value through profit or loss, any cumulative gain or loss previously recognised in other comprehensive income that is reclassified to profit or loss;

(d) ...

Paragraph 123 of IAS 1 is amended. New text is underlined and deleted text is struck through. Paragraph 122 is included for reference only and is not proposed for amendment.

122 An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125) that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

123 In the process of applying the entity's accounting policies, management makes various judgements, apart from those involving estimations, that can significantly affect the amounts it recognises in the financial statements. For example, management makes judgements in determining:

(a) [deleted]

(b) when substantially all the significant risks and rewards of ownership of financial assets and lease assets are transferred to other entities; ~~and~~

(c) whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue~~.~~; and

(d) whether contractual cash flows of a financial asset are solely payments of principal and interest.

IFRIC Interpretation 12 *Service Concession Arrangements*

Paragraphs 24–25 are amended. New text is underlined and deleted text is struck through.

Financial asset

...

24 The amount due from or at the direction of the grantor is accounted for in accordance with IFRS 9 as:

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

(b) measured at fair value through other comprehensive income; or

(c) measured at fair value through profit or loss.

25 If the amount due from the grantor is measured ~~accounted for~~ at amortised cost or fair value through other comprehensive income, IFRS 9 requires interest calculated using the effective interest method to be recognised in profit or loss.

Approval by the Board of *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010)) published in November 2012

The Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010)) was approved for publication by thirteen of the fifteen members of the International Accounting Standards Board. Messrs Cooper and Engström voted against its publication. Their alternative views are set out after the Basis for Conclusions.

Hans Hoogervorst	Chairman
Ian Mackintosh	Vice-Chairman
Stephen Cooper	
Philippe Danjou	
Martin Edelmann	
Jan Engström	
Patrick Finnegan	
Amaro Luiz de Oliveira Gomes	
Prabhakar Kalavacherla	
Patricia McConnell	
Takatsugu Ochi	
Paul Pacter	
Darrel Scott	
Chungwoo Suh	
Wei-Guo Zhang	

CONTENTS

Basis for Conclusions on the Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010))

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

Introduction

BC1 This Basis for Conclusions summarises the considerations of the International Accounting Standards Board (IASB) in reaching the conclusions in the Exposure Draft *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010)). Individual IASB members gave greater weight to some factors than to others.

BC2 When the first requirements of IFRS 9 were issued in 2009, the IASB's priority was to make improvements to the accounting for financial instruments available quickly. Consequently, although financial instruments are part of the convergence efforts with the US Financial Accounting Standards Board (FASB), the IASB issued the classification and measurement requirements for financial assets in IFRS 9 while the FASB was still developing its classification and measurement model. However, the boards remained committed to achieving increased comparability internationally in the accounting for financial instruments.

BC3 In addition, when issuing IFRS 9 in 2009, the IASB acknowledged the difficulties that might be created by differences in timing between the Classification and Measurement phase of the project to replace IAS 39 *Financial Instruments: Recognition and Measurement* and the Insurance Contracts project. The IASB consistently stated that the interaction between IFRS 9 and the Insurance Contracts project would be considered once the insurance contracts model has been developed sufficiently.

BC4 Since the publication of IFRS 9, the IASB has received feedback from interested parties in various jurisdictions who have chosen to apply IFRS 9 early or who have reviewed IFRS 9 in detail in preparation for application. Some have raised application issues.

BC5 Accordingly, the IASB has proposed limited amendments to IFRS 9 with the aims of:

(a) addressing specific application issues raised by those who have chosen to apply IFRS 9 early or who have reviewed IFRS 9 in detail in preparation for application;

(b) seeking to reduce key differences with the FASB's tentative classification and measurement model; and

(c) considering the interaction between the classification and measurement of financial assets and the accounting for insurance contracts liabilities.

Scope of this exposure draft

BC6 The IASB believes that IFRS 9 is fundamentally sound and will result in useful information being provided to users of financial statements. Feedback from interested parties has also confirmed that it is operational. Accordingly, although some would have liked additional issues to be included in this Exposure Draft,[13] the IASB is proposing only limited amendments to IFRS 9 in line with the objectives set out in paragraph BC5.

BC7 In limiting the scope of this Exposure Draft, the IASB was also mindful of the need to:

(a) complete the entire project on financial instruments on a timely basis; and

(b) minimise the cost and disruption to entities that have already applied—or begun preparations to apply—IFRS 9.

BC8 The proposals in this Exposure Draft result both from IASB-only deliberations and joint deliberations with the FASB. The following issues were deliberated:

(a) the assessment of a financial asset's contractual cash flow characteristics—specifically, whether, and if so, what, additional guidance is required to clarify how the principle is to be applied;

(b) the need for bifurcation of embedded features in financial assets and, if this approach were taken, the basis for bifurcation;

(c) the basis for, and the scope of, a possible third measurement category (financial assets mandatorily measured at fair value through other comprehensive income); and

(d) interrelated issues arising from the topics above (including issues considered separately by the IASB).

Classification

The entity's business model

BC9 IFRS 9 already requires the assessment of the entity's business model for managing the financial assets. Financial assets are measured at amortised cost, subject to the contractual cash flow characteristics assessment, if they are held within a business model whose objective is to hold financial assets to collect contractual cash flows (a 'hold to collect' business model). Financial assets that do not meet this condition are measured at fair value through profit or loss.

BC10 After the issue of IFRS 9, the IASB received questions about the level of sales of assets measured at amortised cost that would be considered to be 'more than infrequent', and when sales activity contradicts the objective of the amortised

13 For example, a cost exception for some unquoted equity instruments, which was considered, but not included in IFRS 9 for the reasons discussed in paragraphs BC5.13–BC5.18 of IFRS 9 (2010).

cost measurement category.[14] Interested parties also indicated that significant judgement is involved when classifying some portfolios—notably so-called 'liquidity portfolios', which are portfolios of assets held by banks to satisfy their actual or potential liquidity needs, often in response to regulatory requirements— as being measured at amortised cost or fair value through profit or loss, and that there may be some inconsistency in the interpretation of whether the objective of a business model is to hold financial assets to collect contractual cash flows.

BC11 In addition, the IASB received views from some interested parties about the need for a 'fair value through other comprehensive income' measurement category. These views mainly related to:

(a) whether measurement at fair value through profit or loss appropriately reflects the performance of financial assets that are managed both in order to collect contractual cash flows and for sale, so as to maximise a return from a combination of contractual cash flows and fair value gains. Some believed that the business model assessment results in classification outcomes that are too limited, ie an entity either holds assets to collect contractual cash flows, or it is required to measure the financial assets at fair value through profit or loss, and

(b) the potential accounting mismatch that may arise because of the interaction between accounting for financial assets in accordance with IFRS 9 and the accounting for insurance contracts liabilities under the Insurance Contracts project. In addition, unlike IFRS 9, under the FASB's tentative classification and measurement model[15] at the start of the joint deliberations, financial assets were measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss.

BC12 Accordingly, the IASB considered whether, depending on the contractual cash flows characteristics, financial assets should be mandatorily measured at fair value through other comprehensive income on the basis of the business model within which they are held and, if so, what the mechanics of this measurement category should be. The IASB and the FASB also considered the objective of the business models for measurement at amortised cost, fair value through other comprehensive income, and fair value through profit or loss. The boards also considered which measurement category should be residual.

---

14 Paragraph B.4.1.3 of IFRS 9 states that if more than an infrequent number of sales are made out of a portfolio, the entity needs to assess whether, and if so, how, such sales are consistent with the objective of collecting contractual cash flows (and whether the portfolio would therefore be measured at amortised cost).

15 One of the stated objectives of these proposals is to reduce key differences with the FASB's model. Consequently, depending on the context, references to the FASB's 'tentative classification and measurement model' may refer to their model (a) before the joint deliberations (because that affected the issues deliberated), (b) after the joint deliberations (to clarify whether the objective was achieved), or (c) both (if an aspect of their model did not change as a result of the joint deliberations).

Amortised cost

BC13 The IASB noted that because of the questions raised and the different views in applying a 'hold to collect' business model in IFRS 9, it would be necessary to clarify the business model assessment irrespective of whether an additional business model was to be added to IFRS 9. Thus, the proposals on the business model assessment are not intended to merely accommodate an additional business model. In the proposed amendments to the application guidance, the IASB seeks to address some of the questions received about the business model assessment for the amortised cost measurement category. In particular, questions were raised about the interaction between the examples in paragraph B4.1.4 of IFRS 9 and the reference to selling activity in paragraph B4.1.3.

BC14 The IASB reaffirmed the existing principle in IFRS 9 that, depending on the contractual cash flow characteristics, financial assets would be measured at amortised cost if the objective of the business model is to hold those assets to collect contractual cash flows. Furthermore, the IASB decided to provide additional application guidance on both the types of business activities and the frequency and nature of sales that would prohibit financial assets from being measured at amortised cost.

BC15 In order to assess the business model, an entity needs to consider the frequency and significance of past sales and the reason for those sales, as well as expectations for the future. This is done to determine whether the cash flows from financial assets will arise from the collection of contractual cash flows or from sale. The IASB noted that the credit quality of financial assets is relevant to the entity's ability to collect contractual cash flows. Consequently, it is consistent with an objective of collecting contractual cash flows to sell a financial asset when concerns are raised about the collectability of those cash flows.

BC16 The IASB also noted that it would expect sales out of the amortised cost measurement category to be less frequent than sales out of the other measurement categories in IFRS 9. In order to clarify the relevance (for example, the frequency, significance and the reason for the sales) of selling activity to the business model assessment, the IASB decided to provide additional application guidance to IFRS 9 and to remove some of the language that had appeared contradictory.

Fair value through other comprehensive income

BC17 In this Exposure Draft, the IASB proposes to introduce a fair value through other comprehensive income measurement category for financial assets whose contractual cash flow characteristics are solely payments of principal and interest, and are managed within a defined business model. The IASB believes that this measurement category will:

(a) provide useful information for the financial assets classified in this measurement category, and address the feedback from those who have questioned the appropriate classification for those financial assets under IFRS 9;

(b) address the interaction between the classification and measurement of financial assets and the accounting for insurance contracts liabilities; and

(c) increase comparability with the FASB's tentative classification and measurement model.

BC18 Prior to the joint deliberations, the FASB had already decided to include a fair value through other comprehensive income measurement category in their tentative classification and measurement model for financial assets. This difference would have resulted in many financial assets being classified differently under IFRS and US GAAP if the FASB were to finalise those proposals, because IFRS 9 currently has only two measurement categories for financial assets.

BC19 The boards jointly decided to propose that financial assets should be mandatorily measured at fair value through other comprehensive income if, and only if,[16] they:

(a) have contractual cash flow characteristics that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (paragraph BC46); and

(b) are managed within the relevant business model (described in the following paragraph).

BC20 The boards decided to propose that if the entity's business model is to manage financial assets both to collect contractual cash flows and to sell,[17] financial assets managed within that business model should be measured at fair value through other comprehensive income (depending on their contractual cash flows). The IASB noted that the introduction of the fair value through other comprehensive income measurement category will also address the feedback of those interested parties who have questioned the appropriate classification of financial assets held within a business model in which assets are managed both in order to collect contractual cash flows and for sale.[18]

BC21 The IASB acknowledged that a third measurement category adds complexity to IFRS 9. However, the IASB believes that, for some financial assets, measurement at fair value through other comprehensive income would reflect their performance better than measurement at either amortised cost or fair value through profit or loss, and that the complexity would be justified by the usefulness of the information provided.

BC22 For a business model in which financial assets are managed both in order to collect contractual cash flows and for sale, performance will be affected by both

16 Subject to eligibility for, and election of, the fair value option (paragraph BC74).

17 The business model assessment is made for a group of financial assets, and therefore an expectation to hold (some assets) and an expectation to sell (some assets) are not mutually exclusive.

18 In contrast, the IASB is aware that other interested parties believe that the two-measurement-category classification approach in IFRS 9 results in an appropriate reflection of business models for managing financial assets. Some have stated this view within the context of interpreting a 'hold to collect' business model that is broader than the IASB intended (paragraphs BC13–BC16) and therefore might have a different view in the light of the clarifications to amortised cost.

contractual cash flows and the realisation of fair values. Amortised cost information reflects the decision to hold the assets to collect contractual cash flows unless, and until, they are sold in order to achieve the objective of the business model. Fair value information reflects the cash flows that would be realised if, and when, they were sold. The IASB therefore decided that the fair value through other comprehensive income measurement category should result in a fair value carrying amount in the statement of financial position and amortised cost information being provided in profit or loss. Accordingly, the IASB proposes that for financial assets mandatorily measured at fair value through other comprehensive income:

(a) interest income should be recognised in profit or loss using the effective interest method that is already applied to financial assets measured at amortised cost in IFRS 9;

(b) impairment should be recognised in profit or loss using the same credit impairment methodology as for financial assets measured at amortised cost; and

(c) the cumulative fair value gain or loss recognised in other comprehensive income should be reclassified ('recycled') from equity to profit or loss as a reclassification adjustment when these financial assets are derecognised.

