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Project	**Financial Instruments: Classification and Measurement**		
Paper topic	Accounting for reclassifications of financial assets		

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Introduction

1. In May 2012, the boards discussed whether, and in what circumstances, financial assets should be reclassified between measurement categories. The boards made the following tentative decisions:

   (a) The IASB tentatively decided to extend the existing reclassification requirements in IFRS 9 *Financial Instruments* to debt investments measured at fair value through other comprehensive income (FVOCI).[1]

   (b) The FASB tentatively decided to require financial assets to be reclassified prospectively when, and only when, the business model changes, which should be very infrequent. Changes in the business model that require reclassifications must be (i) determined by the entity's senior management

[1] At that same meeting, the IASB also tentatively decided that a FVOCI measurement category for eligible debt investments should be added to IFRS 9.

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as a result of external or internal changes; (ii) significant to the entity's operations; and (iii) demonstrable to external parties.

2. This paper addresses the remaining issues related to the reclassification of financial assets between measurement categories:

   (a) **Reclassification date**: The FASB will discuss the date on which a reclassification should take effect.[2]

   (b) **Reclassification mechanics**:

      (i) The FASB will discuss the accounting for all possible reclassification scenarios between the three measurement categories.

      (ii) The IASB will discuss the accounting for the reclassification of eligible debt investments into and out of the FVOCI measurement category.[3]

   (c) **Reclassification disclosures**: The IASB will discuss disclosures related to reclassifying eligible debt investments into and out of the FVOCI measurement category.[4]

Reclassification date (FASB only)

3. As noted in paragraph 1, the FASB tentatively decided at the May 2012 joint board meeting that a reclassification must be applied prospectively from the reclassification date when, and only when, the business model changes. That is, the entity would not

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[2] IFRS 9 requires that an entity apply the reclassification prospectively from the *reclassification date*. The reclassification date is defined as the first day of the first reporting period following the change in business model that results in an entity reclassifying financial assets. The staff do not think that the IASB should reconsider that decision because such a change would be inconsistent with the IASB's objective to make limited modifications to IFRS 9. Moreover, the staff believe that the date of reclassification would not be a key difference between the boards' respective classification and measurement models for financial assets particularly given the anticipated infrequency of such events occurring.

[3] IFRS 9 already includes the requirements for reclassifying financial assets between amortised cost and fair value through profit or loss. Those requirements are reproduced in paragraph 8 of this paper. The staff are not asking the IASB to reconsider those requirements.

[4] The IASB will discuss other disclosures related to its classification and measurement model at an IASB-only session at its July board meeting. The FASB will discuss disclosures related to its classification and measurement model comprehensively at a FASB-only meeting at a future date.

restate any previously recognised gains, losses or interest. However, the FASB asked the staff to provide further analysis on the date at which a reclassification should take effect. Specifically, whether the reclassification date should be:

(a) Alternative 1: the first day of the first reporting period following the change in business model; or

(b) Alternative 2: the last day of the reporting period in which there is a change in business model.

4. Alternative 1 is consistent with the requirements in IFRS 9. In making that decision, the IASB reasoned that entities should be prevented from choosing a reclassification date to achieve a particular accounting result. The IASB decided that defining the reclassification date as the first day of the reporting period following the change in business model would provide objectivity and the most discipline. That is because the entity would be required to change its business model before it knows the effect on its financial statements of the resulting reclassifications (ie when the entity changes its business model, its financial results for the following reporting period are unknown). Therefore, the entity is unable to achieve a particular accounting result in the current or next reporting period.

5. Moreover, given that changes in business model are expected to be very infrequent and must be significant to the entity's operations and demonstrable to external parties, the IASB noted that an entity most likely will disclose information about a change in business model in its financial statements in the reporting period in which it takes place. Therefore, interested parties will be informed about the change in business model in the period in which it occurs.

6. However, proponents of Alternative 2 believe that the effects of a change in business model and the resulting reclassifications should affect the entity's financial statements in the reporting period in which the change occurs—ie the effect should not be deferred until the next reporting period. They believe that requiring the reclassification date to be the last day of the reporting period in which there is a change in business model provides sufficient discipline to prevent an entity from choosing a reclassification date to achieve a particular accounting result while also

providing objectivity by reporting the effect of the reclassification in the period in which it occurs.

7. The FASB staff recommend Alternative 2. The FASB staff think that because the change in an entity's business model is expected to be very infrequent, and must be (1) determined by an entity's senior management as a result of external or internal changes, (2) significant to an entity's operations, and (3) demonstrable to external parties, reflecting the effect of the change in the business model in the period in which the change occurs provides more useful information to the users of the financial statements. The staff acknowledge that this recommendation is different from the requirements in IFRS 9. However, as noted above in footnote 2, the staff believe that the date of reclassification would not be a key difference between the boards' respective classification and measurement models for financial assets, particularly given the anticipated infrequency of such events occurring.

Question 1 (for the FASB only)
Does the FASB agree with its staff recommendation in paragraph 7 that the reclassification date should be the last day of the reporting period in which there is a change in an entity's business model? If not, what would you propose instead and why?

Reclassification mechanics (FASB and IASB)

Background

Reclassification mechanics in IFRS 9

8. Consistent with the boards' recent decisions, IFRS 9 requires the effect of reclassifications to be accounted for prospectively. Paragraphs 5.6.2 and 5.6.3 in IFRS 9 set out the requirements for accounting for reclassifications between amortised cost and fair value through profit or loss (FVPL):

   (a) If an entity reclassifies a financial asset from FVPL to amortised cost, the financial asset's fair value at the reclassification date becomes its new

carrying amount. The effective interest rate (EIR) is calculated based on that carrying amount.

