

STAFF PAPER

22 – 24 January 2014

IASB Meeting

Project	Financial Instruments: Classification and Measurement		
Paper topic	Presentation and disclosure		
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Purpose and structure of paper

1. This paper discusses the **presentation and disclosure** proposals in the IASB's exposure draft ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010)) (the 'Limited Amendments ED').
2. Specifically, this paper covers the following proposals:
 - (a) Disclosure and presentation requirements related to the reclassification of assets into or out of the fair value through other comprehensive income (FVOCI) mandatory measurement category; and
 - (b) Other disclosure requirements.
3. This paper provides background information about the proposals, summarises the feedback received, sets out the staff recommendation and asks the IASB whether it wants to confirm the proposals in the Limited Amendments ED.
4. This paper does not discuss the disclosure requirements related to the transition to IFRS 9. Those requirements are discussed in Agenda papers 6C and 6D for this month's meeting.

Disclosure and presentation requirements related to the reclassification of financial assets into or out of FVOCI

Background

Existing requirements in IFRS 7 'Financial Instruments: Disclosures'

5. IFRS 9 *Financial Instruments* has two measurement categories—amortised cost and fair value through profit of loss (FVPL). Pursuant to paragraph 4.4.1 of IFRS 9, an entity must reclassify all affected financial assets when (and only when) it changes its business model for managing financial assets. Paragraphs 5.6.1–5.6.3 of IFRS 9 describe the mechanics for reclassifying financial assets between amortised cost and FVPL. (Paragraphs 5.6.1–5.6.3 are reproduced in Appendix A to this Agenda paper.)

6. Paragraphs 12B–12D in IFRS 7 set out the **disclosure requirements** that apply when an entity reclassifies a financial asset 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.

7. **Paragraph 12C**—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 paragraph 12C of IFRS 7 to respond to criticisms that the reported interest revenue (resulting from a ‘new’ effective interest rate (EIR)) is not useful. The IASB noted that this disclosure will highlight to users of the financial statements the magnitude of the interest revenue amounts that are calculated under the ‘new’ EIR.
8. **Paragraph 12D**—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 paragraph 12D of IFRS 7 provides fair value information for a limited time after reclassification. The IASB decided that this disclosure is not necessary for the long-term because requiring information about the former measurement category is inconsistent with both the objective of prospective reclassification and the relevance of measurement based on the new business model.

Existing requirements in IAS 1 ‘Presentation of Financial Statements’

9. When a financial asset is reclassified from amortised cost to FVPL, its fair value is measured at the reclassification date. Paragraph 82(ca) of 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 at the reclassification date.

Proposals in the Limited Amendments ED

10. The Limited Amendments ED proposed to introduce a third mandatory measurement category—FVOCI. Accordingly, the requirements in paragraph

4.4.1 of IFRS 9 would apply to assets measured at FVOCI such that an entity would be required to reclassify **all** affected financial assets—ie those that are measured at amortised cost, FVPL or FVOCI—when it changes its business model for managing those financial assets. The Limited Amendments ED proposed reclassification mechanics for when an entity reclassifies financial assets into or out of FVOCI. (The proposals related to those mechanics are reproduced in Appendix A to this Agenda paper.)

11. That ED also proposed to extend the disclosure and presentation requirements in IFRS 7 and IAS 1 to reclassifications into and out of the FVOCI measurement category. The following table summarises the relevant proposals:

Existing requirements	Proposals in Limited Amendments ED
IFRS 7, paragraph 12B: <i>General information about the reclassification</i>	Extend to reclassifications into and out of FVOCI such that this disclosure will apply to <u>all reclassifications</u> occurring in accordance with IFRS 9.
IFRS 7, paragraph 12C <i>Information about the 'new' EIR</i>	Extend to reclassifications from FVPL to FVOCI such that this disclosure will apply to <u>all reclassifications from FVPL</u> . ¹ This disclosure will 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).
IFRS 7, paragraph 12D <i>Fair value information for a limited period</i>	Extend to (1) reclassifications from FVPL to FVOCI such that the disclosure will apply to <u>all reclassifications from FVPL</u> and (2) reclassifications <u>from FVOCI to amortised cost</u> . This disclosure will provide fair value information for a limited time after a financial asset is reclassified from FVPL or FVOCI to respond to criticisms that an entity might be able to choose a reclassification date to achieve a particular accounting result. Specifically, it will show the fair value of the asset at the end of the reporting period and the amounts that would have been recognised in profit or loss (P&L) or other comprehensive income (OCI) if the financial asset had not been reclassified.

¹ An EIR is not required to be established for financial assets that are measured at FVPL. As such, this proposal extends the disclosure to all reclassifications that require an EIR to be newly determined in order to apply the mechanics of amortised cost or FVOCI measurement.