BC23 The IASB noted that amortised cost information could not be provided in profit or loss without recycling the gains or losses previously accumulated in other comprehensive income to profit or loss upon derecognition of those financial assets, which is a key feature of the fair value through other comprehensive income measurement category. Even so, the IASB also acknowledged that the gains and losses accumulated in other comprehensive income are not recycled upon derecognition of either:

(a) equity instruments for which an entity makes an irrevocable election at initial recognition to present the fair value changes (other than dividend income) in other comprehensive income; or

(b) financial liabilities designated under the fair value option.

BC24 However, the IASB noted that some of the reasons for not permitting the recycling of these gains or losses accumulated in other comprehensive income do not apply to the proposed fair value through other comprehensive income measurement category. Specifically:

(a) *Equity instruments:* paragraph BC5.25(b) of IFRS 9 discusses the reasons why fair value gains and losses are not recycled for equity instruments. In publishing this Exposure Draft, the IASB also noted that recycling accumulated fair value gains or losses would require an instrument to be assessed for impairment. The requirements for the impairment of equity instruments in IAS 39 were very subjective and were some of the most criticised accounting requirements during the financial crisis. Equity instruments are not subject to impairment in accordance with IFRS 9. In contrast to that, the IASB is proposing that financial assets mandatorily

measured at fair value through other comprehensive income should be subject to the same impairment approach as for financial assets measured at amortised cost.

(b) *Financial liabilities designated under the fair value option:* paragraphs BC5.52–BC5.57 of IFRS 9 discuss the reasons why accumulated amounts attributable to own credit are not recycled for financial liabilities designated under the fair value option. One of the main reasons is that these financial liabilities are typically held to repay contractual amounts and thus the cumulative effect of changes in own credit risk naturally unwinds to zero at maturity. In contrast, the proposed business model for financial assets mandatorily measured at fair value through other comprehensive income is one in which some financial assets are sold prior to maturity, and therefore the fair value gains and losses recognised in other comprehensive income would not naturally unwind at maturity.

BC25 In addition, requiring recycling for financial assets mandatorily measured at fair value through other comprehensive income would be consistent with the FASB's tentative classification and measurement model and thus would achieve the objective of reducing key differences between the boards' classification and measurement models for financial instruments.

BC26 The IASB proposes that, consistent with providing amortised cost information in profit or loss, for the purpose of recognising foreign exchange gains and losses under IAS 21 *The Effects of Changes in Foreign Exchange Rates*, a financial asset measured at fair value through other comprehensive income should be treated as if it was measured at amortised cost in the foreign currency. Consequently, exchange differences resulting from changes in the amortised cost basis (ie interest income calculated using the effective interest method and impairment) should be recognised in profit or loss, with all other exchange differences being recognised in other comprehensive income (like other fair value changes).

BC27 In ED/2009/7 *Financial Instruments: Classification and Measurement* (the '2009 Exposure Draft'), the IASB proposed that financial assets that had basic loan features and were managed on a contractual yield basis would be measured at amortised cost, and all other financial assets would be measured at fair value through profit or loss. As part of the 2009 Exposure Draft, the IASB also solicited feedback on an alternative approach whereby financial assets would have been required to be measured at amortised cost if, and only if, they met the criteria for measurement at amortised cost that were in the 2009 Exposure Draft, **and** met the definition of loans and receivables in IAS 39. All other financial assets would have been measured at fair value in the statement of financial position, with changes in recognised value determined on an amortised cost basis in profit or loss (including impairment in accordance with IAS 39), and other fair value changes presented in other comprehensive income and not recycled to profit or loss.

BC28 The IASB rejected the alternative approach for the reasons discussed in paragraph BC4.43 of IFRS 9, and IFRS 9 did not require any fair value changes to be presented in other comprehensive income for financial assets (unless the presentation alternative was elected for an equity instrument at initial

recognition). However, the fair value through other comprehensive income measurement category in this Exposure Draft is different from the alternative approach in the 2009 Exposure Draft, because:

(a) The alternative approach would have resulted in measurement at fair value through other comprehensive income as a residual classification for financial assets that did not meet both the definition of loans and receivables in IAS 39 and criteria for measurement at amortised cost in the 2009 Exposure Draft. In contrast, this Exposure Draft would define the criteria for measurement at fair value through other comprehensive income and require this measurement only for those financial assets for which it provides useful information.

(b) In addition, recycling upon derecognition would have been prohibited under the alternative approach in the 2009 Exposure Draft, and consequently that approach would not have resulted in amortised cost information being provided in profit or loss for financial assets mandatorily measured at fair value through other comprehensive income. In accordance with this Exposure Draft, recycling upon derecognition is required for financial assets mandatorily measured at fair value through other comprehensive income, just as for financial assets measured at amortised cost.

BC29 In addition to providing useful information as described in the preceding paragraphs, the introduction of a fair value through other comprehensive income measurement category may improve consistency between the classification and measurement of financial assets and insurance contracts liabilities. This is because, according to the tentative decisions in the Insurance Contracts project, changes in insurance contracts liabilities attributable to changes in the discount rate will be presented in other comprehensive income. When the insurer holds financial assets measured at fair value through other comprehensive income, changes in both the fair value of the financial assets that the insurer holds (other than interest calculated using the effective interest method and impairment) and in the value of the insurer's insurance contract liabilities arising from the effect of changes in the discount rate would be presented in other comprehensive income.

BC30 Similar to concerns that were raised with the alternative approach in the 2009 Exposure Draft, interested parties have raised concerns that the introduction of the fair value through other comprehensive income measurement category would increase the use of fair value relative to IFRS 9. However, the IASB notes that it did not seek to increase or reduce the use of fair value measurement. Rather it sought to ensure that relevant information is provided. In addition, the IASB noted that in some cases financial assets that would have been measured at fair value through profit or loss could be measured at fair value through other comprehensive income as a result of the proposals. Thus, in these cases there would not be an increase in the use of fair value.

Fair value through profit or loss

BC31 In IFRS 9, there are only two measurement categories, and the fair value through profit or loss measurement category is residual. This Exposure Draft proposes

the addition of a fair value through other comprehensive income measurement category, and the IASB considered whether fair value through profit or loss should remain the residual measurement category. The IASB considered that there may be some benefits in making the fair value through other comprehensive income measurement category residual, because a clear distinction could be made in the description of amortised cost and the description of fair value through profit or loss.

BC32 However, the IASB noted that the residual measurement category should provide useful information for all of the instruments classified in that measurement category. Amortised cost information is provided in profit or loss for both the amortised cost and the fair value through other comprehensive income measurement categories. This information is only relevant for particular business models and for instruments with particular cash flow characteristics. As a result, neither of these two measurement categories would be useful as a residual measurement category.

BC33 Consequently, the IASB reaffirmed the existing requirement in IFRS 9—that the fair value through profit or loss measurement category is the residual measurement category. As was already the case in IFRS 9, the IASB confirmed that financial assets held for trading and those managed on a fair value basis should be measured at fair value through profit or loss.

Alternative approaches to the business model assessment

BC34 In the deliberations leading to the publication of this Exposure Draft, the boards jointly considered alternative approaches to the business model assessment for all of the measurement categories. These alternatives were considered within the context of the amortised cost measurement category, but would have had implications for the other measurement categories.

BC35 The main alternative approach considered was a business-activity based approach similar to the FASB's tentative approach prior to the joint deliberations. In summary, the business activities under this alternative would have included lending (amortised cost), investing (fair value through other comprehensive income), and trading or held for sale (fair value through profit or loss). A lending business activity criterion would have required the entity to have, in addition to holding the financial assets to collect the contractual cash flows, the ability to negotiate any potential adjustments to contractual cash flows with the counterparty in the event of a potential credit loss. In the IASB's view, requiring entities to have the ability to negotiate the terms with the counterparty might have been unduly costly and complex to apply and might have resulted in different classification of lending activities simply because of the different legal frameworks in different jurisdictions. In addition, the nature of the financial asset would have had an effect on its classification—for example, widely-held bonds would typically have failed to meet the criteria due to the inability to renegotiate the terms on a bilateral basis. The IASB continued to support an approach that would allow financial assets that are held with the objective of collecting contractual cash flows to be measured at amortised cost.

In the IASB's view, because the anticipated future cash flows for widely-held bonds are the contractual cash flows in some cases, measurement at amortised cost is appropriate in such cases.

BC36 For the reasons described in paragraphs BC4.15–BC4.21 of IFRS 9, the IASB reaffirmed the principle in IFRS 9 for the amortised cost measurement category, and the business model approach in IFRS 9 generally.

Contractual cash flow characteristics of financial assets

BC37 Contractual cash flow characteristics of financial assets. In accordance with IFRS 9, subject to the business model assessment, a financial asset is measured at amortised cost if its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. Interest is consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time. As noted in BC4.7 of IFRS 9, amortised cost information is relevant and useful in assessing an entity's likely cash flows for particular types of financial assets in particular circumstances (in other words, for financial assets with simple cash flows, depending on the business model). The contractual cash flow characteristics assessment also identifies instruments to which the effective interest method can be appropriately applied—this method simply allocates interest over the life of the instrument and is only suitable for instruments with cash flows that only represent principal and interest.

BC38 This approach was supported by interested parties and generally found to be operational. However, the IASB received some application questions subsequent to publication of IFRS 9.

BC39 The boards noted that although the assessment of the contractual cash flow characteristics differed between IFRS 9 and the FASB's tentative classification and measurement model (before the joint deliberations), the underlying objective was similar—that is, to identify simple debt instruments that could be eligible for a measurement category other than fair value through profit or loss.

BC40 Accordingly, the IASB decided to re-affirm the principle in IFRS 9 in this Exposure Draft. However, the IASB also decided to propose a minor amendment to the application guidance in IFRS 9 to clarify how the principle should be applied to particular instruments to address the questions that had been received.

BC41 The IASB noted that in some cases the economic relationship between principal and the consideration for the time value of money and the credit risk in a financial asset may be modified. The particular examples considered were when a financial asset contains leverage or an interest rate that is reset or resettable where the frequency of the reset does not match the tenor of the interest rate (an interest rate mismatch). Some had asked whether contractual cash flows could be considered to be solely principal and interest as long as the structure of the economic relationship between principal and interest was consistent with market norms in a particular market. The IASB noted that some market norms may not be consistent with the economic concept of the time value of money.

BC42 Nonetheless, the IASB acknowledged that it did not always intend for financial assets to be measured at fair value through profit or loss due to the existence of a modified relationship between principal and the consideration for the time value of money and the credit risk. However, it was brought to the IASB's attention that some had interpreted the existing application guidance in IFRS 9 very strictly and concluded that any modification in the economic relationship between the principal and the consideration for the time value of money and the credit risk resulted in the financial asset being measured at fair value through profit or loss.

BC43 Accordingly, the IASB decided to propose clarifying that a financial asset only contains contractual cash flows that are payments of principal and the consideration for the time value of money and for the credit risk. However, because the relationship between them is modified due to an interest rate mismatch feature or leverage ('modified economic relationship') an entity needs to assess the significance of that modification to conclude whether the financial asset's cash flows are consistent with the notion of solely principal and interest.

BC44 While developing the proposed clarification, the IASB received feedback about interest rates in regulated environments that modify the economic relationship between principal and the consideration for the time value of money and the credit risk in financial instruments. It was noted that in such environments the base interest rates are established and reset by a central authority, and the base interest rates may not be reset in a manner that reflects the reset period. Furthermore, in such environments there may not be any financial instruments available that are priced on a different basis. Some concerns were raised about how to determine whether the cash flows on such instruments would be considered to satisfy the contractual cash flow characteristics assessment and whether the proposed notion of a modified economic relationship was operational and appropriate in such environments. The IASB noted that it would gather further feedback during and after the comment period on whether the clarifications proposed in this Exposure Draft would appropriately address any concerns related to interest rates in regulated environments.

BC45 The IASB considered whether additional disclosure requirements should be introduced in the light of the proposed clarification to the assessment of the contractual cash flow characteristics. The IASB noted that if the judgements made in assessing the contractual cash flow characteristics are significant and have a significant effect on the amounts recognised in the financial statements, regardless of whether the economic relationship is modified, disclosure of that fact would be required by paragraph 122 of IAS 1 *Presentation of Financial Statements*. The IASB noted that this disclosure might be required, for example, in cases where large volumes of products are issued with a modified economic relationship. The IASB decided to reinforce the general requirement in paragraph 122 of IAS 1 by adding the assessment of the contractual cash flow characteristics of financial assets to the existing list of examples in paragraph 123 of IAS 1.