(b) If an entity reclassifies a financial asset from amortised cost to FVPL, the financial asset is measured at fair value on 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 (P&L).

9. During the IASB's deliberations on this issue, it considered a second alternative for accounting for reclassifications from FVPL to amortised cost (ie item (a) in paragraph 8 above). Specifically the IASB discussed whether, at the reclassification date, the amortised cost should be calculated as if the instrument had always been so classified. The IASB rejected that alternative because, in some cases, it would be impracticable for an entity to apply this alternative. That is because when an entity measures a financial asset at FVPL, it is not required to separately calculate or report interest income, credit impairment expense, or reversals of credit impairment expense.[5] Moreover, some constituents argued that if an entity is not required to apply the new classification retrospectively, it is illogical to require the entity to calculate the new classification retrospectively.

10. The IASB exposure draft (IASB ED)[6] prohibited reclassification. Therefore, while most respondents disagreed with that proposal, many did not comment specifically on how they would account for reclassifications, other than noting that reclassifications should be prospective. However, those who did comment in more detail suggested mechanics that were consistent with the requirements in IFRS 9.

FASB's tentative model

11. Prior to the tentative decisions made in May 2012, the FASB's tentative model prohibited reclassification of financial assets. However, current US GAAP permits

[5] This concern about impracticability is reflected in the transition requirements in IFRS 9 (paragraph 7.2.10). In cases where it is impracticable to retrospectively apply the effective interest method or the impairment requirements upon transition to IFRS 9, the fair value of the financial asset at the date of initial application is treated as the new amortised cost.

[6] IASB ED 2009/7 *Financial Instruments: Classification and Measurement*

reclassifications between particular classification categories. Appendix D summarises those requirements.

Reclassification scenarios

12. The mechanics of the six possible reclassification scenarios are separately discussed in this paper, and labelled as indicated in the table below.

		Measurement after reclassification		
		Amortised cost	**FVOCI**	**FVPL**
Initial measurement	**Amortised cost**	n/a	Scenario 5	Scenario 2 (FASB only)
	FVOCI	Scenario 6	n/a	Scenario 3
	FVPL	Scenario 1 (FASB only)	Scenario 4	n/a

13. A table that summarises the staff's recommendations for the six scenarios is attached as Appendix A to this paper.

14. Throughout the discussion of the reclassification scenarios, the staff have used an example to illustrate the mechanics. For the ease of illustration, the staff have assumed that the expected loss model that has been discussed jointly by the boards would be applied to both financial assets measured at amortised cost and financial assets measured at FVOCI. This is consistent with the IASB's decision in May 2012 that credit impairment losses/reversals on financial assets measured at FVOCI should be recognised in P&L using the same credit impairment methodology as for financial assets measured at amortised cost. However, the FASB has yet to deliberate in the impairment project whether the same credit impairment model should apply to all financial assets in the same way. Depending on the outcome of that future FASB-

only discussion, the staff may need to update the reclassification examples to properly reflect the FASB's decision on that issue.

15. Moreover, in the examples for scenarios where a financial asset is measured at FVOCI, the staff has shown the financial asset at fair value on the balance sheet without separate presentation of an allowance for credit impairments. This was for simplicity and was not meant to prejudge the boards' decision on whether such an allowance should be separately presented or disclosed for assets measured at FVOCI. The IASB will discuss this topic at an IASB-only session at its July board meeting. The FASB will discuss this topic at a FASB-only meeting at a future date.

16. Finally, the staff acknowledge that the business model assessment is not performed on an individual instrument level but rather is performed at a higher level of aggregation, such as at a portfolio level. Therefore, because reclassifications are required when (and only when) the entity's business model changes, such reclassifications would not be expected to affect a single financial asset in isolation. However, for simplicity, we have illustrated the reclassification mechanics for a single financial asset.

17. The example used in the six scenarios is as follows:

> An entity acquires a financial asset on 1/1/X1 with a face value of CU4,500. On that date, the fair value equals the face value. Expected losses for the financial asset on 1/1/X1 are CU20.
>
> On 12/31/X1, the fair value of the financial asset has decreased to CU4,430. Expected losses for the instrument have increased to CU30.
>
> On 1/1/X2, the fair value and expected losses remain the same as on 12/31/X1 and the financial asset is reclassified.
>
> For simplicity, interest is ignored.

Scenario 1: Reclassification from FVPL to amortised cost (FASB only)

18. As noted above in paragraph 8(a), IFRS 9 already includes the requirements for this scenario, ie the fair value of the financial asset at the reclassification date becomes its

new carrying amount. Therefore, the discussion of this scenario is relevant only for the FASB.

19. The staff have identified two alternatives for the FASB to consider:

    (a) Alternative 1: The fair value of the financial asset at the reclassification date becomes its new carrying amount and the EIR is calculated based on that carrying amount (consistent with the requirement in IFRS 9); or

    (b) Alternative 2: At the reclassification date, the amortised cost is calculated as if the financial asset had always been so classified. Thus the original EIR is determined and used for subsequent interest income recognition. Any difference on the reclassification date between the new carrying amount (ie amortised cost) and fair value would be recognised in P&L.

Example

20. Using the fact pattern from the example set out in paragraph 17, the following journal entries illustrate the two alternatives.

Date	Alternative 1 Initial recognition at FVPL			Alternative 2 Initial recognition at FVPL
1/1/X1	FVPL asset	4,500		Same as Alternative 1
	Cash		4,500	

Date	Year-end revaluation			Year-end revaluation
12/31/X1	P&L	70		Same as Alternative 1
	FVPL asset		70	

Date	Reclassification to amortised cost			Reclassification to amortised cost		
1/1/X2	Amortised cost asset	4,430		Amortised cost asset	4,500	
	FVPL asset		4,430	FVPL asset		4,430
	Impairment expense (P&L)[1]	30		P&L		70
	Allowance-amortised cost (AC) asset		30	Impairment expense (P&L)	30	
				Allowance-AC asset		30

[1] This entry reflects the establishment of the impairment allowance per the expected loss model

21. Alternative 1 is consistent with IFRS 9. The staff think this alternative is straightforward and consistent with a prospective approach to reclassification.

