Project	**Financial Instruments: Replacement of IAS 39**
Topic	**Classification and measurement: the "other" measurement attribute**

Background

Proposals in the exposure draft

1. The exposure draft *Financial Instruments: Classification and Measurement* (ED) proposed a two measurement category approach for financial assets and financial liabilities—fair value and amortized cost.

2. A financial asset or financial liability would be measured at amortized cost if two conditions are met:

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

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

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

Tentative decision at the meeting on 29 September

4. At the meeting on 29 September the Board discussed those classification conditions — ie how to make "the cut" between those instruments that should be measured at fair value through profit or loss (FVTPL) and those that should not.

5. At that meeting, the Board confirmed the proposals in the ED that classification and measurement should reflect:

   (a) the entity's business model for managing its instruments; and

(b) the contractual cash flow characteristics of the instrument.

Purpose of this agenda paper

6. Consistent with the project plan discussed on 18 September, the next topic is how to measure the instruments that meet both the proposed conditions and, thus, are not measured at FVTPL.

7. **The objective of this paper is to discuss what the measurement category should be if an instrument is not measured at FVTPL— ie what the "other" measurement category should be.**

8. **This paper does not address whether**:

   (a) there should be exceptions to the approach (eg an option whereby fair value changes for particular instruments would be presented in OCI); or

   (b) subsequent measurement of particular financial liabilities should exclude the effects of own credit risk.

9. As a supplement to the discussion in this paper, the appendix discusses the comments received on the alternative approach (and its two variants) set out in the ED. Questions 14 and 15 asked about those approaches. Almost all of the respondents **did not support** the alternative approach or the variants. Therefore, we did not consider those alternatives further.

Relevant questions in the ED

10. Question 1 in the ED asked respondents about amortized cost:

    Question 1

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

Feedback received in the comment letters and outreach meetings

The "other" measurement category

11. Almost all respondents supported the proposed mixed attribute approach and stated that amortized cost provides relevant and useful information about particular instruments in particular circumstances.

12. Consistent with the proposals in the ED, those respondents believe that amortized cost can provide better information than fair value about the amounts, timing, and uncertainty of cash flows if the instrument:

    (a) is held for the purpose of collecting (or paying) those contractual cash flows, and

    (b) gives rise to contractual cash flows that are payments of principal and interest..

13. In those circumstances, the respondents stated that amortized cost provides information about likely actual cash flows, whereas fair value does not (because fair value assumes that the instrument is sold or transferred on the measurement date).

14. A few respondents said that amortized cost provides useful and relevant information in **more** circumstances (that is, that the amortized cost category should be **broader** than proposed in the ED). Generally those respondents thought that amortized cost was appropriate whenever the entity expects to hold the instruments to collect (or pay) contractual cash flows.

15. A small number of respondents preferred an approach that would measure all financial instruments at fair value. Those respondents said that users would benefit greatly if a single measurement attribute was used for all financial instruments. Also, they said that fair value reflects current and complete information about the instrument's current value. They noted that as market conditions change, the values, risk profiles, and prospective cash flows of the instruments also change—and stated that it is essential that users have a clear understanding of those changes. They said that amortized cost, given its smoothing nature and underlying assumption of a long-term holding period,

provides limited useful information. (The staff notes that this view is not supported by many users of financial statements. In both the comment letters received as well as the (ongoing) investor outreach it is clear that there are very divergent views among investors about (i) what should be fair valued (ii) where fair value information should be presented and/or disclosed and (iii) whether and/or where fair value changes should be recognized.)

Fair value information for instruments measured at amortized cost

16. Paragraph 25 of IFRS 7 requires an entity to disclose the fair value of all classes of financial assets and financial liabilities in a way that permits it to be compared with its carrying amount. The ED did not ask a question about that requirement (or include any proposal to require further fair value information for instruments measured at amortized cost). However, a few of the respondents who supported the proposed mixed attribute approach stressed that fair value information must be disclosed in the notes for all financial instruments that are measured at amortized cost.

17. During our outreach programme (including the round-tables), we asked participants whether fair value information should be presented on the face of the statement of financial position, rather than disclosed in the notes. The responses were mixed from all types of constituents—although most responses were either unsupportive or indifferent.

18. Some **supported** presenting that information on the face of the statement of financial position. These respondents, primarily users, generally thought that the fair value information would be more reliable (ie more rigorously prepared and audited) if it was presented on the face of the statement rather than in the notes. These respondents also noted that the information would be available sooner (ie an entity publishes the financial statements via a results release several weeks before it publishes the accompanying notes).

19. Some (including some users) were **indifferent** about whether fair value information is included in the notes or on the face of the statement of financial

position. These respondents, primarily users, generally noted that as long as the information is available, the location does not matter.

20. Some **opposed** presenting fair value information on the face of the statement of financial position. From an operational standpoint, preparers noted that it would be difficult to generate the fair value information quickly enough to coincide with its results release. Auditors disagreed with the assertion that information disclosed in the notes is less reliable than information on the face of the statements. Auditors and regulators asked whether the benefits of having that information on the face of the financial statement outweigh the costs of generating the information quickly. Regulators were concerned about having "two truths" presented on the face of the statement of financial position and also opposed giving fair value information equal prominence to amortized cost information.