Contractual cash flow characteristics of financial assets mandatorily measured at fair value through other comprehensive income

BC46 As discussed in paragraphs BC17–BC30, the IASB decided to add a fair value through other comprehensive income measurement category to IFRS 9, and that, subject to the assessment of the business model, a financial asset will be mandatorily measured at fair value through other comprehensive income if, and only if, its contractual cash flows are solely payments of principal and interest. Some interested parties expressed the view that entities should be permitted to classify financial assets in the fair value through other comprehensive income measurement category even if the assets' contractual cash flows are not solely payments of principal and interest, for example, if they contain features such as an equity or commodity link. The IASB believes, however, that it would not be appropriate to classify such instruments in the fair value through other comprehensive income measurement category. The main reason for this decision was that the fair value through other comprehensive income measurement category provides amortised cost information in profit or loss and consequently the same considerations for requiring the contractual cash flow characteristics assessment would apply to this measurement category as those that apply to the amortised cost measurement category. In particular, paragraph BC4.23 of IFRS 9 explains that the effective interest method is not an appropriate method to allocate cash flows that are not principal or interest on the principal amount outstanding. In addition, to do otherwise would be to ignore the assessment of some assets' contractual cash flow characteristics. This would be inconsistent with the classification and measurement model for financial assets. It would also require significant changes to IFRS 9, which would go beyond the scope of the limited amendments, and would not minimise the extent of the proposed changes as desired by the IASB given the time and effort already invested by some entities in implementing IFRS 9.

Investments in contractually linked instruments (tranches)

BC47 In accordance with IFRS 9, investments in contractually linked instruments (tranches) may have contractual cash flows that are solely payments of principal and interest if (in summary):

(a) the contractual cash flows of the tranche give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding;

(b) the underlying pool of financial assets has cash flows that are solely principal and interest, or they reduce cash flow variability; and

(c) the tranche being assessed does not have greater exposure to credit risk than the exposure of the underlying assets.[19]

BC48 As a result of these specific criteria in IFRS 9 related to tranches, the IASB received questions about whether a tranche could have contractual cash flows that are solely payments of principal and interest if the tranche is prepayable

19 Paragraphs B4.1.20–B4.1.26 and BC4.26–BC4.36 of IFRS 9 provide additional detail.

contingent upon a prepayment occurring in the underlying pool of assets. The IASB noted that a key principle underlying the contractual cash flow provisions for contractually linked instruments was that an entity should not be disadvantaged simply by holding an asset indirectly if the underlying asset has cash flows that are solely principal and interest and the holding is not subject to more-than-insignificant leverage or a concentration of credit risk relative to the underlying assets. Accordingly, the IASB clarified that a tranche may have contractual cash flows that are solely payments of principal and interest even if:

(a) the tranche is prepayable contingent on a prepayment occurring in the underlying pool. Because the underlying assets must have contractual cash flows that are solely principal and interest, by definition any prepayment features in the underlying assets must be consistent with solely principal and interest.

(b) financial assets in the underlying pool are collateralised by assets that do not meet the qualifying conditions for measurement at amortised cost. In such cases, the possibility that the pool may contain the collateral in the future should be disregarded unless the instrument was acquired with the intention of controlling the collateral. This is consistent with the manner in which collateral underlying financial assets is considered more generally for classification purposes, ie that a financial asset that is collateralised can still have payments that consist solely of principal and interest.

Bifurcation of embedded features

BC49 In accordance with IFRS 9, financial assets are not assessed for bifurcation. Instead, financial assets are classified in their entirety on the basis of their contractual cash flow characteristics (and the business model). However, IFRS 9 retains the bifurcation requirements in IAS 39 for financial liabilities.

BC50 After the issue of IFRS 9, some interested parties continued to express support for the IASB's approach to bifurcation in IFRS 9.

BC51 Others expressed the view that bifurcation should be reintroduced for financial assets. Much of this feedback was similar to some that was received in developing IFRS 9 (paragraph BC4.88 of IFRS 9). They cited reasons why bifurcation is needed for financial assets, including:

(a) components of some financial assets are managed separately, so bifurcation may provide more relevant information to users of financial statements;

(b) a relatively insignificant feature could result in a financial asset being measured at fair value through profit or loss in its entirety; and

(c) symmetry in bifurcating financial assets and financial liabilities is of primary importance. Consequently, because the IASB retained bifurcation for financial liabilities, financial assets should also be bifurcated.

BC52 In addition, some took the view that IFRS 9 inappropriately classified some financial assets at fair value through profit or loss (including financial assets

with interest rate mismatches and/or leverage) and believed that bifurcation would improve the classification of those assets. The IASB believes that the questions about the application of the contractual cash flow characteristics assessment for some financial assets with interest rate mismatches and/or leverage could be resolved by clarifying the application guidance on the cash flow characteristics as described in paragraph BC42–BC43.

BC53 The boards jointly considered whether bifurcation should be pursued for both, or either, financial assets and financial liabilities and, if so, what the basis for bifurcation should be. In the joint deliberations, three approaches to bifurcation were considered:

(a) no bifurcation;

(b) 'closely-related' bifurcation (ie bifurcation using the 'closely related' bifurcation criteria that were contained in IAS 39 and were retained for financial liabilities in IFRS 9); and

(c) 'principal-and-interest' bifurcation.

In assessing these approaches, the boards considered whether they were appropriate for both, or either, financial assets and financial liabilities. For the reasons described in the following paragraphs and consistent with the existing requirements in IFRS 9 for the IASB, the boards jointly decided upon a no-bifurcation approach for financial assets, and to retain their respective existing closely-related bifurcation approaches for financial liabilities. For the IASB, the approach to bifurcation was thus unchanged from IFRS 9, and no changes to bifurcation are proposed in this Exposure Draft.

No bifurcation of embedded features

BC54 A no-bifurcation approach for financial assets is consistent with IFRS 9, which requires an assessment of the contractual cash flows of financial assets in their entirety. In considering this approach, the IASB noted its rationale in IFRS 9 for not bifurcating financial assets (paragraphs BC4.83–BC4.90 of IFRS 9). In developing that rationale, the feedback that the IASB considered was similar to the feedback it has continued to receive from some interested parties, which is described in paragraph BC51.

BC55 In contrast, the IASB noted that if financial liabilities were not bifurcated, more financial liabilities would be measured at fair value through profit or loss, including the host component of financial liabilities that are currently measured at amortised cost. By bifurcating financial liabilities, far fewer non-derivative financial liabilities are measured at fair value through profit or loss. It is the effect of remeasuring non-derivative liabilities at fair value (reflecting changes in the entity's own credit risk) that has been raised as the greatest concern by users of financial statements. In order to address the issue of own credit risk for financial liabilities (which is relevant only to financial liabilities), IFRS 9 retains bifurcation for financial liabilities (paragraph BC4.91 of IFRS 9).

BC56 In addition, feedback has indicated that different information is useful in assessing the amounts, timing and uncertainty of future cash flows from financial liabilities than from financial assets (paragraphs BC4.49 and BC4.89(c)

of IFRS 9). Unlike the difficulty with applying closely-related bifurcation to financial assets, this feedback indicated that the closely-related bifurcation approach works well in practice for financial liabilities.

Closely-related bifurcation

BC57 Although the closely-related bifurcation approach works well for financial liabilities, the IASB noted that the assessment of the contractual cash flow characteristics of financial assets and the closely-related bifurcation approach do not align well. If both the contractual cash flow characteristics assessment and the closely-related bifurcation approach were to be required, the question of which one to apply first would arise. The boards discussed the following possible sequence:

(a) First, the contractual cash flow characteristics of a financial asset would be assessed to determine whether they are solely principal and interest.

(b) If the contractual cash flows were solely payments of principal and interest, the financial asset could be classified in any measurement category, depending on the business model. No further analysis would be necessary.

(c) If the contractual cash flows were not solely payments of principal and interest, embedded features within the financial asset would be assessed for bifurcation under the existing bifurcation requirements (the closely-related requirements), including whether their economic characteristics and risks are closely related to the economic characteristics and risks of the rest of the financial asset.[20] An embedded feature that met the criteria for bifurcation in IAS 39 would be bifurcated and separately accounted for as a derivative at fair value through profit or loss. In contrast, an embedded feature that did not meet the criteria for bifurcation would not be bifurcated from the rest of the financial asset.

BC58 The IASB considered the application of this assessment to two financial assets with the following characteristics:

(a) One financial asset whose contractual cash flow characteristics would be solely principal and interest, except that it contains an embedded derivative that is not consistent with principal and interest or closely related to the rest of the financial asset; and

20 In accordance with paragraph 11 of IAS 39, an embedded derivative is separated (bifurcated) from the 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 host contract;
(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
(c) 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).

(b) another financial asset with the same characteristics as the first (ie its contractual cash flows are not solely principal and interest), except that the embedded derivative is closely related to the rest of the financial asset.

BC59 The embedded derivative would have been bifurcated from the first financial asset and measured at fair value through profit or loss, and the rest of the financial asset could have been measured at amortised cost or fair value through other comprehensive income, depending on the business model. The IASB considered whether the second financial asset should be measured in its entirety:

(a) at fair value through profit or loss, because its contractual cash flows are not solely principal and interest; or

(b) at amortised cost, fair value through other comprehensive income or fair value through profit or loss, depending on the business model because the embedded derivative is closely related to the rest of the financial asset.

BC60 The IASB noted that the classification outcome in paragraph BC59(a) is counter-intuitive. For example, a debt instrument with a leveraged interest rate of 1.75 times LIBOR would be measured at fair value through profit or loss in its entirety. At the same time, a debt instrument whose contractual cash flows are linked to an equity or commodity price would be bifurcated and thus the host would be measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss (depending on the business model), and only the equity or commodity indexed feature would be measured at fair value through profit or loss. In other words, a 'simpler' financial asset (ie one with closely related embedded derivatives) could be classified and measured at fair value through profit or loss in its entirety, whereas a more complex financial asset (ie one with embedded derivatives that are not closely related) could be bifurcated.

BC61 However, the classification outcome in paragraph BC59(b) would also be troublesome because it would effectively override the contractual cash flow characteristics assessment. To illustrate using the same simple example, depending on the business model, the debt instrument with the interest rate of 1.75 times LIBOR could be measured at amortised cost or fair value through other comprehensive income, even though its cash flows do not consist of principal and interest. Consequently, the IASB concluded that, overall, combining the concept of solely principal and interest with closely-related bifurcation would be complicated and might give rise to contradictory outcomes.

BC62 As noted in paragraphs BC55–BC56, feedback received by the IASB has supported the closely-related bifurcation approach for financial liabilities and this approach has therefore been retained in IFRS 9 (paragraph BC4.91 of IFRS 9).[21]

21 The notion of solely principal and interest is not used for financial liabilities so the complication of the interaction with closely related bifurcation does not arise.

'Principal-and-interest' bifurcation

BC63 Under the principal-and-interest bifurcation approach, if a financial instrument had cash flows that are not solely payments of principal and interest, the instrument would be assessed to determine whether it should be bifurcated into:

(a) a host contract with cash flows that are solely payments of principal and interest; and

(b) an embedded residual feature.

BC64 The host contract could qualify for a measurement category other than at fair value through profit or loss, depending on the business model. The embedded feature would be measured at fair value through profit or loss. This approach is different to the approach in IFRS 9 for both financial assets and financial liabilities.

BC65 The IASB also considered variations of a principal-and-interest bifurcation approach whereby bifurcation would be conditional on:

(a) the embedded feature meeting the definition of a derivative; or

(b) the components being separately managed.

If these conditions were not met, the financial instrument would be measured at fair value through profit or loss in its entirety.

BC66 The IASB noted that in many, if not most, cases, the embedded feature would meet the definition of a derivative and would often result in bifurcation of components similar to those that are bifurcated under current requirements. If the embedded feature were required to be a derivative, it would provide greater comparability in the application of the bifurcation guidance and limit opportunities for entities to achieve particular accounting outcomes (for example, by selecting the features it would treat as part of the host and what would be left as the residual).

BC67 Feedback from some interested parties indicated that a hybrid instrument can be managed either as a single unit of account or as more than one unit of account. They believe that bifurcation based on separate management of components would result in more useful information being provided and provide discipline in how bifurcation is achieved. Some who hold this view believe that a hybrid contract should be bifurcated only if the components are separately managed. When a hybrid instrument is managed in its entirety, it represents a single unit of account and, therefore, bifurcation may not provide the most relevant information to users of financial statements.

BC68 The IASB noted that a principal-and-interest bifurcation approach that is based on the separate management of the components of an instrument would be an instrument-by-instrument assessment of the management of financial instruments. This would be inconsistent with the assessment of the business model that requires the management of financial assets to be assessed at a higher level of aggregation. It would also introduce an additional 'management' concept into the model.

BC69 The IASB noted that a principal-and-interest bifurcation approach, including variants on such an approach, might, in principle, be more compatible with the requirement to assess whether the contractual cash flow characteristics of financial assets are solely payments of principal and interest than would a closely-related approach. However, because a principal-and-interest bifurcation approach would have introduced new concepts into classification and measurement for both financial assets and financial liabilities, it would have raised questions about how the host contract and embedded feature should be defined and measured, and would have introduced the risk of unintended consequences. In addition, if it were pursued for financial liabilities, the principal-and-interest bifurcation approach would have required principal-and-interest-based classification requirements to be developed for financial liabilities. While many cite the current bifurcation requirements in IAS 39 as one of the greatest sources of complexity in the accounting for financial instruments, practice has developed and both preparers and users of financial statements understand the current requirements for financial liabilities.

