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Exposure Draft

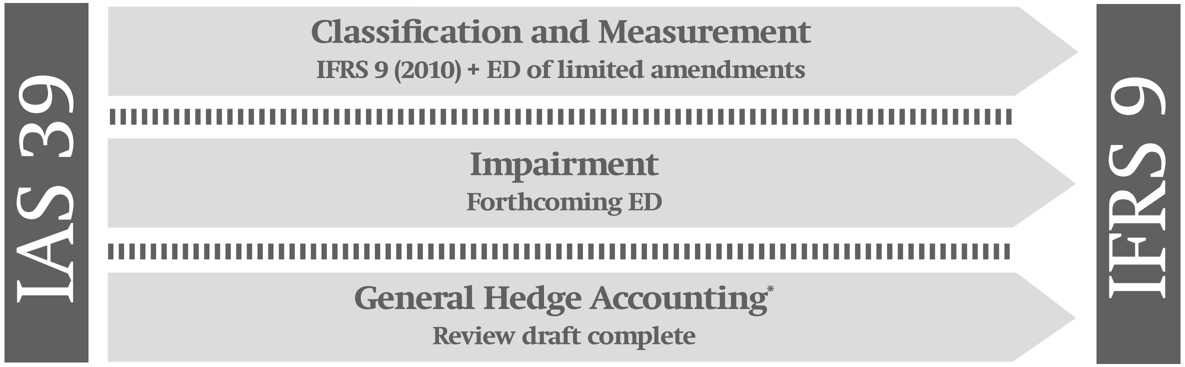
Snapshot: Financial Instruments: Classification and Measurement (Limited Amendments to IFRS 9)

This snapshot provides a brief introduction to the proposed limited amendments to the classification and measurement requirements for financial instruments that have been published for public comment by the International Accounting Standards Board (IASB).

Project objective:	With these proposals, the IASB aims to: • reduce the differences between IFRS and US GAAP in the accounting for financial instruments; • consider the interaction with accounting for insurance contracts; and • clarify the existing classification and measurement requirements for financial assets.
Project stage:	This Exposure Draft (ED) proposes limited amendments to the classification and measurement requirements for financial instruments.
Next steps:	The IASB invites comments from interested parties and will undertake outreach during the comment period. Upon completion of these consultations, the IASB will redeliberate the proposals and expects to complete this project along with the Impairment and General Hedge Accounting phases during 2013.
Comment deadline:	The ED is open for public comment until **28 March 2013**.

IFRS™

Reform of financial instrument accounting



*Macro hedge accounting is being deliberated separately from this project

The IASB is undertaking its reform of accounting for financial instruments in phases. This ED is the result of the Classification and Measurement phase of that project. The IASB published the new requirements for classifying and measuring financial instruments in IFRS 9 *Financial Instruments* (issued October 2010). This ED proposes some limited amendments to those requirements.

Why revise the requirements for classification and measurement?

The IASB had three primary objectives for publishing the ED and limited the discussions to matters consistent with those objectives:

(a) The consideration of the interaction between the classification and measurement of financial assets and the accounting for insurance contract liabilities. The IASB stated that the interaction between IFRS 9 and the Insurance Contracts project would be considered once the insurance contract model was developed sufficiently.

(b) The clarification of a narrow range of application questions, such as the amount/frequency of sales that would be consistent with a 'hold to collect' business model and how to apply the contractual cash flow characteristics assessment when there is an interest rate mismatch or the interest rate is leveraged.

(c) The reduction of key differences between the IASB's requirements for classification and measurement of financial instruments and the tentative classification and measurement model considered by the US Financial Accounting Standards Board (FASB), thereby achieving increased comparability internationally in the accounting for financial instruments.

Why only limited-scope amendments?

The IASB believes that IFRS 9 is fundamentally sound. In particular the IASB believes that, when classifying financial instruments, using a basis that focuses on the information provided to users of financial statements about future cash flows is the right one. Consequently, the ED does not fundamentally change these concepts in IFRS 9.

The IASB is also mindful of the need to complete the entire project on financial instruments in a timely manner and to minimise the cost and disruption to entities that have already applied IFRS 9 or who have undertaken significant preparations to apply IFRS 9.

Proposed revisions to the requirements for classification and measurement

Classification determines how financial assets and financial liabilities are accounted for in financial statements and, in particular, how they are measured on an ongoing basis.

IAS 39

- Rule-based
- Complex and difficult to apply
- Four classification categories for financial assets
- Multiple impairment models
- Own credit gains and losses recognised in profit or loss

IFRS 9 (2010)

- Principle-based
- Classification driven by business model and nature of cash flows
- Two measurement bases
- One impairment model
- Own credit gains and losses presented in OCI
- Interaction with insurance contracts to be considered

IFRS 9 (this ED)

- As for IFRS 9 (2010), plus
- Clarified 'hold to collect' business model
- Improved 'contractual cash flow' test
- FVOCI measurement category

IFRS 9 applies one classification approach for all types of financial assets, including those that contain embedded derivative features.
Two criteria are used to determine how financial assets should be classified and measured:

(a) Contractual cash flows—are the contractual cash flows solely payments of principal and interest?