22. The primary drawback of Alternative 1 is that the resulting EIR does not reflect the contractual terms of the instrument. In the past, some have expressed the view that the resulting interest income recognition (resulting from the new EIR) is not useful or relevant.

23. Alternative 2 would require an entity to retrospectively calculate the instrument's EIR (although previous reporting periods would not be re-stated). As a result of using the original EIR, interest income would reflect the contractual terms of the financial asset. However, Alternative 2 is more operationally challenging because it would require an entity to retrospectively calculate the instrument's EIR and effects of credit impairment.

24. On balance, we recommend Alternative 1— that the fair value of the instrument on the reclassification date should become its new carrying amount. This alternative is less operationally challenging and consistent with the notion of prospective reclassification and the requirements in IFRS 9.

Scenario 2: Reclassification from amortised cost to FVPL (FASB only)

25. As noted above in paragraph 8(b), IFRS 9 already includes the requirements for this scenario. Therefore, the discussion is relevant only for the FASB.

26. When a financial asset is reclassified from amortised cost to FVPL, the staff believe that it should be measured at fair value at the reclassification date with the difference between the previous carrying amount and fair value recognised in P&L. This is the approach required by IFRS 9.

27. Using the fact pattern from the example set out in paragraph 17, the journal entries would be as follows:

Date	Initial recognition at amortised cost		
1/1/X1	Amortised cost asset	4,500	
	Cash		4,500
	Impairment expense (P&L)	20	
	Allowance-AC asset		20

Date	Year-end revaluation		
12/31/X1	Impairment expense (P&L)	10	
	Allowance-AC asset		10

Date	Reclassification to FVPL		
1/1/X2	FVPL asset	4,430	
	Allowance-AC asset	30	
	P&L	40	
	Amortised cost asset		4,500

Questions 2 and 3 (for the FASB only)

Does the FASB agree with the staff recommendations:

(2) in paragraph 24—when a financial asset is reclassified from FVPL to amortised cost (Scenario 1), the fair value of a financial instrument on the reclassification date becomes its new carrying amount (Alternative 1);
(3) in paragraph 26—when a financial asset is reclassified from amortised cost to FVPL (Scenario 2), it is measured at fair value on the reclassification date with the difference between the previous carrying amount and fair value recognised in P&L?

If not, what would you propose instead and why?

Scenario 3: Reclassification from FVOCI to FVPL (IASB and FASB)

28. If a financial asset is reclassified from FVPL to FVOCI, it will have the same carrying amount – fair value – before and after the reclassification. However when the financial asset is measured at FVOCI, particular fair value changes will accumulate in OCI. Therefore, in Scenario 3, the boards need to consider how to treat those accumulated balances when the financial asset is reclassified to FVPL.

29. The staff recommend that those accumulated OCI balances are recycled from OCI to P&L on the date of reclassification. We believe that this recommendation is consistent with IFRS 9 and the staff's recommendation in Scenario 2. Specifically, according to the requirements in IFRS 9 and the recommendation for the FASB set out earlier in this paper, if a financial asset is reclassified from amortised cost to FVPL, the difference between the previous carrying amount and fair value is recognised in P&L at the reclassification date. We think it would be inappropriate to account for the accumulated OCI balance differently since, in both scenarios, the financial asset is being reclassified to FVPL. Moreover, the IASB tentatively decided in May 2012 that financial assets measured at FVOCI should have the same profile in P&L as financial assets measured at amortised cost.

30. Using the fact pattern from the example set out in paragraph 17, the journal entries would be as follows:

Date	Initial recognition at FVOCI		
1/1/X1	FVOCI asset	4,500	
	Cash		4,500
	Impairment expense (P&L)	20	
	OCI		20

Date	Year-end revaluation		
12/31/X1	Impairment expense (P&L)	10	
	OCI	60	
	FVOCI asset		70

Date	Reclassification to FVPL		
1/1/X2	FVPL asset	4,430	
	FVOCI asset		4,430
	P&L	40	
	OCI		40

Scenario 4: Reclassification from FVPL to FVOCI (IASB and FASB)

31. Consistent with the previous scenario, if a financial asset is reclassified from FVPL to FVOCI, it will have the same carrying amount – fair value – before and after the reclassification. The staff think that the mechanics of this reclassification scenario are straightforward because, unlike Scenario 3, there is not an accumulated OCI balance at the reclassification date.

32. The staff recommends that the financial asset should continue to be measured at fair value and particular changes in fair value subsequent to the reclassification date will be recognised in OCI.

33. At the reclassification date, an EIR will be calculated based on the carrying amount (ie the fair value) and the impairment requirements would be applied. That is consistent with the requirements in IFRS 9 and Alternative 1 in Scenario 1 for reclassifying a financial asset from FVPL to amortised cost.

34. The staff acknowledges that another alternative would be to recognise in OCI on the reclassification date the amounts that had been previously recognised in P&L (ie on

the reclassification date, the prior periods' P&L amounts would be reversed out of P&L and recognised in OCI). This would be consistent with Alternative 2 in Scenario 1. The staff do not recommend this alternative because it is inconsistent with the notion of prospective application and with the staff's recommendation in Scenario 1.