Consideration of approaches for financial assets and financial liabilities

BC70 The IASB considered which of the three approaches discussed above would result in the most useful and relevant information for both, or either, financial assets and financial liabilities.

BC71 In order to decide on the approach in the light of the considerations raised in the preceding paragraphs, the IASB noted that a no-bifurcation approach works well for financial assets and was supported by most parties. However, the same was not considered to be true for financial liabilities (paragraphs BC54–BC56). The IASB also noted that the accounting for financial liabilities in IFRS 9, including the own credit requirements, are well supported. Also, a closely-related bifurcation approach works well for financial liabilities but does not align with the contractual cash flow characteristics assessment for financial assets (paragraphs BC57–BC62). A principal-and-interest bifurcation approach might work for financial assets, but would require a change in practice with largely similar outcomes for financial liabilities, and would have introduced new concepts and the risk of unintended consequences for both financial assets and financial liabilities (paragraphs BC63–BC69). The IASB also noted that the project to consider limited amendments to IFRS 9 was limited in scope and that no new information about the accounting for financial liabilities had been brought to their attention.

BC72 Consequently, consistent with IFRS 9 the IASB decided to continue to require the closely related bifurcation approach for financial liabilities and not to require or permit bifurcation for financial assets.

Other proposed amendments

BC73 As a result of the proposed introduction of the fair value through other comprehensive income measurement category in IFRS 9, the IASB considered the following interrelated issues for such instruments:

(a) availability of the existing fair value option in IFRS 9;

(b) reclassification; and

(c) presentation and disclosure requirements.

Fair value option for financial assets mandatorily measured at fair value through other comprehensive income

BC74 In accordance with IFRS 9, entities are permitted to designate financial assets that would otherwise be measured at amortised cost as measured at fair value through profit or loss if, and only if, such designation eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch'). Such designation is available at initial recognition and is irrevocable. The IASB decided that the same fair value option in IFRS 9 should be available for financial instruments that would otherwise be measured at fair value through other comprehensive income, for the same reasons that apply to financial assets measured at amortised cost (paragraph BC4.79 of IFRS 9).

Reclassifications into and out of the fair value through other comprehensive income measurement category

BC75 For the same reasons as noted in the Basis for Conclusions to IFRS 9,[22] the IASB decided that reclassification requirements should also apply to financial assets mandatorily measured at fair value through other comprehensive income. That is, all affected financial assets will be required to be reclassified into or out of the fair value through other comprehensive income measurement category when, and only when, the entity changes its business model for managing financial assets. The IASB noted that the number of measurement categories does not affect the rationale for the reclassification requirements in IFRS 9. Consistent with the existing requirements in IFRS 9, the IASB decided that reclassifications into and out of the fair value through other comprehensive income measurement category should be prospective, and that previously recognised gains, losses or interest should not be restated.

BC76 The IASB noted that, because amortised cost information is provided in profit or loss for financial assets mandatorily measured at fair value through other comprehensive income (paragraph BC22), reclassifications between the amortised cost and fair value through other comprehensive income measurement categories should not change the recognition of interest revenue. That is, the entity would have established the effective interest rate when the financial asset was originally recognised and would continue to use that rate after the financial asset is reclassified.

BC77 The IASB also considered disclosure requirements for reclassifications into and out of the fair value through other comprehensive income measurement category. The IASB noted that paragraphs 12B–12D of IFRS 7 set out disclosure requirements for reclassifications of financial assets between the fair value through profit or loss and amortised cost measurement categories under IFRS 9. The IASB decided that these disclosures would likewise be useful for, and should

22 Paragraphs BC4.111–BC4.120 of IFRS 9.

apply to, reclassifications into and out of the fair value through other comprehensive income measurement category.

Presentation and disclosure requirements for financial assets mandatorily measured at fair value through other comprehensive income

BC78 The IASB considered presentation and disclosure requirements for financial assets mandatorily measured at fair value through other comprehensive income under the proposals in the Exposure Draft. As discussed in paragraph BC22, the IASB decided that amortised cost information in profit or loss is relevant for financial assets mandatorily measured at fair value through other comprehensive income. Consequently, the same impairment and interest revenue recognition methods would be required for such financial assets as for financial assets measured at amortised cost. Likewise, the IASB decided that, in principle, the same presentation and disclosure requirements should be applied to these two measurement categories. Accordingly, the IASB decided that the impairment disclosures for financial assets mandatorily measured at fair value through other comprehensive income should be consistent with those for assets measured at amortised cost, including disclosure of an accumulated impairment amount.

BC79 However, the IASB noted that, by definition, financial assets mandatorily measured at fair value through other comprehensive income are recognised at fair value on the statement of the financial position, and that presentation of an accumulated impairment amount on the statement of financial position would be a departure from that fair value carrying amount. Consequently, the IASB decided to prohibit the presentation of an accumulated impairment amount on the face of the statement of financial position for financial assets mandatorily measured at fair value through other comprehensive income.

BC80 The IASB considered whether to add to IAS 1 a requirement to separately present in the statement of comprehensive income gains or losses on sales of financial assets mandatorily measured at fair value through other comprehensive income. The IASB noted that paragraph 82(aa) of IAS 1 requires such separate presentation for financial assets measured at amortised cost. That requirement was introduced to ensure transparency and provide discipline around sales out of the amortised cost measurement category. However, financial assets are mandatorily measured at fair value through other comprehensive income because they are held within a business model in which assets are managed both for the collection of contractual cash flows and for sale. Consequently, because sales out of this measurement category are part of the business model, the IASB decided not to require separate presentation of gains or losses on such sales in the statement of comprehensive income. In addition, the IASB noted that this information will be available to users of financial statements. That is because paragraph 7 of IAS 1 requires entities to disclose reclassification adjustments of components of equity, one of which will be gains or losses on financial assets mandatorily measured at fair value through other comprehensive income upon derecognition.

Transition

Transition to the proposed amendments to the business model assessment

BC81 In accordance with the existing transition provisions in IFRS 9, the business model assessment is performed on the basis of facts and circumstances that exist on the date of initial application of IFRS 9. The IASB noted that the proposals in this Exposure Draft do not have any implications on the ability to assess the business model at the date of initial application of IFRS 9.

BC82 The resulting classification is required to be applied retrospectively. The IASB noted that this requirement would also be appropriate for the fair value through other comprehensive income measurement category. Accordingly, the IASB did not propose any amendments to this requirement.

Transition to the proposed amendments to the contractual cash flow characteristics assessment

BC83 In accordance with the existing transition provisions in IFRS 9, when IFRS 9 is initially applied, the assessment of the contractual cash flow characteristics is based on the facts and circumstances that existed at the initial recognition of the financial asset, and the resulting classification is applied retrospectively. As discussed in paragraphs BC37–BC45, the proposals in this Exposure Draft would clarify how the assessment of contractual cash flow characteristics in IFRS 9 would be applied. The IASB noted that assessing the contractual cash flow characteristics in accordance with IFRS 9 already requires judgement but acknowledged that the proposed clarification introduces a greater degree of judgement and presents a greater risk that hindsight will be used when the assessment is required of whether the modification in economic relationship is more than insignificant. Accordingly, in the light of the proposed amendment to the contractual cash flow characteristics assessment, the IASB concluded that it should address situations when it is impracticable (for example, due to the risk of using hindsight) to make the assessment based on the terms of the financial asset and other relevant facts and circumstances that existed at initial recognition of the financial asset.

BC84 The IASB considered the following alternatives to deal with this issue:[23]

(a) assess the contractual cash flow characteristics using the clarified criteria as of the earliest period practicable, as would be required by paragraph 24 of IAS 8 in the absence of specific transition provisions;

(b) assess the contractual cash flow characteristics using the clarified criteria based on the terms of the financial asset and the facts and circumstances at the date of initial application of IFRS 9; and

23 These transition alternatives would be different to the way the contractual cash flow characteristics of other financial assets are assessed at the date of initial application of IFRS 9 (and on an ongoing basis under IFRS 9).

(c) assess the contractual cash flows as at initial recognition using the criteria in IFRS 9 (2010). If an entity were unable to conclude that they were solely payments of principal and interest in accordance with the criteria in IFRS 9 (2010), the instrument would be measured at fair value through profit or loss.

BC85 In deciding between the alternatives, the IASB noted that the assessment of the contractual cash flow characteristics should not be performed other than at the date of initial recognition of the financial asset. This would result in an outcome that was inconsistent with the principle in IFRS 9, which requires contractual cash flows to be assessed as at initial recognition with no subsequent reassessment (and this requirement also applies at transition to IFRS 9). The first two alternatives are not consistent with that principle; however, the third alternative would be consistent with the existing principle (and transition provisions) in IFRS 9. Consequently, the IASB proposes that in cases where it is impracticable to apply the clarified criteria at the date of initial application of IFRS 9, an entity would be required to make the contractual cash flow characteristics assessment using the criteria in IFRS 9 (2010).

BC86 The IASB considered whether additional disclosures should be required because of this proposed amendment to the transition provisions. However, the IASB noted that paragraph 28(h) of IAS 8 already requires disclosures when retrospective application, in accordance with the requirements of a Standard, is impracticable upon initial application of that Standard.

BC87 In addition, the IASB noted that disclosure of the carrying values of the financial assets whose contractual cash flows have been assessed under IFRS 9 (2010) rather than the clarified version due to impracticability would provide useful information and enhance comparability. Accordingly, the IASB decided that entities should be required to disclose, until the affected financial assets are derecognised, the carrying values of the financial assets whose contractual cash flows have been assessed under IFRS 9 (2010) rather than the clarified assessment proposed in this Exposure Draft.

Fair value option

BC88 The IASB considered the existing transition provisions in IFRS 9 for the fair value option in the light of the limited amendments to IFRS 9. When the classification and measurement requirements for financial assets are initially applied, entities are both:

(a) permitted to reconsider their fair value option elections for both financial assets and financial liabilities—that is, to elect to apply the fair value option even if an accounting mismatch already existed before the date of initial application and/or revoke the fair value option even if an accounting mismatch continues to exist; and

(b) required to revoke their fair value option elections for both financial assets and financial liabilities if an accounting mismatch no longer exists at the date of initial application.

BC89 The transition provision described in the previous paragraph is available only once when the entity initially applies the classification and measurement

requirements for financial assets.[24] Consequently, this transition provision would still be available to entities who have not yet applied IFRS 9. In the deliberations leading to the publication of this Exposure Draft, the IASB noted that entities that apply IFRS 9 (2009) and/or IFRS 9 (2010) before they apply the limited amendments to IFRS 9 will have already applied this transition provision. However, the application of the amended classification and measurement requirements could cause the measurement attribute of some financial assets to change and, consequently, accounting mismatches could also change. Accordingly, the IASB considered whether such entities should be permitted or required to re-consider the existing fair value option elections when they apply the limited amendments to IFRS 9.

BC90 The IASB noted that permitting entities to reconsider all of their fair value option elections again would undermine the irrevocable nature of these elections. The fair value option is generally only available at initial recognition and is irrevocable so that entities are unable to 'cherry pick' their designations to achieve a desired result in profit or loss. However, the IASB did not consider that the 'cherry picking' concern would be relevant if the entities were permitted to apply the fair value option only as a result of changes in accounting mismatches created by the initial application of the limited amendments. Additionally, the IASB noted that requiring entities to revoke their fair value option elections when an accounting mismatch no longer exists would prevent one-sided profit or loss effects until the position that continues to be measured at fair value is derecognised, which could be for a long period of time.

BC91 Consequently, the IASB decided that entities that have already applied IFRS 9 (2009) and/or IFRS 9 (2010) before they apply the limited amendments to IFRS 9 should be:

(a) permitted to apply the fair value option to new accounting mismatches created by the initial application of the amended classification and measurement requirements; and

(b) required to revoke previous fair value option elections if an accounting mismatch no longer exists as a result of the initial application of the amended classification and measurement requirements.

Early application

BC92 In accordance with the existing transition provisions in IFRS 9, entities are permitted to early apply IFRS 9. If they choose to do so, they are required to apply all requirements issued prior to those that they choose to early apply, but they are not required to apply subsequent requirements until the mandatory effective date. The IASB considered whether entities should continue to be permitted to early apply previous versions of IFRS 9 after the completed version of IFRS 9 is issued (ie when the Classification and Measurement, Impairment and General Hedge Accounting chapters are completed).

24 Paragraphs BC7.19 and BC7.27–BC7.28 of IFRS 9 discuss the reason that the fair value option transition provision is available only once.

BC93 The IASB noted that having multiple versions of IFRS 9 available for application (in addition to IAS 39) reduces comparability for users of financial statements. The IASB therefore decided that early application of these limited amendments would not be permitted. Furthermore, the IASB decided that six months after the completed version of IFRS 9 is issued, previous versions of IFRS 9 should no longer be available to be newly early applied. However, those entities that had already applied a previous version of IFRS 9 could continue to apply that version. The IASB also decided that early application should continue to be permitted but that, once the completed version of IFRS 9 is issued, all chapters must be applied at once.[25] In considering this issue, the IASB noted that the fair value through other comprehensive income measurement category proposed in this Exposure Draft has been designed to be applied with the same impairment model as that applied to financial assets measured at amortised cost and therefore the proposed amendments to IFRS 9 and the new impairment model are best applied together as a package.

