Project: **Financial Instruments – Replacement of IAS 39**

Topic: **Classification and measurement: reclassification for instruments measured at cost**

Purpose of this paper

1. At the meeting on 15 October we will ask the Board whether it wishes to retain a cost exception for particular investments in unquoted equity instruments and derivatives that are linked to and must be settled by delivery of such equity instruments (agenda paper 3). The staff recommendation in that paper is to **eliminate** the cost exception (but include more guidance on when cost might represent fair value for subsequent measurement).

2. **<u>This paper is only relevant if the Board does NOT agree with the staff recommendation in agenda paper 3 and decides to keep a cost exception (or some variation thereof). If the Board agrees with the staff recommendation, we will not need to discuss this paper.</u>**

3. **The purpose of this paper is to ask the Board:**

   (a) **whether instruments should be reclassified between cost and fair value if a reliable measure <u>becomes</u> available or is <u>no longer</u> available; and**

   (b) **if so, under what circumstances should reclassifications be required and how should such reclassifications be accounted for.**

Proposals in the ED

4. The exposure draft (ED) proposed to eliminate the cost exception in IAS 39. The ED proposed to measure **all** equity investments and derivatives at fair value. As a result, the question of reclassification between fair value and cost was irrelevant.

Guidance in IAS 39

5. IAS 39 has a cost exception. The related reclassification requirements are in paragraphs 53–55 of IAS 39. To summarize:

   (a) If a reliable measure **becomes available** for a financial asset or financial liability for which such a measure was previously not available, the asset or liability shall be remeasured at fair value, and the difference between its carrying amount and fair value shall be accounted for either in profit or loss (if the instrument is classified as held-for-trading) or other comprehensive income (OCI) (if the instrument is classified as available-for-sale)

   (b) If, in the rare circumstance that a reliable measure of fair value is **no longer available**, it becomes appropriate to carry a financial asset or financial liability at cost rather than at fair value, the fair value of the financial asset or the financial liability on that date becomes its new cost. Any previous gain or loss on that asset that had been recognized directly in equity is accounted for on the basis of whether or not the instrument has a fixed maturity.

Staff analysis and recommendations

6. Consistent with IAS 39, we think that reclassifications should be **required** if:

   (a) a reliable measure **becomes available** for a financial asset or financial liability for which such a measure was previously not available; or

(b) in the rare circumstance that a reliable measure of fair value is **no longer available**, it becomes appropriate to carry a financial asset or financial liability at cost.

7. We see no benefit in **permitting** (rather than requiring) reclassifications if a reliable measure becomes available. The Board already decided that fair value is the most relevant measurement attribute for equity investments and derivatives; therefore cost should not continue to be used if fair value information becomes available. (A discussion of optionality is not relevant in the case where a reliable measure of fair value is no longer available.)

8. We recommend carrying forward the requirements in IAS 39, with minor modifications to reflect the new classification approach:

   (a) If a reliable measure **becomes available** for a financial asset or financial liability for which such a measure was previously not available, the asset or liability shall be remeasured at fair value, and the difference between its carrying amount (cost) and fair value shall be accounted for **in profit or loss** or **other comprehensive income** (if the entity had elected at initial recognition to measure the asset at FVTOCI).

   (b) In the rare circumstance that a reliable measure of fair value is **no longer available** and it becomes appropriate to carry a financial asset or financial liability at cost, the fair value of the financial asset or the financial liability on that date becomes its new cost.

   Any previous gain or loss on an asset that has been presented in OCI (ie because an entity had elected at initial recognition to measure the asset at FVTOCI) shall **not** be recycled to profit or loss (even on derecognition).

9. The recommendation in the last sentence of paragraph 8(b) assumes that the Board retains the proposal in the ED related to instruments measured at FVTOCI that prohibits recycling amounts to profit or loss. If the Board does not retain that proposal and requires recycling, the amounts presented in OCI

discussed in paragraph 8(b) would be recycled to profit or loss when the instrument is derecognized or impaired. That is consistent with the existing requirements in IAS 39 (paragraph 54(b)).

Question 1 – Reclassification between cost and fair value
Does the Board agree with the staff recommendation that reclassifications should be required if: (a) a reliable fair value measure **becomes available** for a financial asset or financial liability for which such a measure was previously not available; and (b) a reliable fair value measure is **no longer available** and it becomes appropriate to carry a financial asset or financial liability at cost? If not, what would you propose instead and why?

Question 2 – Reclassification between cost and fair value
Does the Board agree with the staff recommendation that such reclassifications should be accounted for as set out in paragraph 8 and 9? If not, what would you propose instead and why?

Disclosures

Guidance in IFRS 7

10. Paragraph 12 of IFRS 7 provides the disclosures relevant to reclassifications between the cost exception (in IAS 39) and fair value. To summarize, if an entity reclassifies a financial asset or financial liability between cost and fair value, the entity must disclose:

    (a) the amount reclassified into and out of each category; and

    (b) the reason for that reclassification.

Staff recommendation

11. We recommend carrying forward the disclosure requirements in IFRS 7. We also recommend that for the purposes of the disclosure in paragraph 10(a) above, the entity show separately FVTPL and FVTOCI.

Question 3 – Disclosure
Does the Board agree with the staff recommendation that the following disclosures should be required for all reclassifications between fair value and cost: (a) the reason for the reclassification; (b) the amount reclassified into and out of each category (showing separately FVTPL and FVTOCI). If not, what would you propose instead and why?