35. Using the fact pattern from the example set out in paragraph 17, the journal entries for the staff's recommendation would be as follows:

Date	Initial recognition at FVPL		
1/1/X1	FVPL asset	4,500	
	Cash		4,500

Date	Year-end revaluation		
12/31/X1	P&L	70	
	FVPL asset		70

Date	Reclassification to FVOCI		
1/1/X2	FVOCI asset	4,430	
	FVPL asset		4,430
	Impairment expense (P&L)	30	
	OCI		30

Scenario 5: Reclassification from amortised cost to FVOCI (IASB and FASB)

36. If a financial asset is reclassified from amortised cost to FVOCI, the staff recommend that the financial asset should be measured at fair value at the reclassification date. Any difference between the previous carrying amount and the fair value would be recognised in OCI. This recommendation is consistent with the requirements in IFRS 9 and the staff recommendation for the FASB in Scenario 2 for reclassifying a financial asset from amortised cost to FVPL. The only difference between the two scenarios is how to treat the difference between the previous carrying amount and fair value – ie if the financial asset is reclassified into FVPL (Scenario 2), that difference is recognised in P&L whereas if the financial asset is reclassified into FVOCI (Scenario 5), it is recognised in OCI.

37. The staff notes that interest income would not change when the entity reclassifies a financial asset from amortised cost to FVOCI. That is, the entity would have established the EIR when the financial asset was originally recognised (and measured at amortised cost) and would continue to use that rate when the asset is reclassified to FVOCI.

38. Using the fact pattern from the example set out in paragraphs 17, the journal entries would be as follows:

Date	Initial recognition at amortised cost		
1/1/X1	Amortised cost asset	4,500	
	Cash		4,500
	Impairment expense (P&L)	20	
	Allowance-AC asset		20

Date	Year-end revaluation		
12/31/X1	Impairment expense (P&L)	10	
	Allowance-AC asset		10

Date	Reclassification to FVOCI		
1/1/X2	FVOCI asset	4,430	
	Allowance-AC asset	30	
	OCI	40	
	Amortised cost asset		4,500

Scenario 6: Reclassification from FVOCI to amortised cost (IASB and FASB)

39. The staff have identified three alternatives for reclassifying a financial asset from FVOCI to amortised cost. The three alternatives are similar in that they all would measure the financial asset at fair value at the reclassification date (although one alternative subsequently adjusts that fair value measurement such that it results in an amortised cost carrying amount at the reclassification date, see Alternative 1 below) and would recognise the same amounts of interest income and impairment expense over the life of the financial asset. The primary difference among the alternatives is the accounting for the fair value changes that have been accumulated in OCI—specifically the timing of when and the method of how those accumulated OCI balances would be derecognised:

(a) Alternative 1: Measure the financial asset at fair value on the reclassification date. Derecognise the accumulated OCI balance at the reclassification date with the offsetting entry recognised against the financial asset balance. As a result, the financial asset will be measured at the reclassification date at amortised cost as if it had always been so classified.

(b) Alternative 2: Measure the financial asset at fair value on the reclassification date. Maintain the accumulated OCI balance related to the financial asset's original FVOCI classification until the financial asset is ultimately derecognised.

(c) Alternative 3: Measure the financial asset at fair value on the reclassification date. Amortise the accumulated OCI balance related to the financial asset's original FVOCI classification over the remaining life of the financial asset.

40. Using the fact pattern from the example set out in paragraph 17, the journal entries for the three alternatives would be as follows:

Date	Alternative 1 Initial recognition at FVOCI			Alternative 2 Initial recognition at FVOCI	Alternative 3 Initial recognition at FVOCI
1/1/X1	FVOCI asset	4,500		Same as Alternative 1	Same as Alternative 1
	Cash		4,500		
	Impairment expense (P&L)	20			
	OCI		20		

Date	Year-end revaluation			Year-end revaluation	Year-end revaluation
12/31/X1	Impairment expense (P&L)	10		Same as Alternative 1	Same as Alternative 1
	OCI	60			
	FVOCI asset		70		

Date	Reclassification to amortised cost			Reclassification to amortised cost			Reclassification to amortised cost		
1/1/X2	Amortised cost asset	4,430		Amortised cost asset	4,430		Amortised cost asset	4,430	
	FVOCI asset		4,430	FVOCI asset		4,430	FVOCI asset		4,430
	OCI	30		OCI	30		OCI	30	
	Allowance-AC asset		30	Allowance-AC asset		30	Allow-AC asset		30
	Amortised cost asset	70							
	OCI		70						

The accumulated OCI balance of 70 is derecognised by the final entry.

The accumulated OCI balance of 70 would be derecognised when the financial asset is derecognised.

The accumulated OCI balance of 70 would be amortised over the financial asset's remaining life.

41. The overall effect of Alternative 1 is that the accumulated balance in OCI is derecognised at the reclassification date (with the offsetting entry to the financial asset) and thus the financial asset would be measured as if it had always been classified at amortised cost.

42. Under both Alternative 2 and Alternative 3, the financial asset would be measured at fair value at the reclassification date. The difference between Alternative 2 and Alternative 3 is how the accumulated OCI balance is ultimately derecognised. The balance either can remain in OCI until the financial asset is derecognised (Alternative 2) or it can be amortised over the financial asset's remaining life (Alternative 3). Both alternatives could be operationally more complex than Alternative 1 because the entity would be required to track the accumulated OCI balance associated with the reclassified financial asset, ie so that the accumulated balance can be derecognised at the appropriate time.

43. However, as noted above in paragraph 39, the three alternatives have the same P&L profile – that is, interest income and credit impairment expense would be the same. The difference among the three is the timing and method of the derecognition of the accumulated OCI balance and, accordingly, the carrying amount of the reclassified financial asset. This is illustrated in Appendix B, which provides the journal entries under all three alternatives from the initial recognition to derecognition (repayment).