BC94 In making these decisions, the IASB noted that the phased approach (including transition) was originally developed in response to requests from the G20 and the Financial Stability Board that improvements to the accounting for financial instruments should be available quickly, and for this reason the classification and measurement requirements in IFRS 9 were issued before impairment and hedge accounting were completed. Once all of the phases are complete, the IASB noted that the decrease in comparability and the complexity of continuing to permit a phased approach to transition would not be justified because the completed version of IFRS 9 would be available for early application.

BC95 In addition, the IASB decided that phased early application of IFRS 9 would be prohibited effective six months after the completed version of IFRS 9 is issued. This was to minimise the cost and disruption to entities that are preparing to apply IFRS 9 at the time it is being issued.

Presentation of 'own credit' gains or losses on financial liabilities

BC96 IFRS 9 (2010) requires that the effects of changes in the credit risk of financial liabilities designated under the fair value option are presented in other comprehensive income unless such treatment would create or enlarge an accounting mismatch in profit or loss. Those amounts presented in other comprehensive income are not subsequently recycled to profit or loss. The IASB developed the 'own credit' requirements to respond to widespread concerns about the effects of changes in a financial liability's credit risk affecting profit or loss whilst an entity will generally not realise these effects unless the liability is held for trading.

BC97 Some respondents to the Exposure Draft that preceded IFRS 9 (2010) urged the IASB to finalise the proposals as an amendment to IAS 39, rather than add the proposals to IFRS 9. At that time, the IASB decided that it would be inappropriate to amend IAS 39 while it was in the process of replacing it.

25 Except for the presentation of 'own credit' gains or losses on financial liabilities, which would be available for early application under the proposals in this Exposure Draft (paragraphs BC97–BC107).

BC98 The transition requirements in IFRS 9 (2010) require that if an entity elects to early apply the classification and measurement requirements for financial liabilities, it must also apply the classification and measurement requirements for financial assets at the same time. As a result of the IASB's decision in November 2011 to consider limited amendments to IFRS 9, entities that have not already applied the classification and measurement requirements of IFRS 9 are less likely to consider early applying IFRS 9 before the limited amendments to IFRS 9 are issued.

BC99 Since the publication of IFRS 9 (2010), requests for the IASB to accelerate the application of the own credit requirements have intensified. That is because markets continue to be volatile and own credit gains or losses remain significant, which accentuates the concerns about the usefulness of reporting gains when an entity is experiencing deterioration in its own credit quality.

BC100 As discussed in paragraphs BC92–BC95, the IASB decided that six months after the completed version of IFRS 9 is issued, entities will no longer be permitted to newly early apply previous versions of IFRS 9. Entities wishing to apply the amended classification and measurement requirements will therefore have to wait until the completed version of IFRS 9 is issued (and entities have developed and implemented the necessary impairment systems) before they are able to apply the classification and measurement requirements. That effectively makes the availability of the own credit requirements for early application dependent on the implementation of an expected loss impairment model. Consequently, the IASB considered whether the own credit requirements in IFRS 9 should be made available more quickly.

BC101 The IASB considered the following possible approaches to address the concerns about the availability of the own credit requirements for early application:

(a) do not permit the own credit requirements to be applied in isolation (ie no acceleration);

(b) amend IAS 39 to incorporate the own credit requirements;

(c) modify the early application guidance in IFRS 9 (2010) and later versions of IFRS 9 to permit the early application of the own credit requirements in isolation; or

(d) once the completed version of IFRS 9 is issued, permit the early application of the own credit requirements in isolation.

BC102 The IASB noted that the approach in BC101(a) would result in greater comparability and would be consistent with eliminating the phased application of IFRS 9. In addition, paragraph 10 of IFRS 7 already requires disclosure of the changes in own credit risk, during the period and cumulatively, for financial liabilities designated as at fair value through profit or loss in accordance with IAS 39. The IASB further observed that preparers also often provide non-GAAP information that adjusts for the changes in own credit risk. The IASB acknowledged that although this is not an ideal situation, it is a process that is fairly well understood by both preparers and users of financial statements and results in the users of financial statements understanding the effect of own

credit risk. However, given the considerations in paragraphs BC96–BC100, the IASB decided to make the own credit requirements available for early application in isolation.

BC103 The IASB noted that the approaches in paragraphs BC101(b)–(d) would all have a similar outcome—in effect, the accounting for financial instruments would continue as in IAS 39 except that the accounting for own credit risk would be changed. The difference would be in the steps needed to achieve the outcome and the likely time to completion. These approaches would all reduce comparability between entities during the time leading up to the mandatory effective date of IFRS 9.

BC104 The IASB noted that the approach in BC101(b) would insulate the application of the own credit requirements from the overall IFRS 9 timeline and would be consistent with the recommendations made by a number of interested parties. However, the IASB reiterated that it no longer intends to make changes to IAS 39 while it is in the process of replacing it. Furthermore, the own credit requirements were developed within the context of IFRS 9 and so would require more changes to IAS 39 than simply inserting the own credit requirements. This also carries the risk of causing unintended consequences as a result of the amendment.

BC105 The IASB also noted that the approaches in paragraphs BC101(c)–(d) would have a similar effect, ie allowing an entity to only change the presentation of own credit gains or losses while continuing to otherwise account for financial instruments in accordance with IAS 39. However, both of these approaches would be inconsistent with the IASB's decision to eliminate the phased implementation of IFRS 9. The IASB noted that an advantage of the approach in paragraph BC101(d) is that, if a jurisdiction only wants to adopt IFRS 9 when fully complete, this approach is more appropriate so that entities within that jurisdiction would be able to early apply only the own credit requirements similarly to other entities outside that jurisdiction.

BC106 The IASB acknowledged that a disadvantage of the approach in paragraph BC101(d) is that the early application relief will only be available once the remaining phases of IFRS 9 have been issued. However, the IASB does not anticipate that the time difference between completion of the approaches in BC101(c)–(d) would be significantly different. Consequently, based on current circumstances, the IASB decided on the approach in paragraph BC101(d). The IASB decided to take this approach because the own credit requirements would be available for early application in isolation roughly as soon as they would be available if these requirements were instead added to IFRS 9 (2010). By exposing the proposal as part of this Exposure Draft, the IASB noted that it would still be possible to change this approach if necessary.

Transition disclosures

BC107 As part of these proposals, the IASB decided to specify the quantitative disclosures that would be required upon initial application of the new classification and measurement requirements for financial instruments rather than relying on the general quantitative disclosure requirements of other

Standards. Consequently, the IASB decided to limit the quantitative transition disclosures to those contained in IFRS 7.

Prior periods

BC108 In accordance with IFRS 9, comparative periods need not be restated when the classification and measurement requirements are initially applied.[26] The IASB noted that it would be inconsistent to provide comparative relief for the classification and measurement requirements while requiring disclosure of restated line-item amounts under IFRS 9 for the comparative period. Consequently, the IASB confirmed that in the period in which IFRS 9 is initially applied, disclosure of the line item amounts that would have been reported in prior periods in accordance with the classification and measurement requirements in IFRS 9 should not be required.

Current period

BC109 The IASB considered three primary factors in evaluating whether each line item should be required to be reported in accordance with the classification and measurement requirements in both IFRS 9 and IAS 39 in the current period when those requirements in IFRS 9 are initially applied. These factors are:

(a) the usefulness of the disclosures;

(b) the cost of providing such disclosures; and

(c) whether the existing transition disclosure requirements are sufficient and enable users of financial statements to assess the effect of transition.

BC110 In assessing the usefulness of this disclosure, the IASB considered the interaction between classification and measurement and hedge accounting at transition. The concept of hedge accounting does not lend itself to assumptions about what hedge accounting (under IAS 39) might have been, because hedge accounting is an elective accounting treatment that allows the resolution of accounting mismatches. In order to apply hedge accounting, an entity must make that election and then, if the hedging relationship meets the qualifying criteria, prospectively applies hedge accounting. In accordance with IAS 39, an entity can also discontinue hedge accounting at any time and without giving any reason. This means that any IAS 39-based hedge accounting information 'as if applied in the current period' would be based on highly speculative assumptions that could distort comparability. Consequently, the IASB confirmed that considering hedge accounting in accordance with IAS 39 in the period during which hedge accounting in accordance with IFRS 9 is first applied would not be appropriate. This means that a line-item disclosure provided for classification and measurement in the current period in accordance with IAS 39 would be essentially incomplete as it would not give a true picture of IFRS 9 relative to IAS 39. The IASB also noted that requiring disclosure of IAS 39 amounts in the current period would require entities to incur the costs of running parallel systems, which would be onerous for preparers.

26 However, an entity would be permitted to restate prior periods if it were possible to do so without the use of hindsight.

BC111 Lastly, the IASB noted that IFRS 7 already includes modified transition disclosure requirements that focus on changes in the statement of financial position at the date of initial application of IFRS 9 and the effect on the key financial statement line items for the current period. The IASB believes that these disclosures will allow users of financial statements to assess the effect of transition to IFRS 9. In addition, the IASB noted that users of financial statements provided favourable feedback on these disclosures because these disclosures provide the necessary information to explain the transition (paragraphs BC7.35I–BC7.35J of IFRS 9).

BC112 Consequently, the IASB decided that in the period in which IFRS 9 is initially applied, disclosure of the current-period line-item amounts that would have been reported in accordance with the classification and measurement requirements in IAS 39 should not be required.

First-time adopters of IFRS

BC113 The IASB noted that the transition provisions to IFRS 9 for entities that apply IFRS for the first time should generally be the same as for entities already applying IFRS. However, the IASB acknowledged that there are unique considerations for first-time adopters. This is because the date of initial application of IFRS 9 for a first-time adopter is defined as the date of transition to IFRS and, according to IFRS 1 *First-time Adoption of International Financial Reporting Standards*, consistent accounting policies are required to be applied throughout an entity's first IFRS financial statements. Consequently, in order to apply IFRS 9 in its first IFRS financial statements, a first-time adopter must present all of the periods in those financial statements in accordance with IFRS 9. This requirement may cause extra challenges for first-time adopters because retrospectively applying some aspects of the completed version of IFRS 9 (especially impairment) would be impracticable due to the risk of hindsight if those requirements were not actually applied during the reporting periods covered by the first IFRS financial statements. Consequently, a first-time adopter may be unable to apply the completed version of IFRS 9 in its first IFRS financial statements. Accordingly, the IASB intends to reconsider transition to IFRS 9 for first-time adopters once the re-deliberations of these proposed limited amendments to IFRS 9 and the Impairment project progress sufficiently to make sure that first-time adopters of IFRS are given adequate lead time to apply IFRS 9 and are not at a disadvantage in comparison to existing preparers.

Analysis of the effects of this Exposure Draft

Introduction

BC114 The following paragraphs describe the IASB's analysis of the likely effects that will result from the amendments proposed by this Exposure Draft (the 'proposals') to the classification and measurement requirements for financial instruments in IFRS 9 *Financial Instruments* (issued October 2010)—hereafter referred to as IFRS 9. The effects analysed relate only to the proposals rather than to IFRS 9 more generally. However, because the proposals would amend aspects of IFRS 9, some of the requirements of IFRS 9 are relevant to the effects of the proposals and are therefore discussed when it is necessary to provide context to this analysis.

BC115 The IASB is committed to assessing and sharing knowledge about the likely costs of implementing proposed new requirements and the likely, associated ongoing costs and benefits of each new Standard—these costs and benefits are collectively referred to as 'effects'. The IASB gains insight on the likely effects of the proposals for new or revised Standards through its formal exposure of proposals and through its analysis and consultations with relevant parties through outreach activities.

BC116 In evaluating the likely effects of the proposals, the IASB has considered how:

(a) activities would be reported in the financial statements of those applying IFRS;

(b) comparability of financial information would be improved between different reporting periods for an individual entity and between different entities in a particular reporting period;

(c) the new approach would improve the usefulness of the financial information in assessing the future cash flows of an entity;

(d) more useful financial reporting would result in better economic decision-making;

(e) the compliance costs for preparers would likely be affected, both on initial application and on an ongoing basis; and

(f) the likely costs of analysis for users of financial statements (including the costs of extracting data, identifying how the data has been measured and adjusting data for the purposes of including them in, for example, a valuation model) would be affected.

How activities would be reported in the financial statements of those applying IFRS

Approach to classifying financial assets

BC117 After IFRS 9 was issued, it came to the IASB's attention that there were different views of applying the 'hold to collect' business model that result in measuring financial assets at amortised cost. Consequently, the IASB is proposing a clarification of the 'hold to collect' business model (paragraphs B4.1.9–B4.1.9E).