Existing requirements	Proposals in Limited Amendments ED
<p>IAS 1, paragraph 82(ca)</p> <p><i>Separate presentation of amounts recognised in P&L at the reclassification date</i></p>	<p>Paragraph 82(cb) was added to IAS 1 to extend this requirement to reclassifications from FVOCI to FVPL, such that this presentation requirement will apply to <u>all reclassifications into FVPL</u>.</p> <p>This presentation proposal will separately present in the statement of comprehensive income the amount previously recognised in OCI that is reclassified to P&L when an asset is reclassified from FVOCI to FVPL.</p>

Feedback received

12. The Limited Amendments ED did not ask a specific question on the IASB's proposals to extend the disclosure and presentation requirements in IFRS 7 and IAS 1 to reclassifications into and out of the FVOCI measurement category—and respondents did not provide feedback on those proposals.

Staff analysis and recommendation

13. In November 2013, the IASB tentatively decided to confirm its proposal in the Limited Amendments ED to introduce FVOCI into IFRS 9 as a mandatory measurement category. At that time, the IASB also tentatively decided to confirm that when an entity changes its business model for managing its financial assets, it must reclassify all affected financial assets according to the reclassification mechanics set out in IFRS 9 and the Limited Amendments ED. Accordingly, we think the IASB should confirm the related proposals for disclosures and presentation. Specifically:
- (a) Paragraph 12B in IFRS 7 (general disclosure) should be extended to reclassifications into and out of the mandatory FVOCI measurement category. As a result, this disclosure will apply to all reclassifications occurring in accordance with IFRS 9.
 - (b) Paragraph 12C in IFRS 7 (related to the 'new EIR' and resulting interest revenue) should be extended to reclassifications from FVPL to

FVOCI. As a result, this disclosure will apply to all reclassifications from FVPL (ie all scenarios where a ‘new’ EIR must be computed).

- (c) Paragraph 12D in IFRS 7 (fair value information for a limited time) should be extended to (i) reclassifications from FVPL to FVOCI and (ii) reclassifications from FVOCI to amortised cost.
- (d) Paragraph 82 in IAS 1 should be amended to include reclassifications from FVOCI to FVPL. As a result, when an asset is reclassified from FVOCI to FVPL, the amount previously recognised in OCI that is reclassified to P&L will be separately presented in the statement of comprehensive income.

Question 1 for the IASB

Does the IASB agree with the staff recommendation in paragraph 13 to confirm the disclosure and presentation proposals in the Limited Amendments ED related to the reclassification of financial assets into and out of the mandatory FVOCI measurement category?

Other disclosure proposals

Background

- 15. The Limited Amendments ED proposed other disclosures in the light of the proposed amendments to the classification and measurement requirements in IFRS 9.

Judgement in assessing an asset’s contractual cash flow characteristics

- 16. Paragraph 122 of IAS 1 requires an entity to disclose the judgments that management has made in the process of applying its accounting policies that have the most significant effect on the amounts recognised in the financial statements. The Limited Amendments ED proposed that the judgement involved in the assessment of an asset’s contractual cash flow characteristics should be added to paragraph 123 of IAS 1 as an example of a judgement that could have a significant effect on the amounts recognised in the financial statements.

17. That proposal resulted from the IASB's proposed amendment to how the notion of 'solely principal and interest' (solely P&I) should be applied in particular circumstances. Specifically, the Limited Amendments ED proposed to clarify that a financial asset is eligible for a measurement category other than FVPL if the economic relationship between principal and the consideration for the time value of money and the credit risk of an asset is modified but the degree of modification is not more than insignificant. In making this assessment, an entity would consider all available information—that is, historical experience, current conditions and future forecasts—and would apply judgement. The IASB noted that that proposed amendment may introduce more judgement in an entity's assessment of the asset's contractual cash flow characteristics—and thus proposed the amendment to IAS 1 that is described above in paragraph 16.

Impairment of assets mandatorily measured at FVOCI

18. The Limited Amendments ED proposed that IFRS 7 should prohibit an entity from presenting an allowance balance on the face of the statement of financial position for financial assets mandatorily measured at FVOCI. That is because FVOCI assets are presented at fair value on the statement of financial position—and presentation of an accumulated impairment amount would be a departure from that fair value carrying amount and would be complicated and potentially confusing. For example, in order to provide a full picture, in addition to the accumulated impairment amount, the entity would need to show a fair value adjustment that is required to re-establish a fair value carrying amount. This proposal is related to the IASB's impairment project and thus is discussed further in Agenda paper 5A for this meeting.