44. The staff also note that irrespective of which alternative the boards decide to pursue, they could consider two different methodologies for derecognising the accumulated OCI balance. In the journal entries above (and in Appendix B), the staff assumed that the derecognition of the accumulated OCI balance would affect OCI and thus the statement of comprehensive income – ie, OCI would be debited or credited to derecognise the accumulated OCI balance. We recommend that methodology because we think it is consistent with reclassifying a financial asset from amortised cost to FVOCI (Scenario 5) whereby the financial asset is measured at fair value at the reclassification date and any difference between the carrying amount and fair value is recognised in OCI. However, others may believe that the reclassification in Scenario 6 should not affect the statement of comprehensive income and therefore think that the accumulated OCI balance should be derecognised by directly adjusting equity. In

that case, there would be no effect on the statement of comprehensive income – ie the derecognition of the accumulated OCI balance would affect only the balance sheet. That would be similar to the IASB's decision in its general hedge accounting project related to basis adjustments in relation to forecast non-financial transactions. In that project, the IASB decided to remove the hedging gain or loss directly from accumulated OCI.

45. The staff recommend Alternative 1 because we think that the accumulated OCI balance should be eliminated when the financial asset is reclassified. That accumulated balance is not relevant or related to the reclassified asset (ie because the financial asset is now measured at amortised cost). That is consistent with our recommendation in Scenario 3 whereby the accumulated OCI balance is recycled when the financial asset is reclassified from FVOCI to FVPL. The only difference between Scenario 3 and this scenario is that it would be inappropriate in this scenario to recognise the accumulated OCI balance in P&L.

46. Moreover, maintaining the accumulated OCI balance until the asset is derecognised (Alternative 2) is inconsistent with both the financial asset's former measurement category (ie FVOCI) **and** its new measurement category (amortised cost). That is because if the financial asset continued to be measured at FVOCI, the accumulated OCI balance would be updated over the remaining life of the financial asset (ie it would not remain static until derecognition) and if the financial asset were measured at amortised cost, there would not be a balance accumulated in OCI. Similarly, amortising the accumulated OCI balance over the remaining life of the financial asset (Alternative 3) results in a carrying amount that is neither amortised cost nor fair value.

Questions 4-7 (for the FASB and IASB)

Do the FASB and IASB agree with the staff recommendation:

(4) in paragraph 29—when a financial asset is reclassified from FVOCI to FVPL to (Scenario 3), any accumulated OCI balances are recycled from OCI to P&L on the date of reclassification;
(5) in paragraph 32—when a financial asset is reclassified from FVPL to FVOCI (Scenario 4), it will continue to be measured at fair value and particular changes in fair value subsequent to the reclassification date will be recognised in OCI;
(6) in paragraph 36—when a financial asset is reclassified from amortised cost to FVOCI (Scenario 5), it should be measured at fair value on the reclassification date with any difference between the previous carrying amount and the fair value recognised in OCI; and
(7) in paragraph 45—when a financial asset is reclassified from FVOCI to amortised cost (Scenario 6), it should be measured at fair value on the reclassification date and the accumulated OCI balance at the reclassification date should be derecognised with an offsetting entry recognised against the financial asset balance.

If not, what would you propose instead and why?

Reclassification disclosures (IASB only)

47. This section discusses disclosures for reclassifications into and out of the FVOCI measurement category. Specifically it considers whether:

(a) the existing reclassification disclosures in IFRS 7 *Financial Instruments: Disclosures* for reclassifications between FVPL and amortised cost should be extended to reclassifications into and out of FVOCI; and

(b) additional disclosures should be added to IFRS 7 for reclassifications into and out of FVOCI.

Existing requirements in IFRS 7

48. Paragraphs 12B-12D in IFRS 7 set out the disclosure requirements when a financial asset is reclassified between amortised cost and FVPL:

12B An entity shall disclose if, in the current or previous reporting periods, it has reclassified any financial assets in accordance with paragraph 4.4.1 of IFRS 9. For each such event, an entity shall disclose:

(a) the date of reclassification.

(b) a detailed explanation of the change in business model and a qualitative description of its effect on the entity's financial statements.

(c) the amount reclassified into and out of each category.

12C For each reporting period following reclassification until derecognition, an entity shall disclose for assets reclassified 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 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.

49. As noted in paragraph 8 of this paper, when a financial asset is reclassified from FVPL to amortised cost, its fair value at the reclassification date becomes its new carrying amount. The IASB required the disclosure in 12C to respond to criticisms that the reported interest revenue (resulting from a 'new' EIR) is not useful. The IASB noted that this disclosure will highlight to users the magnitude of the interest revenue amounts that are calculated under a 'new' EIR.

50. As noted in footnote 2 of this paper, IFRS 9 defines 'reclassification date' as the first day of the first reporting period following a change in business model. That is because the IASB wanted to prevent an entity from choosing a reclassification date to

achieve a particular accounting result. Consistent with the objective of prohibiting an entity from 'cherry picking' a reclassification date, the disclosure in 12D provides fair value information for a limited time after reclassification. However, the IASB decided that this disclosure is not necessary for the long-term because requiring information about the former measurement category is inconsistent with the objective of prospective reclassification.

Existing requirements in IAS 1

51. If a financial asset is reclassified from amortised cost to FVPL, paragraph 82(ca) of IAS 1 *Presentation of Financial Statements* requires separate presentation in the statement of comprehensive income of any gain or loss arising from a difference between the asset's previous carrying amount and its fair value on the reclassification date.

Extending the existing requirements to reclassifications into and out of FVOCI

Paragraph 12B of IFRS 7

52. The disclosure in paragraph 12B of IFRS 7 provides general information about the reclassification. Therefore the staff recommend extending this disclosure to reclassifications into and out of FVOCI such that the disclosure applies to all reclassifications occurring in accordance with IFRS 9.