BC118 In addition, the IASB proposes to add a third measurement category to IFRS 9 that provides a clear rationale for when financial assets should be measured at fair value through other comprehensive income. In accordance with the proposals, financial assets are measured at fair value through other comprehensive income when they meet the criteria specified in paragraph 4.1.2A.[27] Consequently the proposals, in conjunction with the related requirements in IFRS 9, eliminate accounting arbitrage and reduce complexity by eliminating the rule-based classification associated with the financial asset measurement categories in IAS 39.

27 The mandatory classification at fair value through other comprehensive income is for debt instruments only and is different from the election to designate equity investments at fair value through other comprehensive income as permitted by paragraph 5.7.5 of IFRS 9.

Bifurcation of embedded features in financial assets

BC119 IFRS 9 eliminates the application of the complex and rule-based requirements in IAS 39 for the bifurcation of hybrid financial assets. In accordance with IFRS 9, a financial asset is accounted for in its entirety on the basis of all of its features. That is in contrast to IAS 39, where components of a financial asset could have been classified and measured separately—resulting in the financial asset being measured at amortised cost or fair value through other comprehensive income (available for sale), while some or all of the embedded features were measured at fair value through profit or loss, even though the financial asset was a single instrument that was settled as a whole on the basis of all of its features.

BC120 Under IFRS 9, a financial asset with an equity-indexed interest rate will be measured at fair value through profit or loss in its entirety, because an equity-indexed interest rate is not consistent with the notion of principal and interest as described in paragraph 4.1.3. However, financial assets with structured features will not always be measured at fair value through profit or loss because of the embedded features. For example, financial assets that contain prepayment or extension features, and unleveraged interest rate caps and floors, can be considered to have payments that are solely principal and interest if the effect of those features is consistent with the concept of principal and interest as described in paragraph 4.1.3. As a result, these may qualify for a measurement category other than fair value through profit or loss (depending on the holder's business model).

BC121 The proposed amendments do not reintroduce bifurcation for financial assets. However, the proposals described in paragraphs B4.1.9–B4.1.9E clarify the existing concept of 'solely principal and interest' in IFRS 9. This will increase the range of financial assets that are considered to have payments that are solely principal and interest within the provisions of IFRS 9.

Reclassification

BC122 IAS 39 included complex rules for the reclassification of financial assets, and different entities could choose to reclassify financial assets in different circumstances. In contrast, IFRS 9 requires the reclassification of financial assets when (and only when) the business model for managing those financial assets changes. Changes in business model are demonstrable events and are expected to be very infrequent. For example, a change in business model can arise from a business combination, if a reporting entity changes the way it manages its financial assets following the acquisition of a new business.

BC123 The proposals extend the concept of reclassifications in IFRS 9 to also apply to financial assets that are mandatorily measured at fair value through other comprehensive income.

Main changes to the approach to classifying and measuring financial liabilities

BC124 IFRS 9 carries forward almost all of the requirements in IAS 39 for the classification and measurement of financial liabilities, including the bifurcation of particular embedded derivatives. As a result, most financial liabilities, apart

from derivatives or financial liabilities that an entity designates under the fair value option, will continue to be measured at amortised cost.

BC125 The main concern the IASB was asked to address in relation to financial liabilities was the so-called 'own credit' issue, whereby changes in the credit risk of a financial liability give rise to gains or losses in profit or loss. Users of financial statements told the IASB that recognising such gains or losses in profit or loss does not result in useful information. As a result of retaining the bifurcation requirements, in general the only non-derivative financial liabilities measured at fair value that will give rise to own credit gains or losses were those designated at fair value through profit or loss under the fair value option. IFRS 9 addresses this concern by requiring that the effect of changes in an entity's own credit risk should be presented in other comprehensive income.[28] This change means that entities no longer recognise gains in profit or loss when their credit risk deteriorates, and losses when their credit risk improves.

BC126 The proposals would result in these changes to the own credit requirements being available sooner than they would otherwise. Except for these changes to early application (paragraphs BC127–BC128), the proposals do not change the approach to classifying and measuring financial liabilities.

Early application

BC127 In order to address critical issues during the financial crisis and to make improvements to financial reporting available more quickly, the IASB decided to replace IAS 39 in phases and to allow entities the option to early apply only some phases of IFRS 9 (although if a later phase was applied, earlier phases were also required to be applied). Consequently, entities have the option to apply the requirements for financial assets (IFRS 9 (2009)) only, or the requirements for financial assets and financial liabilities (IFRS 9 (2010)) or, following the completion of [draft] Chapter 6 Hedge Accounting, the requirements for financial assets, financial liabilities and hedge accounting. However, in this Exposure Draft the IASB proposes that once the completed version of IFRS 9 is issued, an entity that subsequently elects to apply IFRS 9 early must either apply the completed version of IFRS 9 (ie all of the classification and measurement requirements, impairment and hedge accounting) or apply only the own credit requirements.

BC128 This will mean that once the completed version of IFRS 9 is issued and before its mandatory effective date, fewer combinations of accounting for financial instruments will be available to be newly early applied. Until the mandatory effective date of IFRS 9, entities that have not already applied a previous version of IFRS 9 will either continue to apply IAS 39 unchanged, apply IAS 39 along with the own credit requirements (as described in paragraph BC125) or apply the completed version of IFRS 9.

28 This applies unless that treatment would create or enlarge an accounting mismatch in profit or loss, in which case all changes in fair value are presented in profit or loss.

Comparability of financial information

BC129 At a high level, classification and measurement, in accordance with both IAS 39 and IFRS 9, require consideration of similar aspects of financial instruments—their contractual cash flow characteristics and how they are managed. However, IAS 39 and IFRS 9 approach these aspects of financial instruments in very different ways. IAS 39 was complex and rule-based and the classification of financial assets placed emphasis on an entity's intentions in respect of individual financial assets. IAS 39 also involved an element of free choice. As discussed in the following paragraphs, IFRS 9 and these proposals require systematic classifications with less accounting choice. Consequently, differences in financial reporting between reporting periods for an individual entity, and between different entities in a particular reporting period, will more often reflect the differences in underlying economics rather than being affected by differences in accounting choices.

The business model assessment

BC130 In contrast to IAS 39, the business model assessment in IFRS 9 is determined by how financial assets are managed. This is not a question of intention for an individual instrument but is instead based on an assessment of objective evidence at a higher level of aggregation. As a result, the assessment is a matter of fact, which results in less accounting choice than is available when applying IAS 39 today.

BC131 The proposals will improve comparability by improving consistency in how different entities apply the guidance in IFRS 9 and classify and measure their financial assets. The proposals enhance the guidance for assessing whether financial assets are held to collect contractual cash flows and should therefore be measured at amortised cost (depending on the contractual cash flows). In addition, the proposals would add a fair value through other comprehensive income measurement category to IFRS 9. The IASB has received some preliminary views that the addition of this measurement category will also enhance the application of the amortised cost measurement category. In addition, the fair value through other comprehensive income measurement category will allow some business models to be better reflected in the financial statements. This will improve comparability between entities because economically similar instruments that are managed in a similar manner will be accounted for in the same way. Differences in financial reporting will more often reflect the underlying economic differences.

Reclassifications

BC132 IAS 39 permitted reclassifications at the entity's discretion in rare circumstances. Users of financial statements consistently commented that these reclassifications decreased the comparability and usefulness of the financial reporting. In contrast, IFRS 9 makes reclassifications mandatory when (and only when) there has been a change in the business model. The reclassification requirements will enhance comparability because an entity will generally account for its financial instruments consistently over time. The exception will be in the rare circumstance that the entity's business model changes, in which

case required reclassification nonetheless strengthens comparability because financial assets will continue to be accounted for consistent with how they are managed.

Early application

BC133 The proposals will remove the option in IFRS 9 to early apply only some of the requirements in IFRS 9 (paragraph BC127–BC128). Instead, following the completion of IFRS 9, entities will either continue to apply IAS 39 unchanged, apply IAS 39 along with the presentation for own credit gains and losses, or apply the completed version of IFRS 9. This decision was made in order to improve comparability for users of financial statements because there will be fewer versions of IFRS 9 available.

Convergence with the FASB

BC134 One of the main reasons for undertaking the limited scope project that has led to the publication of the proposals was to more closely align IFRS 9 with the classification and measurement approach that is being developed by the FASB.

BC135 The FASB and the IASB have agreed on common language for the objectives of the amortised cost and fair value through other comprehensive income measurement categories, with the fair value through profit or loss measurement category representing the residual measurement category in both boards' models. While the boards may have slightly different application guidance to describe these measurement categories, there will be closer alignment between IFRS 9 and the FASB's tentative model by having common objectives for these business models and through the introduction of a third measurement category for financial assets. This will be beneficial to users of financial statements as it will enhance comparability between financial statements prepared in accordance with IFRS and those prepared in accordance with US GAAP.

Usefulness of financial information in assessing the future cash flows of an entity

Financial assets

BC136 In the Basis for Conclusions to IFRS 9, the IASB acknowledged that some users of financial statements support a single measurement method—fair value—for all financial assets. However, the IASB continues to believe that both amortised cost and fair value can provide useful information to users of financial statements for particular types of financial assets in particular circumstances. In issuing both IFRS 9 and these proposals, the IASB did not seek to increase or reduce the use of fair value measurement. Instead, it sought to ensure that information based on a specific measurement attribute is provided when it is relevant. The IASB decided that if that measurement attribute and the profit or loss effect for financial assets are aligned with both (a) the business model for managing financial assets and (b) their contractual cash flow characteristics, financial reporting will provide relevant information about the timing, amounts and uncertainty of an entity's future cash flows. For example, financial assets held in a traditional banking business that involves deposit funding and mortgage lending will typically qualify for amortised cost measurement.

The business model

BC137 The business model for managing financial assets determines whether their cash flows are realised through the collection of contractual cash flows, through the sale of the instruments or both. Consequently, the business model provides information that is useful in assessing the amounts, timing and uncertainty of the entity's future cash flows.

BC138 If the objective of an entity's business model is to collect contractual cash flows then (depending on the characteristics of the contractual cash flows) amortised cost measurement in both the statement of financial position and in profit or loss provides information about future cash flows. However, if the objective of the business model is to realise cash flows by selling financial assets, fair value measurement provides more relevant information about future cash flows in both the statement of financial position and in profit or loss.

BC139 The proposals would clarify the application guidance for a 'hold to collect' business model that results in financial assets being measured at amortised cost (depending on their contractual cash flow characteristics). This clarification will improve the quality of the financial information and its usefulness in assessing the amounts, timing and uncertainty of an entity's future cash flows by resulting in amortised cost measurement only for financial assets that are truly held to collect contractual cash flows.

BC140 Usefulness of financial information will be further improved by the proposal to introduce a fair value through other comprehensive income measurement category to IFRS 9. As described in greater detail in paragraph 5.7.1A, the fair value through other comprehensive income measurement category results in a fair value carrying amount in the statement of financial position while the effect on profit or loss would be the same as if the financial assets were measured at amortised cost. This is considered appropriate for such a business model because, by design, both holding and selling activities are taking place, making both amortised cost and fair value information relevant to the financial statements. Because of the addition of this fair value through other comprehensive income measurement category to IFRS 9, some question whether the classification and measurement approach will still be an improvement over IAS 39. However, in contrast to the available-for-sale measurement category in IAS 39, there is a clear business model resulting in measurement at fair value through other comprehensive income. This will allow entities to better reflect the way in which financial assets are managed and improve the usefulness of the information provided for those business models in assessing the timing, amounts and uncertainty of an entity's future cash flows.

Contractual cash flow characteristics

BC141 Since the publication of IFRS 9, the IASB has received questions as to how the contractual cash flow characteristics of particular instruments should be assessed, notably of financial assets that contain leverage or an interest rate mismatch feature as described in paragraphs B4.1.9–B4.1.9E. For example, some questioned if a relatively simple variable-rate loan would have to be measured at

fair value through profit or loss if it has an interest smoothing feature that limits the variability in the interest rate via a calculation that is consistent with the notion of time value of money.

BC142 As a result, the IASB proposes a clarification that, if the relationship between principal and interest is modified by leverage or an interest rate mismatch, the effect of the modification should be considered when determining whether the cash flows are solely payments of principal and interest. The feedback received so far has indicated that this proposed clarification will result in some financial assets now meeting the contractual cash flow characteristics assessment in IFRS 9. Consequently, this clarification will result in a better alignment between the economic concept of principal and interest and the relevant criteria in IFRS 9. For example, the simple variable-rate loan described in the previous paragraph could be measured at amortised cost because its contractual cash flows are economically principal and interest.

BC143 In addition to questions of clarity, after the publication of IFRS 9 some interested parties suggested that bifurcation for financial assets should be reintroduced, partly because of a concern that some financial assets will be measured at fair value through profit or loss in their entirety, whereas under IAS 39 only the derivative component would have been measured at fair value through profit or loss. The IASB believes that, to some extent, the concern will be addressed for some financial assets by the clarifications to the principal and interest criteria because, despite the presence of embedded features, these financial assets may economically have principal and interest cash flows. However, for other financial assets—for example, where the contractual cash flows are linked to an underlying that is unrelated to principal or interest, such as a commodity price—the proposals will not change the requirements in IFRS 9. For the reasons discussed in detail in paragraphs BC4.83–BC.4.89 of IFRS 9 and BC70–BC72 of this Exposure Draft, the IASB believes that classifying financial assets in their entirety rather than bifurcating them will result in financial information that is more useful in assessing the amounts, timing and uncertainty of future cash flows.