(b) What is the objective of the business model within which the financial assets are held?

The ED builds on that structure.

Cash flow characteristics

The ED proposes to clarify when contractual cash flows are still considered to consist of principal and interest when the interest rate is leveraged or is reset for a period that does not match the rate used (for example, the interest rate is reset every month to a three-month interest rate). The ED proposes that the financial asset has cash flows that are solely payments of principal and interest if the effect of such a leverage or mismatch feature could not be more than insignificant when compared with the cash flows of an instrument that does not contain such a feature but that is otherwise identical.

Business model assessment

The IASB believes that information about amortised cost is useful when simple debt instruments (such as simple loans and bonds) are held in a business model with the objective of collecting contractual cash flows. IFRS 9 already includes a 'hold to collect' business model, but the IASB was asked when sales of debt instruments classified as such can be considered consistent with that business model.

The ED proposes to clarify the business model criteria by providing additional application guidance on both the types of business activities and the frequency and nature of sales that could qualify for amortised cost measurement.
The frequency and significance of past sales, the reasons for those sales and the expectations for future sales need to be considered to decide when future cash flows are expected to arise from contractual cash flows or from the proceeds of sales.

Proposed revisions to the requirements for classification and measurement continued...

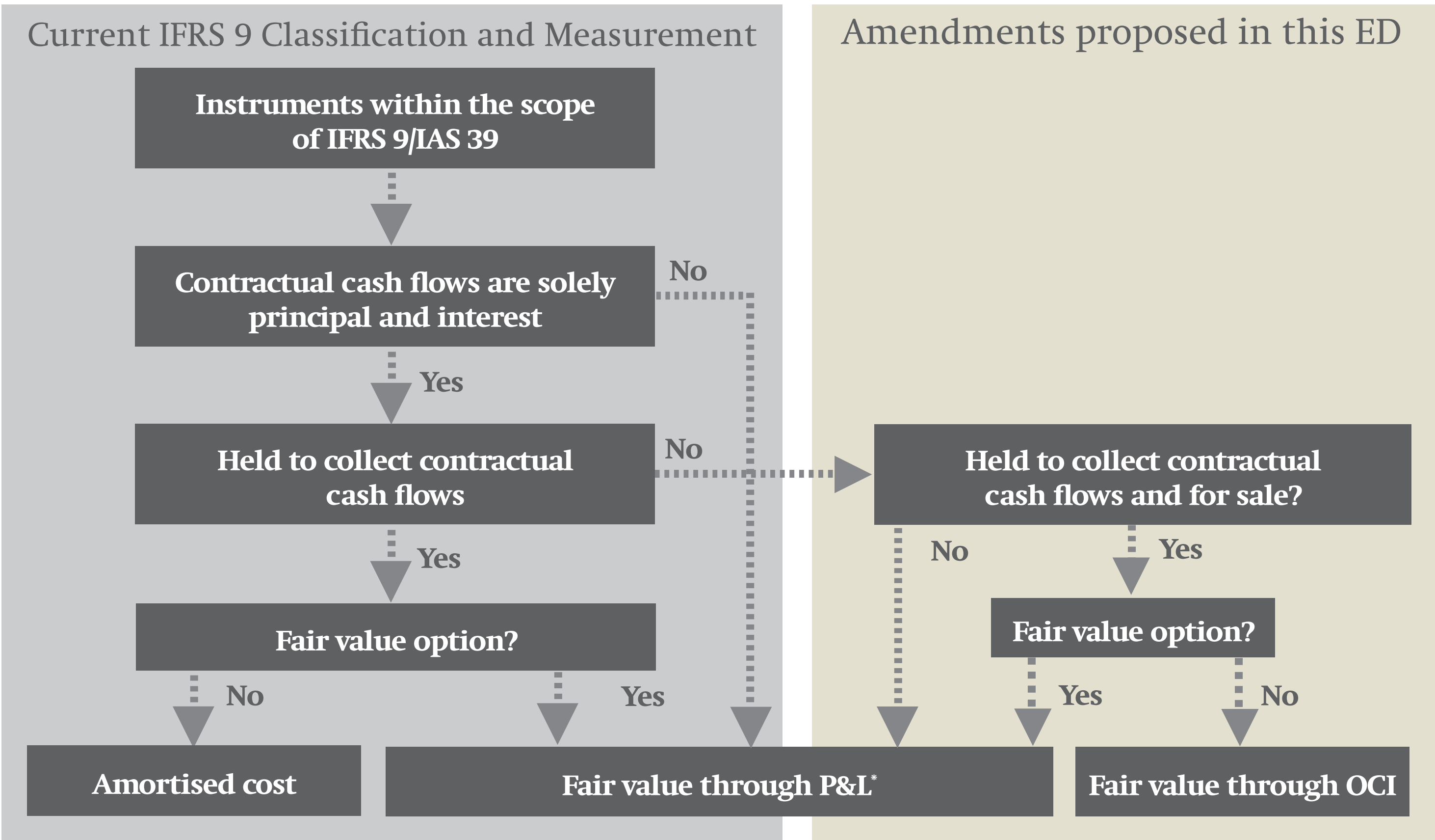
Fair value through other comprehensive income

The IASB believes that both amortised cost and fair value information (the market value of an asset) are useful when simple debt instruments are managed both to collect contractual cash flows and for sale, because performance of a business model with these 'mixed' objectives is affected by both the collection of contractual cash flows and realisation of fair values. IFRS 9 does not currently include this business model but some interested parties, including insurance companies, said that they needed such a business model to properly reflect their activities.