Paragraph 12C of IFRS 7

53. As mentioned in paragraph 49, the IASB decided that the disclosures in paragraph 12C of IFRS 7 would provide useful information when interest revenue is calculated on the basis of a new EIR (ie when the EIR is determined at the reclassification date). While these disclosures were developed in the context of reclassifications from FVPL to amortised cost, the staff believe that they are also relevant for a reclassification from FVPL to FVOCI (Scenario 4). That is because under Scenario 4 a new EIR will be calculated based on the financial asset's fair value at the reclassification date. Therefore, the staff recommend that paragraph 12C is extended to reclassifications

from FVPL to FVOCI. As a result, the requirements in paragraph 12C will apply to all reclassifications from FVPL.

Paragraph 12D of IFRS 7

54. As mentioned in paragraph 50, the IASB required the disclosures in paragraph 12D to provide fair value information for a limited time after a financial asset is reclassified from FVPL into amortised cost.

55. Staff believe that the disclosure requirement in paragraph 12D(b) —ie the fair value gain or loss that would have been recognised in P&L during the period if the financial assets had not been reclassified—would be relevant for reclassifications from FVPL to FVOCI (Scenario 4). As noted in paragraph 50, such a disclosure responds to criticisms that an entity might be able to choose a reclassification date to achieve a particular accounting result. Consistent with that objective, this disclosure would show the amounts that would have been recognised in P&L if the financial asset had not been reclassified. However, the disclosure requirement in paragraph 12D(a) —ie the fair value of the financial assets at the end of the reporting period—is not necessary because the reclassified assets would be measured at fair value before and after reclassification.

56. In addition, the staff believe that the disclosures in paragraph 12D could also be relevant to reclassifications from FVOCI to amortised cost (Scenario 6). That is because, after it is reclassified, the financial asset will no longer be measured at fair value and thus some fair value changes will no longer affect the statement of comprehensive income (ie OCI). However, the staff acknowledges that the disclosure in paragraph 12D(b) was originally developed to present the amount that would have been recognised in P&L if the financial asset had not been reclassified—and some may believe that this disclosure is less useful when the asset is reclassified from FVOCI to amortised cost since it will have the same P&L profile before and after the reclassification.

IAS 1

57. As noted in paragraph 51, if a financial asset is reclassified from amortised cost to FVPL (Scenario 2), IAS 1 requires separate presentation in the statement of

comprehensive income of any gain or loss arising from a difference between the asset's previous carrying amount and its fair value on the reclassification date.

58. The staff believe that this information is equally relevant for reclassifications from amortised cost to FVOCI (Scenario 5)−where any difference between the asset's previous carry amount and its fair value on the reclassification date would be recognised in OCI. The staff believe that paragraph 82A in IAS 1 would currently require that information to be separately presented in the statement of comprehensive income, ie amounts recognised in OCI as the result of reclassifying financial assets from amortised cost to FVOCI are different in nature from other amounts recognised in OCI, particularly given the anticipated infrequency of such reclassifications occurring.

Additional requirements for reclassifications into or out of FVOCI

59. If the IASB decides to pursue the staff's recommendations in this paper for accounting for reclassifications into and out of FVOCI, we think the disclosures discussed in the proceeding section are sufficient−ie the current requirements would be extended to reclassifications into and out of FVOCI but no additional requirements would be necessary.

60. However, if the IASB decides not to pursue the staff recommendation for reclassifications from FVOCI to amortised cost (Scenario 6) but rather decides to pursue either Alternative 2 or Alternative 3, the staff recommend that an entity is required to disclose the accumulated OCI balance at the end of each reporting period that is attributable to financial assets that are no longer measured at FVOCI.

Summary of recommended disclosures

61. In summary, the staff recommend that the existing reclassification disclosures in IFRS 7 be extended to reclassifications into or out of FVOCI as follows:

    (a) Paragraph 12B (general disclosure) should be extended to apply to all reclassification into and out of FVOCI. As a result, the disclosures in that paragraph would apply to all reclassifications;

(b) Paragraph 12C (related to the 'new' EIR and resulting interest income) should apply to reclassifications from FVPL to FVOCI. As a result, the disclosures in that paragraph would apply to all reclassifications from FVPL (ie all scenarios where a 'new' EIR must be computed); and

(c) Paragraph 12D (fair value information for a limited time) should apply to reclassifications from FVPL to FVOCI and reclassifications from FVOCI to amortised cost.

62. For Board members' convenience, Appendix C presents the recommended and required disclosures—along with the staff's recommendations for reclassification mechanics (discussed earlier in this paper)—in a tabular format.

Question 8 (for the IASB)

Does the IASB agree with the recommended disclosures in paragraph 61 for reclassifications into and out of the FVOCI measurement category? Specifically:

(a) paragraph 12B should be extended to all reclassifications into and out of FVOCI;

(b) paragraph 12C should be extended to reclassifications from FVPL to FVOCI; and

(c) paragraph 12D should be extended to apply to reclassifications from FVPL to FVOCI and from FVOCI to amortised cost.

If not, what would you propose instead and why?