BC144 In addition to providing information that is more useful in assessing future cash flows, the elimination of bifurcation also simplifies the information about financial assets that is provided to users of financial statements. When a financial asset was bifurcated, the components of that financial asset were measured in different ways, and also could have been presented in different places in the financial statements. Consequently, although the settlement of the financial asset considers all of its contractual terms, there was no way to understand that financial asset as a whole until settlement took place.

Financial liabilities

BC145 In IFRS 9, the IASB made fewer changes to the classification and measurement of financial liabilities than to financial assets. Views received from users of financial statements, and others, indicated that amortised cost is the most appropriate measurement attribute for many financial liabilities because it reflects the issuer's legal obligation to pay the contractual amounts in the

normal course of business (ie on a going concern basis) and, in many cases, the issuer plans to hold liabilities to maturity and pay the contractual amounts.

BC146 However, if a liability has structured features (for example, embedded derivatives), amortised cost is difficult to apply and understand because the cash flows can be highly variable. Consequently, the IASB decided to retain the bifurcation requirements in IAS 39 for financial liabilities. The views received by the IASB indicated that the bifurcation approach in IAS 39 is generally working well for financial liabilities and that a new bifurcation approach (such as a principal-and-interest-based bifurcation methodology as described in paragraphs BC63–BC69) would most likely have the same classification and measurement outcomes as the approach in IAS 39.

BC147 However, views received indicated—and the IASB agreed—that the effects of changes in a liability's credit risk ought not to affect profit or loss unless the liability is held for trading, because an entity will generally not realise the effects of changes in the liability's credit risk unless the liability is held for trading. The result of the IASB's decisions, including the own credit requirements for financial liabilities described in BC96–BC106, result in information being reported for financial liabilities that is more useful in assessing the amounts, timing and uncertainty of the entity's future cash flows.

BC148 Currently, in accordance with IFRS 9, in order to apply the own credit requirements an entity must also apply the classification and measurement requirements in IFRS 9 for financial assets. However, as a result of the IASB's decision to consider limited amendments to the classification and measurement requirements for financial assets, entities that have not already applied the requirements for financial assets are unlikely to consider applying them before the limited amendments are issued. The proposals would allow an entity to early apply only the own credit requirements and to otherwise continue accounting for their financial instruments in accordance with IAS 39, thereby enabling entities to benefit from the improved financial reporting for gains or losses on changes in own credit risk as requested by preparers and users of financial statements alike.

Better economic decision-making as a result of improved financial reporting

BC149 As described in greater detail in the Basis for Conclusions to IFRS 9 and this Exposure Draft, the IASB believes that the proposals, in conjunction with the related requirements in IFRS 9, satisfy the fundamental qualitative characteristics of useful financial information as stated in Chapter 3 of the IASB's *Conceptual Framework*. That is, they would:

(a) provide information that is more useful in assessing the amounts, timing and uncertainty of an entity's future cash flows than the information reported in accordance with IAS 39 (BC136–BC148) and is therefore more relevant and timely; and

(b) reduce accounting choice and instead require classifications that are consistent with economic substance (BC117–BC128). Consequently, the financial reporting is a more faithful representation than the financial

reporting in accordance with IAS 39. It is also more complete and neutral and is supported by economic substance, which will help it to be free from error and verifiable.

In addition, the IASB notes that the proposals, in conjunction with the related requirements in IFRS 9, enhance the comparability (BC129–BC135) and understandability (BC117–BC128) of the financial information relative to IAS 39.

BC150 In assessing whether the proposals, in conjunction with the related requirements in IFRS 9, would improve financial reporting, the IASB also considered the concerns voiced by some interested parties, especially those related to financial assets. Some believe that, in conjunction with the related requirements in IFRS 9, the proposals will result in more financial assets being reported at fair value as compared to the requirements in IAS 39, and this concerns them for one or more of the following reasons:

(a) While fair value might be relevant during times of relative market stability, it lacks relevance and reliability during times of relative market instability.

(b) Fair value reporting leads to procyclicality, meaning that it magnifies economic or financial fluctuations. In response to changes in fair value, entities may need, or choose, to sell different amounts of financial assets than they normally would, and the entity may have a different estimate of the present value of the future cash flows than is indicated by the fair value or market price (fair value amounts that are lower than the entity's estimate of future cash flows are of particular concern).

(c) Although the objective of many regulatory frameworks is to encourage economic stability rather than to provide useful information to users of financial statements, regulatory reporting nonetheless uses some of the amounts reported in accordance with IFRS. Consequently, IFRS reporting has effects for regulated entities. For example, regulated entities (especially banks) are often required to increase their capital reserves when their regulatory reporting indicates that they may face increased risk. Decreases in the fair value of some financial assets and increases in impairment losses both trigger the requirement to increase capital reserves. In order to meet this requirement, regulated entities may decrease lending during an economic downturn, which can further exacerbate the downturn.

BC151 Some are of the view that fair value information is less relevant for all financial instruments in times of relative market instability. Others, including the IASB, agree that fair value is not equally relevant for all financial instruments, but believe that fair value is relevant in all market conditions for some financial instruments. Consequently, the IASB believes that the new approach to classifying and measuring financial instruments will provide relevant information that will lead to better economic decision-making throughout economic cycles.

BC152 The IASB did not seek to increase or reduce the number of financial instruments that would be measured at fair value. The use of fair value is essentially unchanged in IFRS 9 relative to IAS 39 for financial liabilities (and in fact, a

portion of the fair value changes will now be recognised in other comprehensive income rather than profit or loss), and the proposals do not change this fact. In addition, financial assets are measured at fair value only when it is relevant because of the contractual cash flow characteristics of the asset and/or the entity's business model. Depending on the entity, its particular financial assets, and how it manages them, the proposals, in conjunction with the related requirements in IFRS 9, may actually result in fewer financial assets being measured at fair value than under IAS 39. For example, because of the rule-based criteria for amortised cost measurement under IAS 39, debt securities that are quoted in active markets are typically measured at fair value in accordance with IAS 39, even if they are held within a business model in which assets are managed to collect contractual cash flows. Such financial assets may be measured at amortised cost in accordance with IFRS 9, and this would be unchanged by the proposals.

BC153 The IASB acknowledges that the fair value through other comprehensive income measurement category may affect some regulated banks, because the Basel III regulatory framework removes the 'regulatory filter' for fair value gains or losses recognised in other comprehensive income.[29] Consequently, if this regulatory change remains in place, the fair value changes of financial assets that are measured at fair value through other comprehensive income will have a direct effect on regulatory capital. However, the addition of the fair value through other comprehensive income measurement category will only have the potential to adversely affect regulatory capital if those financial assets would otherwise have been measured at amortised cost. In these proposals, the IASB is clarifying the assessment of contractual cash flows, which may increase the use of the amortised cost measurement category relative to IFRS 9. However, the proposals will also clarify the meaning of a 'hold to collect' business model that results in amortised cost measurement (depending on the contractual cash flow characteristics), which may cause some financial assets that entities expected to measure at amortised cost not to be measured at amortised cost.

BC154 The objective of financial reporting should be to provide transparent information that is useful in order to enable better economic decision-making. The IASB notes that the objective of providing useful information does not contradict the objective of economic stability. Instead, the IASB believes that transparency is essential to maintain stability in the long term.

The likely effect on compliance costs for preparers, both on initial application and on an ongoing basis

BC155 Although the initial application of IFRS 9 may require significant costs, the IASB does not expect preparers to incur significant incremental costs on an ongoing basis in comparison to applying IAS 39. The IASB notes the following factors that mitigate the ongoing costs of applying IFRS 9 in comparison to IAS 39:

29 Footnote 10 of Basel III: *A global regulatory framework for more resilient banks and banking systems* ('Basel III') published by the Basel Committee on Banking Supervision states "that '[t]here is no adjustment applied to remove from Common Equity Tier 1 unrealised gains or losses recognised on the balance sheet [the 'regulatory filter'] ... The Committee will continue to review the appropriate treatment of unrealised gains, taking into account the evolution of the accounting framework." In contrast, Basel II did contain a regulatory filter.

(a) the entity's business model is determined on a more aggregated basis than an individual instrument level and is a matter of fact that can be observed by the way in which an entity is managed and information provided to its management;

(b) the contractual cash flows need not be analysed in all business models (ie when the assets are not held in a business model whose objective is to collect the contractual cash flows or where the assets are managed both in order to collect contractual cash flows and for sale); and

(c) IAS 39 already has requirements that entities evaluate the contractual terms of their financial instruments on an instrument-by-instrument basis.

BC156 In addition, the IASB notes that the elimination of bifurcation and tainting for financial assets measured at amortised cost, as well as having a single impairment method, will simplify compliance with the classification and measurement requirements for financial assets.

BC157 For financial liabilities, the classification and measurement model is largely unchanged from IAS 39, except for the own credit requirements for financial liabilities designated as at fair value through profit or loss under the fair value option (paragraphs BC124–BC126). Entities are already required to disclose the gains or losses recognised for changes in own credit risk and there should therefore not be any incremental costs to preparers for financial liabilities.

BC158 For the reasons described in the preceding paragraphs, the IASB believes that the benefits of the improvements to financial reporting described in the Basis for Conclusions to this Exposure Draft will justify the costs to implement and apply the proposals, in conjunction with the related requirements in IFRS 9.

The likely effect on costs of analysis for users of financial statements

BC159 The likely benefits of improved reporting resulting from the proposals, in conjunction with the related requirements in IFRS 9, are expected to outweigh costs of analysis for users of financial statements. However, the extent of the benefit will depend on existing practices.

BC160 Some of the complexity in IAS 39 is eliminated and it is therefore easier for users of financial statements to understand and use the financial reporting information for financial instruments. In addition, although some users of financial statements favour fair value as a primary measurement attribute for financial assets, users of financial statements as a group have consistently commented that both amortised cost information and fair value information are useful in particular circumstances. The IASB has developed the proposals, in conjunction with the related requirements in IFRS 9, to provide information that is useful in predicting an entity's future cash flows. Also, existing and proposed disclosures provide additional information that will enable users of financial statements to readily understand how financial instruments have been classified and measured, and to use supplementary information from

disclosures in their modelling as desired (for example, the fair value of financial instruments measured at amortised cost or the carrying value of reclassified financial assets).

Alternative Views on Exposure Draft

Alternative views of Messrs Cooper and Engström

AV1 Messrs Cooper and Engström voted against the publication of the Exposure Draft because they disagree with the proposal to introduce the fair value through other comprehensive income measurement category. They believe that:

(a) the proposal would unnecessarily increase complexity for the reporting of financial instruments;

(b) the distinction between the supposed different business models that justify measurement at fair value through other comprehensive income rather than at fair value through profit or loss is unclear, would lead to diversity in practice and is insufficient to justify a difference in accounting treatment; and

(c) faithful representation of insurance contracts in financial statements does not need the fair value through other comprehensive income measurement category for (some) assets that back insurance liabilities.

AV2 Messrs Cooper and Engström believe that the existing IFRS 9 classification at either amortised cost or fair value through profit or loss should be retained; although they support clarification of the 'hold to collect' business model and the proposed amendments to the contractual cash flow characteristics assessment.

Increased complexity that is undesirable and unnecessary

AV3 One of the IASB's main objectives for replacing IAS 39 with IFRS 9 is to reduce the complexity of accounting for financial instruments. An important component of that is to reduce the number of measurement categories of financial instruments and the even larger number of different measurement and presentation methods in IAS 39. This objective was widely supported and Messrs Cooper and Engström believe this has been achieved in the current IFRS 9 classification and measurement requirements. They consider that the proposals in this Exposure Draft would reverse a significant part of this improvement in reporting.

AV4 Messrs Cooper and Engström believe that, where amortised cost is judged to be the most appropriate basis for reporting, this should be applied consistently throughout the financial statements. Likewise, if fair value provides the more relevant information, it should be applied consistently. In their view the fair value through other comprehensive income measurement category provides a confusing mixture of amortised cost and fair value measurement that will make financial statements more complex and less easy to understand. While they accept that in many cases fair value is an important additional piece of information for assets that are appropriately reported under amortised cost, they believe that this should be provided as supplementary information in the notes, albeit with prominent and clear disclosure.