The ED proposes the introduction of a fair value through other comprehensive income (FVOCI) measurement category for simple debt instruments. In this measurement category, the balance sheet (statement of financial position) will reflect the fair value carrying amount while amortised cost information is presented in profit or loss. The difference between the fair value and amortised cost information will be recognised in other comprehensive income (OCI).

Amortised cost information will be provided by calculating interest and impairment in the same way as for financial assets measured at amortised cost. In addition, when financial assets are removed from an entity's balance sheet (derecognised), the fair value gains or losses accumulated in OCI will be reclassified (recycled) to profit or loss to result in the same gains or losses that would have been recognised if the assets were measured at amortised cost.

Process for deciding measurement



* Presentation option for equity investments to present fair value changes in OCI

Proposed revisions to the requirements for classification and measurement continued...

Own credit gains or losses

Interested parties had raised concerns about the volatility that occurs in profit or loss for non-derivative financial liabilities that are measured in accordance with the fair value option. IFRS 9 requires the changes in value caused by changes in an entity's own credit risk ('own credit') to be recognised in OCI. However, in order to adopt this treatment for own credit in IFRS 9, an entity must at the same time apply the new requirements for financial assets. The IASB continued to receive requests to accelerate the application of the requirements for the presentation of own credit gains or losses, because markets continue to be volatile and own credit gains or losses remain significant.

To address these concerns the ED proposes that once the completed version of IFRS 9 is issued, an entity can elect to early apply only the own credit requirements in IFRS 9. In effect, for those wanting to apply only the own credit requirements early, accounting for financial instruments would continue as in IAS 39 *Financial Instruments: Recognition and Measurement* except for changes in the accounting for own credit gains or losses.

Transition

Currently, entities can elect to apply the completed phases of IFRS 9 from different dates before the mandatory effective date of the Standard (for example, an entity could choose only to apply the changes to financial asset accounting for a specific reporting period and only apply the changes to financial liability accounting in a later reporting period, or it could apply both from the same date).

The ED proposes to improve the comparability for users of financial statements by eliminating this phased early application of IFRS 9. Early application of IFRS 9 would continue to be permitted, but once IFRS 9 is finalised, except for own credit as outlined above, all phases of IFRS 9 (Classification and Measurement, Impairment and General Hedge Accounting) must be applied from the same date. Previous versions of IFRS 9 would no longer be available for early application.

What is the impact of the proposed limited amendments?

The proposed limited amendments are intended to improve the ability of users of financial statements to understand how cash flows from financial assets will be realised and the amount, timing and uncertainty of those cash flows.

The IASB believes that the proposals in the ED, in conjunction with the related requirements in IFRS 9, will:

- continue to enhance the provision of information that is useful for decision-making, and that is based on the business model within which assets are held;
- result in more consistent application of the 'hold to collect' business model that results in amortised cost measurement for simple debt instruments;
- more closely align the measurement of financial assets with the way in which financial assets are managed and cash flows are realised, ie to collect contractual cash flows, for sale or both;
- address the interaction between the classification and measurement of financial assets and the accounting for insurance contract liabilities by reducing the mismatch between the measurement of financial assets and the related insurance contract liabilities because some fair value gains and losses on both would be recognised in OCI; and
- increase comparability with the FASB's tentative classification and measurement model. In particular, both the ED and the model as currently tentatively agreed by the FASB will base classification of financial assets on both whether the contractual cash flows consist solely of principal and interest and on an entity's business model. In addition, the objective of the hold to collect and hold to collect or sell business models are aligned and for both boards the fair value through profit or loss measurement category is the residual.

How can I comment on the ED?

The ED includes questions on the proposals. Respondents are invited to comment on any or all of those questions and to comment on any other issue that the IASB should consider in finalising the proposals. The IASB's redeliberations of the proposals will take place in public meetings as announced on the IASB website.

The deadline for comments on the ED is **28 March 2013**. To view the ED and submit your comments, visit www.ifrs.org.

To stay up to date with the latest developments on IFRS 9 sign up for email alerts on the project homepage on www.ifrs.org.

Important information

This Snapshot has been compiled by the staff of the IFRS Foundation for the convenience of interested parties. The views expressed within this document are those of the staff who prepared the document. They do not purport to represent the views of the IASB and should not be considered as authoritative. Comments made in relation to the application of IFRSs or US GAAP do not purport to be acceptable or unacceptable application of IFRSs or US GAAP.

Official pronouncements of the IASB are available in electronic form to eIFRS subscribers. Printed editions of IFRSs are available for ordering from the IASB website at http://go.ifrs.org/Limited-Amendments-to-IFRS-9.

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