Appendix A: Summary of the staff recommendations for reclassification mechanics

		Measurement after reclassification		
		Amortised cost	**FVOCI**	**FVPL**
Initial measurement	**Amortised cost**	n/a	Scenario 5 Remeasure at fair value on the reclassification date with any difference recognised in OCI.	Scenario 2 (FASB only) Remeasure at fair value on the reclassification date with any difference recognised in P&L.
	FVOCI	Scenario 6 Fair value on the reclassification date becomes the new carrying amount. Derecognise the accumulated OCI balance against that fair value carrying amount.	n/a	Scenario 3 Continue to measure at fair value. Recycle the entire OCI balance through P&L on the reclassification date.
	FVPL	Scenario 1 (FASB only) Fair value on the reclassification date becomes the new carrying amount.	Scenario 4 Continue to measure at fair value with subsequent changes in fair value recognised in OCI.	n/a

Appendix B – Journal entries for Scenario 6 from initial recognition to derecognition

A1. The purpose of this appendix is to compare the three alternatives for Scenario 6 over the life of the financial asset. The journal entries below continue the illustration that is set out in paragraph 40 of the paper, which is based on the fact pattern described paragraph 17:

a. An entity acquires a financial asset on 1/1/X1 with a face value of CU4,500. On that date, the fair value equals the face value. Expected losses for the financial asset on 1/1/X1 are CU20.

b. On 12/31/X1, the fair value of the financial asset has decreased to CU4,430. Expected losses for the instrument have increased to CU30.

c. On 1/1/X2, the fair value and expected losses remain the same as on 12/31/X1 and the financial asset is reclassified.

A2. To continue the example, the following additional information is provided:

a. The instrument has a three-year term that ends on 12/31/X3.

b. The contractual interest rate and EIR is 5%. Interest is paid at the end of each year.

c. No credit losses are realised.

Date	Alternative 1 Initial recognition at FVOCI		
1/1/X1	FVOCI asset	4,500	
	Cash		4,500
	Impairment expense (P&L)	20	
	OCI		20

Alternative 2 Initial recognition at FVOCI		
FVOCI asset	4,500	
Cash		4,500
Impairment expense (P&L)	20	
OCI		20

Alternative 3 Initial recognition at FVOCI		
FVOCI asset	4,500	
Cash		4,500
Impairment expense (P&L)	20	
OCI		20

Date	Year-end revaluation		
12/31/X1	Impairment expense (P&L)	10	
	OCI	60	
	FVOCI asset		70
	Cash	225	
	Interest revenue		225[7]

Year-end revaluation		
Impairment expense (P&L)	10	
OCI	60	
FVOCI asset		70
Cash	225	
Interest revenue		225

Year-end revaluation		
Impairment expense (P&L)	10	
OCI	60	
FVOCI asset		70
Cash	225	
Interest revenue		225

[7] For simplicity, the staff have shown the net journal entry for interest revenue, ie the gross entry would be DR Financial asset, CR Interest revenue, DR Cash, CR Financial asset.

Date	Alternative 1 Reclassification to amortised cost			Alternative 2 Reclassification to amortised cost			Alternative 3 Reclassification to amortised cost		
1/1/X2	Amortised cost asset	4,430		Amortised cost asset	4,430		Amortised cost asset	4,430	
	FVOCI asset		4,430	FVOCI asset		4,430	FVOCI asset		4,430
	OCI	30		OCI[8]	30		OCI[9]	30	
	Allowance - AC asset		30	Allowance - AC asset		30	Allowance - AC asset		30
	Amortised cost asset	70							
	OCI		70						

Date	Year-end interest revenue recognition			Year-end interest revenue recognition			Year-end interest revenue recognition		
12/31/X2	Cash	225		Cash	225		Cash	225	
	Interest revenue		225	Interest revenue		225	Interest revenue		225
							Amortised cost asset	34	
							OCI		34

[8] The accumulated OCI balance of 70 would be eliminated when the financial asset is derecognised.

[9] The accumulated OCI balance of 70 would be amortised over the financial asset's remaining life.

Date	Interest revenue recognition & repayment		
	Cash	225	
	Interest revenue		225
12/31/X3	Cash	4,500	
	Allowance-AC asset	30	
	Impairment expense		30
	Amortised cost asset		4,500

Interest revenue recognition & repayment		
Cash	225	
Interest revenue		225
Cash	4,500	
Allowance - AC asset	30	
Impairment expense		30
OCI		70
Amortised cost asset		4,430

Interest revenue recognition & repayment		
Cash	225	
Interest revenue		225
Amortised cost asset	36	
OCI		36
Cash	4,500	
Allowance - AC asset	30	
Impairment expense		30
Amortised cost asset		4,500

Appendix C – Summary of the staff recommendations for reclassification mechanics and reclassification disclosures

<table>
<tr><td colspan="2" rowspan="2"></td><td colspan="3">Measurement after reclassification</td></tr>
<tr><td>Amortised cost</td><td>FVOCI</td><td>FVPL</td></tr>
<tr><td rowspan="2">Initial measurement</td><td>Amortised cost</td><td>n/a</td><td><u>Scenario 5</u>
Mechanics: Remeasure at fair value on the reclassification date with any difference recognised in OCI.

No disclosures proposed but IAS 1 would require separate presentation of the difference recognised in OCI</td><td><u>Scenario 2</u>
Currently required:
Mechanics: Remeasure at fair value on the reclassification date with any difference recognised in P&L.

No disclosures required but IAS 1 requires separate presentation of the difference recognised in P&L.</td></tr>
<tr><td>FVOCI</td><td><u>Scenario 6</u>
Mechanics: Fair value on the reclassification date becomes the new carrying amount. Derecognise the accumulated OCI balance against that fair value carrying amount.

Disclose (for a limited time): The fair value of the financial assets at the end of the reporting period and the fair value gain or loss that would have been recognised in OCI during the reporting period if the financial assets had not been reclassified.</td><td>n/a</td><td><u>Scenario 3</u>
Mechanics: Continue to measure at fair value. Recycle the entire OCI balance through P&L on the reclassification date.