FASB approach

21. Under the FASB's proposed approach, all financial assets and liabilities would be measured at fair value with changes in fair value presented either in:

    (a) profit or loss; or

    (b) OCI

22. As a result, fair value would be presented on the face of the statement of financial position for all instruments (unless the entity elects the exception described below in paragraph 24). An entity must also present the amortized cost of the instrument on the face of the statement of financial position if the instrument:

    (a) is the entity's own debt and is measured at fair value through profit or loss; or

    (b) is a financial asset or financial liability measured at fair value through OCI

23. In other words, an entity must present **both** fair value and amortized cost for particular instruments.

24. As an exception to the FASB's approach, an entity's own debt may be measured at amortized cost in particular circumstances. But as we mentioned in paragraph 9, this paper does not discuss exceptions.

Staff recommendation

The "other" measurement category

25. Consistent with the vast majority of comments received, we think that the "other" measurement category should be amortized cost. Therefore, we recommend that the proposed mixed measurement model is carried forward to the IFRS.

26. We think that amortized cost provides relevant and decision-useful information if

    (a) the objective of the entity's business model is to hold the instruments to collect (or pay) contractual cash flows; and

    (b) the instrument has contractual cash flow characteristics that reflect payments of principal and interest on the principal outstanding

27. **In fact, those two conditions were developed during the ED stage <u>specifically</u> to identify those instruments where amortized cost provides relevant and decision-useful information.**

28. The objective of amortized cost is to allocate interest income or expense over the expected life of a financial instrument. Amortized cost is an appropriate measurement attribute only if those amounts are predictable and expected to affect profit or loss over time in way that reflects an allocation approach. The two conditions were developed to meet that objective.

Fair value information for instruments measured at amortized cost

29. We do not recommend requiring fair value information to be presented on the face of the statement of financial position at this stage.

30. That proposal was not discussed in the ED nor did the ED ask a question on the topic. As a result, very few respondents addressed it. Furthermore, the responses during our outreach programme were mixed with very few constituents strongly supporting such a requirement.

31. If the Board wishes to explore this requirement further, we think that it should be considered at a later date so the staff can have additional discussions with users and other constituents. For example, this topic could be addressed subsequently as part of the convergence process when the IASB and FASB work to reconcile any differences in their approaches.

Question 1: The "other" measurement category

Does the Board agree with the staff recommendation that the "other" measurement category should be amortized cost?

If not, why? What measurement attribute do you want to use instead, and why?

Question 2: Fair value information

Does the Board agree with the staff recommendation that fair value information should continue to be required to be disclosed in the notes to the financial statements but **not** required to be presented on the face of the statement of financial position?

If not, why and what would you suggest instead?

Appendix

A1. As we noted in paragraph 9, this appendix is for Board members' information only. Given that almost all respondents did **not** support the alternative approach or the variants in the ED, we did not analyze them further.

A2. However, consistent with our pledge in the summary comment letter analysis (agenda paper 7 for the 18 September meeting), the objective of the appendix is to provide Board members with more detailed information on the responses to Questions 14 and 15.

Summary of the alternative approach and variants

A3. The ED summarized an alternative approach and two variants on it. The alternative approach and both variants would result in **more** instruments being measured at fair value than the approach proposed in the ED:

A4. Under the alternative approach and the first variant, all financial assets would be measured at fair value except for those assets that **both**:

(a) met the two conditions specified in the exposure draft **and**

(b) met the definition of *loans and receivables* in IAS 39.

A5. Under the second variant, all financial assets and financial liabilities would be measured at fair value.

A6. The alternative approach and the variants would require disaggregation of changes in fair value for particular instruments in particular circumstances.

Relevant questions in the ED

A7. Questions 14 and 15 in the ED asked respondents about the alternative approach and the two variants:

Question 14

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

(a) in the statement of financial position?

(b) in the statement of comprehensive income?

If so, why?

Question 15

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

Summary of comments received

A8. Almost all respondents **did not support** the alternative approach or the variants. Those respondents did not believe that any of those approaches provide more decision-useful information than the proposed approach.

A9. Respondents noted that the alternative approach and both variants would result in **more** instruments being measured at fair value than the approach proposed in the ED —and did not support that outcome. Moreover, respondents stated that the alternative approach (and the first variant) does not have an underlying principle because it is based on the proposed conditions **and** the definition of *loans and receivables*. Also, some of the respondents pointed out that financial assets and financial liabilities would have different classification conditions since the definition of *loans and receivables* only applies to the former.

A10. Finally, respondents noted that splitting gains and losses between profit or loss and OCI would increase complexity and reduce understandability.

A11. A small number of respondents supported the alternative approach or the variants. The primary reasons given were:

(a) **support for a full fair value approach**—This is discussed in paragraph 15

(b) **convergence with the FASB**—While neither the alternative approach nor the variants are the same as the FASB's proposed approach, the second variant is similar.