'Managed both in order to collect contractual cash flows and to sell' is not a distinct business model

AV5 The proposed amendments are based on the assertion that there are distinct business models that justify accounting for qualifying debt instruments using either fair value through other comprehensive income or fair value through profit or loss, and that these different business models can be observed by the way the business is managed and its performance evaluated by the entity's key management personnel. Messrs Cooper and Engström believe that, while the reasons for holding debt instruments outside a 'hold to collect' business model can vary significantly, it is not possible to identify distinct business models or that these reasons justify different accounting. For example, managing assets with the objective to maximise return through opportunistic selling and reinvestment is given as an illustration of management in order to collect contractual cash flows and for sale (see B4.1.4B, Example 1); however, where assets are managed and performance evaluated on a 'fair value basis' with collection of contractual cash flows being 'incidental', the proposals would require the use of fair value through profit or loss (see paragraph B4.1.6). Messrs Cooper and Engström believe that managing to maximise return and on a fair value basis is a distinction without a difference and is not a valid justification for a very different accounting treatment. Considering the difficulty in differentiating between business models that justify either fair value through other comprehensive income or fair value through profit or loss, Messrs Cooper and Engström believe that there is a significant risk of diversity in practice in how these accounting methods would be applied.

AV6 Messrs Cooper and Engström accept that differentiating between different business models is subjective, nevertheless they believe that it is possible to identify a distinct 'hold to collect' business model for which earning an interest margin is the primary objective and where the realisation of fair value changes through the sales of assets is not a significant factor in assessing performance. In contrast, they do not believe it is possible to differentiate between business models aside from the 'hold to collect' model, and that in all other cases the appropriate accounting treatment is fair value through profit or loss.

AV7 Messrs Cooper and Engström believe that if fair value is indeed the most appropriate measurement basis the full fair value change is relevant in assessing overall performance and should be presented within profit or loss. If debt instruments are, for example, managed with the objective of maximising return then showing only amortised cost-based interest income and realised value changes in profit or loss would fail to provide a faithful representation of this economic activity. Furthermore, the use of fair value through other comprehensive income permits an entity significant freedom to manage profit or loss simply through the selective sale of assets (although Messrs Cooper and Engström acknowledge that gains and losses from such sales are prominently disclosed). While Messrs Cooper and Engström believe that, for assets measured at fair value, all fair value changes should be reported in profit or loss, they observe that, in accordance with IFRS 9, an entity is able to disaggregate fair value gains or losses to highlight certain components (such as the interest yield) if this helps in providing relevant information about performance.

The fair value through other comprehensive income measurement category is not necessary to achieve improvements to insurance accounting

AV8 The proposals state that one of the considerations that led the IASB to propose introducing the fair value through other comprehensive income measurement category is the interaction with the current IASB Insurance Contracts project. The tentative decision by the IASB to introduce the fair value through other comprehensive income measurement category was taken at the same meeting as, and was related to, the tentative decision to require some changes in insurance contracts liabilities arising from changes in the discount rate to be recognised in other comprehensive income. While the insurance proposals are yet to be re-exposed, due to the interaction of the proposals in this Exposure Draft and the tentative decisions for insurance contracts Messrs Cooper and Engström believe that respondents should consider the relevance of using other comprehensive income for insurance contracts when commenting on the proposals in this Exposure Draft.

AV9 Messrs Cooper and Engström believe that the reason that the IASB has tentatively concluded that gains and losses attributable to changes in discount rates for some insurance contracts should be recognised in other comprehensive income is so that the volatility arising from changes in interest rates does not impact profit or loss and that the underwriting results can be differentiated from the impact of market movements. In order to avoid this approach creating an accounting mismatch it would be necessary to recognise in other comprehensive income the change in the fair value of assets backing those insurance liabilities. This would appear to be partially achieved under the proposals in this Exposure Draft since many (but not all) assets held to back insurance liabilities would qualify for measurement at fair value through other comprehensive income. Some might argue that reporting changes in assets and liabilities (other than those arising from interest accretion and impairment) in other comprehensive income would successfully isolate the effect of market movements and highlight within other comprehensive income the impact of any investment (including duration) mismatches. However, Messrs Cooper and Engström do not believe this to be the case.

AV10 If a debt instrument held to back an insurance liability has the same duration as that liability, and both are held to maturity, then reporting changes in the value of both in other comprehensive income would not be a problem (although it would arguably also be of no use as the gains and losses would exactly offset anyway). However, in the opinions of Messrs Cooper and Engström, in all other situations (such as where assets are sold prior to maturity or where there is a duration mismatch between the assets and liabilities) the overall amounts separately reported in profit or loss and in other comprehensive income would have little meaning. While comprehensive income would be meaningful, the resulting disaggregation between profit or loss and other comprehensive income would not. Also, the use of other comprehensive income for changes in the insurance liability discount rate would create accounting mismatches if assets held to back those insurance liabilities did not qualify for measurement at fair value through other comprehensive income.

AV11 Messrs Cooper and Engström believe that the use of other comprehensive income for insurance contracts combined with measurement at fair value through other comprehensive income for (some) assets that back insurance liabilities would lead to unnecessary complexity, a lack of transparency in insurance accounting, opportunities for earnings management through selective realisation of assets and would not faithfully represent the performance of entities engaged in this activity. Accordingly, they believe that the introduction of the fair value through other comprehensive income measurement category in IFRS 9, combined with the use of other comprehensive income for certain changes in insurance contracts liabilities, will undermine the potential improvements in the quality of financial reporting by entities engaged in issuing insurance contracts resulting from the introduction of an insurance contracts standard.

AV12 Messrs Cooper and Engström believe that the appropriate accounting for insurance contracts is to report all changes in insurance liabilities in profit or loss and that, consequently, the existing IFRS 9 treatment of related assets (which would likely result in the frequent use of fair value through profit or loss, either because the assets would be required to be so measured or would be designated as such under the fair value option to address accounting mismatches that would otherwise arise if the assets were measured at amortised cost) should be retained, albeit with appropriate disaggregation of gains or losses to enable clear identification of the sources of earnings for such entities.

Convergence in the accounting for financial instruments

AV13 Mr Engström supports the ambition of having converged financial instruments standards for IFRS and US GAAP. However Mr Engström notes that convergence in the accounting for financial instruments is challenging to achieve, and that the recent and current projects on offsetting, hedge accounting and impairment have not resulted in a converged approach. Mr Engström believes that publication of this Exposure Draft should follow the publication by the FASB of its final proposals on financial instruments to allow respondents to consider the proposals at the same time. Mr Engström acknowledges that this could lead to a delay in the completion of the proposed Limited Amendments to IFRS 9 but believes that such delay would be justified as it would facilitate convergence in this important area.

[Draft] Amendments to the Illustrative Example of IFRS 9 *Financial Instruments* (2010)

The financial assets table in paragraph IE6 of IFRS 9 (2010) is amended. New text is underlined and deleted text is struck through. Paragraph IE6 is included for reference and is not proposed for amendment.

Disclosures on Transition from IAS 39 to IFRS 9

IE6 The following illustration is an example of one possible way to meet the quantitative disclosure requirements in paragraphs 44S–44W of IFRS 7 at the date of initial application of IFRS 9. However, this illustration does not address all possible ways of applying the disclosure requirements of this IFRS.

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 at 1 January 2015

Financial assets	(i)	(ii)	(iii)	(iv) = (i) + (ii) + (iii)	(v) = (iii)
	IAS 39 carrying amount 31 December 2014 (1)	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2015	Retained earnings effect on 1 January 2015 (2), (3)
~~Measurement category:~~					
Fair value through profit or loss					
Additions:					
From available for sale (IAS 39)		(a)			(c)
From amortised cost (IAS 39) – required reclassification		(b)			
From amortised cost (IAS 39) – fair value option elected at 1 January 2015					
Subtractions:					
To amortised cost (IFRS 9)					
To fair value through other comprehensive income – debt instruments (IFRS 9)					
To fair value through other comprehensive income – equity instruments (IFRS 9)					
Total change to fair value through profit or loss					
Fair value through other comprehensive income					

continued...

...continued

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 at 1 January 2015

Financial assets	(i)	(ii)	(iii)	(iv) = (i) + (ii) + (iii)	(v) = (iii)
	IAS 39 carrying amount 31 December 2014 (1)	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2015	Retained earnings effect on 1 January 2015 (2), (3)
Additions – debt instruments:					
From available for sale (IAS 39)					(g)
From amortised cost (IAS 39)					(h)
From fair value through profit or loss (IAS 39) – required reclassification based on classification criteria					(i)
From fair value through profit or loss (fair value option under IAS 39) – fair value option criteria not met at 1 January 2015					(j)
From fair value through profit or loss (IAS 39) – fair value option revoked at 1 January 2015 by choice					(k)
Additions – equity instruments:					
From available for sale (IAS 39)					
From fair value through profit or loss (fair value option under IAS 39)–fair value through other comprehensive income elected at 1 January 2015					
From cost (IAS 39)					
Subtractions – debt and equity instruments:					
Available for sale (IAS 39) to fair value through profit or loss (IFRS 9) – required reclassification based on classification criteria					(d)

continued...

...continued

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 at 1 January 2015

Financial assets	(i)	(ii)	(iii)	(iv) = (i) + (ii) + (iii)	(v) = (iii)
	IAS 39 carrying amount 31 December 2014 (1)	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2015	Retained earnings effect on 1 January 2015 (2), (3)
Available for sale (IAS 39) to fair value through profit or loss (IFRS 9) – fair value option elected at 1 January 2015					
Available for sale (IAS 39) to amortised cost (IFRS 9)					(e)
Total change to fair value through other comprehensive income					
Amortised cost					
Additions:					
From available for sale (IAS 39)					**(f)**
From fair value through profit or loss (IAS 39) – required reclassification					
From fair value through profit or loss (fair value option under IAS 39) – fair value option criteria not met at 1 January 2015					
From fair value through profit or loss (IAS 39) – fair value option revoked at 1 January 2015 by choice					
Subtractions:					
To fair value through other comprehensive income (IFRS 9)					(l)
To fair value through profit or loss (IFRS 9) – required reclassification based on classification criteria					

continued...

...continued

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 at 1 January 2015

Financial assets	(i)	(ii)	(iii)	(iv) = (i) + (ii) + (iii)	(v) = (iii)
	IAS 39 carrying amount 31 December 2014 (1)	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2015	Retained earnings effect on 1 January 2015 (2), (3)
To fair value through profit or loss (IFRS 9)–fair value option elected at 1 January 2015					
Total change to amortised cost					
Total financial asset balances, reclassifications and remeasurements at 1 January 2015	**(i)**	**Total (ii) = 0**	**(iii)**	**(iv) = (i) + (ii) + (iii)**	

(1) Includes the effect of reclassifying hybrid instruments that were bifurcated under IAS 39 with host contract components of (a), which had associated embedded derivatives with a fair value of X at 31 December 2014, and (b), which had associated embedded derivatives with a fair value of Y at 31 December 2014.

(2) Includes (c), (d), (e) and (f), which are amounts reclassified from other comprehensive income to retained earnings at the date of initial application.

(3) Includes (g), (h), (i), (j), (k) and (l), which are amounts reclassified from retained earnings to accumulated other comprehensive income at the date of initial application.

[DRAFT] APPENDIX
Amendments to the guidance on other IFRSs

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

Paragraphs IG56–IG59 are amended. New text is underlined and deleted text is struck through.

Measurement

IG56 In preparing its opening IFRS statement of financial position, an entity applies the criteria in IFRS 9 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 through profit or loss and those that are measured at amortised cost or, in case of financial assets, at fair value through other comprehensive income. The resulting classifications are applied retrospectively.

IG57 For those financial assets and financial liabilities measured at amortised cost or, in case of financial assets, at fair value through other comprehensive income in the opening IFRS statement of financial position, an entity determines their carrying amount ~~cost~~ on the basis of circumstances existing when the assets and liabilities first satisfied the recognition criteria in IFRS 9. However, if the entity acquired those financial assets and financial liabilities in a past business combination, their carrying amount in accordance with previous GAAP immediately following the business combination is their deemed cost in accordance with IFRSs at that date (paragraph C4(e) of the IFRS).

IG58 An entity's estimates of impairments of financial assets mandatorily measured at fair value through other comprehensive income or 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.[30]

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 (or another component of equity, as appropriate) at the date of transition to IFRSs only to the extent that it results from adopting IAS 39 and IFRS 9. Because all derivatives, other than those that are financial guarantee contracts or are designated and effective hedging instruments, are

30 References to the requirements in IAS 39 will be replaced by references to the relevant paragraphs in this Standard in the completed version of this Standard.

measured 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 and IFRS 9 are initially applied (other than for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

IG59 An entity may, in accordance with its previous GAAP, have measured investments in equity instruments at fair value and recognised the revaluation gain outside profit or loss. If an investment in equity instruments is classified as at fair value through profit or loss, the pre-IFRS 9 revaluation gain that had been recognised outside profit or loss is reclassified into retained earnings on initial application of IFRS 9. If, on initial application of IFRS 9, an investment in an equity instrument is ~~classified~~ designated as at fair value through other comprehensive income, then the pre-IFRS 9 revaluation gain is recognised in a separate component of equity. Subsequently, the entity recognises gains and losses on ~~the financial asset~~ such investment in equity instruments in other comprehensive income (except dividends, which are recognised in profit or loss) and accumulates the cumulative gains and losses in that separate component of equity. On subsequent derecognition, the entity may transfer that separate component of equity within equity.