No disclosures proposed but IAS 1 would require information about the amount recycled from OCI to P&L on the reclassification date.</td></tr>
</table>

<table>
<tr><td colspan="2"></td><th colspan="3">Measurement after reclassification</th></tr>
<tr><td colspan="2"></td><th>Amortised cost</th><th>FVOCI</th><th>FVPL</th></tr>
<tr><th>Initial measurement</th><th>FVPL</th><td>Scenario 1
Currently required:
Mechanics: Fair value on the reclassification date becomes the new carrying amount.

Disclose: The EIR determined on the date of reclassification and the interest income recognised during the period.
(For a limited time) The fair value of the financial assets at the end of the reporting period and the fair value gain or loss that would have been recognised in P&L during the reporting period if the financial assets had not been reclassified.</td><td>Scenario 4
Mechanics: Continue to measure at fair value with subsequent changes in fair value recognised in OCI.

Disclose: The EIR determined on the date of reclassification and the interest income recognised during the period.
(For a limited time) The fair value gain or loss that would have been recognised in P&L during the reporting period if the financial assets had not been reclassified.</td><td>n/a</td></tr>
</table>

Appendix D – Current US GAAP reclassification requirements

D1. The purpose of this appendix is to summarise the current US GAAP requirements for reclassifications between categories. See ASC 320-10-35-5 through 35-16.

D2. Reassessment of Reclassification

35-5 At each reporting date, the appropriateness of the classification of an entity's investments in debt and equity securities shall be reassessed. For example, if an entity no longer has the ability to hold securities to maturity, their continued classification as held-to-maturity would not be appropriate.

35-6 Because an entity is expected not to change its intent about a held-to-maturity security, the requirement to reassess the appropriateness of a security's classification focuses on the entity's ability to hold a security to maturity. The preceding paragraph acknowledges that facts and circumstances can change; for example, an entity can lose the ability to hold a debt security to maturity. However, that acknowledgment in no way diminishes the restrictive nature of the held-to-maturity category.

35-7 After securities are reclassified to available-for-sale in response to a taint, judgment is required in determining when circumstances have changed such that management can assert with a greater degree of credibility that it now has the intent and ability to hold debt securities to maturity.

D3. Sales and Transfers that Taint the Entity's Held-to-Maturity Intent

35-8 A sale or transfer of a security classified as held-to-maturity that occurs for a reason other than those specified in paragraphs 320-10-25-6, 320-10-25-9, and 320-10-25-14, calls into question (taints) the entity's intent about all securities that remain in the held-to-maturity category. The entity makes the same assertion about all debt securities in the held-to-maturity category—namely, that it has the positive intent and ability to hold each security to maturity. Only a sale or transfer in response to certain changes in conditions will not call into question an entity's intent to hold other debt securities to maturity in the future.

35-9 When a sale or transfer of held-to-maturity securities represents a material contradiction with the entity's stated intent to hold those securities to maturity or when

a pattern of such sales has occurred, any remaining held-to-maturity securities shall be reclassified to available-for-sale. The reclassification shall be recorded in the reporting period in which the sale or transfer occurred and accounted for as a transfer under the following paragraph.

D4. Transfers of Securities Between Categories

35-10 The transfer of a security between categories of investments shall be accounted for at fair value. At the date of the transfer, the security's unrealized holding gain or loss shall be accounted for as follows:

a. For a security transferred from the trading category, the unrealized holding gain or loss at the date of the transfer will have already been recognized in earnings and shall not be reversed.

b. For a security transferred into the trading category, the portion of the unrealized holding gain or loss at the date of the transfer that has not been previously recognized in earnings shall be recognized in earnings immediately.

c. For a debt security transferred into the available-for-sale category from the held-to-maturity category, the unrealized holding gain or loss at the date of the transfer shall be reported in other comprehensive income.

d. For a debt security transferred into the held-to-maturity category from the available-for-sale category, the unrealized holding gain or loss at the date of the transfer shall continue to be reported in a separate component of shareholders' equity, such as accumulated other comprehensive income, but shall be amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount. The amortization of an unrealized holding gain or loss reported in equity will offset or mitigate the effect on interest income of the amortization of the premium or discount (discussed in the following sentence) for that held-to-maturity security. For a debt security transferred into the held-to-maturity category, the use of fair value may create a premium or discount that, under amortized cost accounting, shall be amortized thereafter as an adjustment of yield pursuant to Subtopic 310-20.

35-11 Transfers from the held-to-maturity category should be rare, except for transfers due to the changes in circumstances identified in paragraph 320-10-25-6(a) through (f).

35-12 In addition, given the nature of a trading security, transfers into or from the trading category also should be rare.

35-13 Available-for-sale securities shall not be automatically transferred to the trading category because the passage of time has caused the maturity date to be within one year or because management intends to sell the security within one year. Similarly, if an entity plans to sell a security from the held-to-maturity category in response to one of the conditions in paragraphs 320-10-25-6 and 320-10-25-9, the security shall not be automatically reclassified to available-for-sale or trading before the sale.

35-14 Paragraph 860-10-55-75 gives an Example addressing whether a transferor has the option to classify debt securities as trading at the time of a transfer.

35-15 When a security is transferred from held-to-maturity to available-for-sale, the security's amortized cost basis carries over to the available-for-sale category for all of the following purposes:

a. The subsequent amortization of the historical premium or discount

b. The comparisons of fair value and amortized cost for the purpose of determining unrealized holding gains and losses under paragraph 320-10-35-1

c. The required disclosures of amortized cost.

35-16 When a security is transferred from available-for-sale to held-to-maturity, the difference between the par value of the security and its fair value at the date of transfer is amortized as a yield adjustment in accordance with Subtopic 310-20. That fair value amount, adjusted for subsequent amortization, becomes the security's amortized cost basis for the disclosures required by paragraphs 320-10-50-2 through 50-3, 320-10-50-5, and 320-10-50-10.