Feedback received

19. The Limited Amendments ED did not ask a specific question on these disclosure proposals. However, a few respondents provided feedback on the proposal that the judgement involved in the assessment of an asset's contractual cash flow characteristics should be added to paragraph 123 of IAS 1 as an example of a judgement that could have a significant effect on the amounts recognised in the financial statements. Those respondents agreed with that proposal and said that it

would enhance transparency and the understanding of users of the financial statements.

Staff analysis and recommendation

20. In September 2013, the IASB tentatively decided to confirm its proposal that a financial asset could be eligible for a measurement category other than FVPL if the time value of money component of an interest rate is ‘modified’ (ie not perfect).² Therefore we think the rationale in paragraph 17 of this paper for the proposed disclosure is still relevant—and thus the IASB should confirm its proposal that the judgement involved in the assessment of an asset’s contractual cash flow characteristics should be added to paragraph 123 of IAS 1 as an example of a judgement that could have a significant effect on the amounts recognised in the financial statements.
21. At the September 2013 meeting, the IASB made two tentative decisions related to the assessment of an asset’s contractual cash flow characteristics. Specifically, a financial asset will be eligible for classification at other than FVPL (subject to the business model assessment) if the asset:
- (a) has a regulated interest rate if that rate provides consideration that is broadly consistent with consideration for the passage of time and does not introduce exposure to risks or volatility in cash flows that are inconsistent with the basic lending-type return; and/or
 - (b) is acquired (or originated) with a significant premium or discount and is prepayable at an amount that represents par plus accrued and unpaid interest (and may include reasonable additional compensation for the early termination of the contract) but the fair value of the prepayment feature on initial recognition of the financial asset is insignificant.

² When the time value of money component of the interest rate is modified, the IASB clarified at its September 2013 meeting that both qualitative and quantitative approaches could be used to determine whether the interest rate provides consideration for just the passage of time. Related to the quantitative approach, the IASB also tentatively decided to replace the ‘not more than insignificant’ threshold in the Limited Amendments ED with a ‘not significant’ threshold (that is, a financial asset with a modified time value of money component of the interest rate would meet the solely P&I condition if its contractual cash flows could not be significantly different from the benchmark instrument’s cash flows).

22. We note that the example added to paragraph 123 of IAS 1, described above in paragraph 20, will apply to all of the judgements that management has made in the process of applying the contractual cash flow characteristics assessment—which will, in accordance with the Board’s tentative decisions, include judgements related to the factors described above in paragraph 21(a) and 21(b).

Question 2 for the IASB

Does the IASB agree with the staff recommendation in paragraph 22 to confirm the proposal that the judgement involved in the assessment of an asset’s contractual cash flow characteristics should be added to IAS 1 as an example of a judgement that could have a significant effect on the amounts recognised in the financial statements?

Appendix A

Extract from the Limited Amendments ED—reclassification mechanics

Paragraphs 5.6.2–5.6.3 are amended. Deleted text is struck through and new text is underlined. Paragraph 5.6.1 is included for reference only and is not proposed for amendment.

5.6 Reclassification of financial assets

- 5.6.1 If an entity reclassifies financial assets in accordance with paragraph 4.4.1, it shall apply the reclassification prospectively from the *reclassification date*. The entity shall not restate any previously recognised gains, losses or interest.
- 5.6.2 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset out of the amortised cost measurement category and so that it is measured at into the fair value through profit or loss measurement category, its fair value is determined at 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.
- 5.6.3 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset out of the fair value through profit or loss measurement category and so that it is measured at into the amortised cost measurement category, its fair value at the reclassification date becomes its new carrying amount.

Paragraphs 5.6.4–5.6.7 are added.

- 5.6.4 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset out of the amortised cost measurement category and into the fair value through other comprehensive income measurement category, its fair value is determined at the reclassification date. Any gain or loss arising from a difference between the previous carrying amount and fair value is recognised in other comprehensive income. The effective interest rate is not adjusted as a result of the reclassification.
- 5.6.5 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset out of the fair value through other comprehensive income measurement category and into the amortised cost measurement category, the financial asset is reclassified at its fair value at the reclassification date. However, the cumulative gain or loss previously recognised in other comprehensive income is removed from equity and adjusted against the fair value of the financial asset at the reclassification date. This adjustment affects other comprehensive income but does not affect profit or loss and is therefore not a reclassification adjustment (see IAS 1 *Presentation of Financial Statements*). The effective interest rate is not adjusted as a result of the reclassification.
- 5.6.6 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset out of the fair value through profit or loss measurement category and into the fair value through other comprehensive income measurement category, its fair value at the reclassification date becomes its new carrying amount.
- 5.6.7 If, in accordance with paragraph 4.4.1, an entity reclassifies a financial asset out of the fair value through other comprehensive income measurement category and into the fair value through profit or loss measurement category, its fair value at the reclassification date becomes its new carrying amount. The cumulative gain or loss previously

recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment (see IAS 1) at the reclassification date.