27 Feb – 29 Feb 2012

STAFF PAPER

REG FASB | IASB Meeting

Project	**Financial instruments: classification and measurement**
Paper topic	Cover paper

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Background

1. In November 2011, the IASB decided to consider making limited modifications to IFRS 9 with the following objectives:
   (a) to address specific application questions raised by constituents;
   (b) to consider the interaction of the classification and measurement model for financial assets with the insurance project; and
   (c) to consider the differences with the FASB's tentative classification and measurement model.
2. In making this decision, the IASB noted that IFRS 9 has generally been found to be conceptually sound and operational. The IASB also noted that many constituents have either already adopted IFRS 9 or dedicated significant resources in preparation for adoption. The IASB therefore agreed to be mindful of the extent of change to IFRS 9 and to complete the project expeditiously, seeking to minimise the cost and disruption to constituents. Consistent with these objectives,

in December 2011, the IASB confirmed that the scope of the project would be limited.

3. The FASB issued a comprehensive proposed Accounting Standards Update Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815) (proposed Update) in May 2010. The proposed Update would have required most financial instruments to be measured at fair value. However, in the light of the feedback received, the FASB has moved to a mixed-attribute model and is now nearing the completion of its re-deliberations. While both IFRS 9 and the FASB's tentative model are mixed-measurement models, differences between them remain.
4. Consistent with the boards' long-standing objective of increasing international comparability in the accounting for financial instruments and the feedback received from constituents, the boards decided in January 2012 to jointly redeliberate selected aspects of their classification and measurement models to seek to reduce key differences. The boards tentatively decided to discuss the following key differences:

   (a) the contractual cash flow characteristics of financial assets;

   (b) the need for bifurcation of financial assets and if pursued, the basis for bifurcation;

   (c) the basis for and the scope of a possible third classification category (debt instruments measured at fair value through other comprehensive income); and

   (d) any interrelated issues from the topics above (for example, disclosures or the model for financial liabilities).

5. The boards decided to discuss each issue jointly and consider what changes, if any, they would propose to make to their separate models and incorporate in their respective exposure drafts.

Purpose of this paper

6. This paper explains the order in which the staff plan to address the issues subject to the boards' joint discussions. It is for informational purposes only and, thus, there is no question for the boards.

Issues to be discussed

7. Both IFRS 9 and the FASB's tentative classification and measurement model involve assessing the characteristics of a financial asset and the objective of the business model within which the financial asset is held. Under IFRS 9 an entity first considers the business model within which the financial assets are held. Instruments that pass the business model assessment are subject to an assessment of their contractual cash flows characteristics. In contrast, under the FASB's tentative classification and measurement model for financial assets, an entity first assesses the characteristics of the instrument. This assessment is followed by the assessment of the business model. The staff believe that the order of the assessment of the business model and the cash flow characteristics does not change the classification conclusion.
8. The figure below provides an overview of the key topics related to the classification and measurement of financial assets that are within the scope of the joint discussions. The sequencing of the topics is explained in the following paragraphs with reference to the classification categories A, B, C and D, which are set out in the figure. The figure does not address the order in which the classification criteria should be assessed.

Classification category

A Amortised cost	B Fair value - OCI[1]	C Fair value - PL	D Fair value - PL
Meets business model criteria for amortised cost **and** passes cash flow characteristics assessment	Meets business model criteria for fair value - OCI **and** passes cash flow characteristics assessment	Meets business model criteria for fair value – PL or residual category **and** passes cash flow characteristics assessment	Fails cash flow characteristics assessment (regardless of the business model)

9. **Contractual cash flow characteristics** – At this meeting, the staff will propose an approach to the assessment of the contractual cash flow characteristics of a financial asset (Agenda Paper 5A/FASB Memo 133) that attempts to:

    (a) address the feedback the IASB has received on the application of the contractual cash flows characteristics assessment in IFRS 9 to particular financial assets; and

    (b) more closely align the financial assets characteristics assessment in IFRS 9 and the FASB's tentative model.

10. At this meeting, the staff will ask the boards whether they agree with the proposed approach. This decision will determine the population of financial assets that fall into categories A-C versus those that fall into category D. This will serve as a foundation for subsequent topics.

11. **Business model and the FV-OCI measurement category** – At this meeting, the staff will discuss the current business model assessment under IFRS 9 and the FASB's tentative model (Agenda Paper 5B/FASB Memo 134). This session will be for educational purposes only and thus the staff will not ask the boards to make

[1] The joint discussion of the FV-OCI classification on the basis of business model only applies to debt instruments (ie those instruments that pass the cash flow characteristics assessment). This does not impact the FV-OCI designation that is available under IFRS 9 for equity investments on initial recognition.

any decisions. The objective of the education session is to ensure that each board understands the other model and their respective basis for conclusions.

12. At a future meeting, the staff will ask the boards whether and, if so, how they would like to align their respective business model assessments. In developing the FV-OCI category, the staff will consider its applicability to the insurance industry. These decisions will ultimately determine which financial assets fall into categories A, B and C.
13. **Bifurcation of financial assets** – At a future meeting, the staff will ask the boards whether financial assets that fall into category D should be considered for bifurcation and, if so, what the basis for that bifurcation should be. This may result in a component of a debt instrument that satisfies the contractual cash flow characteristics assessment being considered for classification into categories A, B or C.
14. **Interrelated issues for financial liabilities** – As the boards discuss particular key aspects of the classification of financial assets, the staff will ask the boards to consider any consequences for the accounting for financial liabilities, including the need for greater symmetry in the classification and measurement of financial assets and financial liabilities.
15. Finally, the staff will ask the boards to discuss any further interrelated issues including transition, disclosures and other sweep issues. Some of these discussions may need to be joint while others may need to be separate. The boards will also separately consider what further changes, if any, they would like to make to their respective models and incorporate into their respective exposure drafts.