IFRS 9 *Financial Instruments* asset classification and measurement

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September 2017

Practical Workshop for the National Bank of Republic of Belarus

CFRR Centre for Financial Reporting Reform

WORLD BANK GROUP Governance

STAREP

Strengthening Auditing and Reporting in the Countries of the Eastern Partnership

STAREP is co-funded by:

Austrian Development Cooperation

BMF FEDERAL MINISTRY OF FINANCE

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European Union

LE GOUVERNEMENT DU GRAND-DUCHÉ DE LUXEMBOURG
Ministère des Finances

Aims

Understand the judgments in applying IFRS 9 regarding:

- classification of financial assets
  - applying the SPPI test
  - applying the business model test
  - options to designate at FVPL and FVOCI
  - reclassifications of financial assets
- measurement of financial instruments at initial recognition
- subsequent measurement of financial assets

Financial asset accounting overview of differences between IAS 39 and IFRS 9

Recognition and derecognition (IAS 39 and IFRS 9)

Recognition: when party to the contractual provisions of the instrument (principle)

Derecognition: an eclectic approach driven by vague notions and complex rules

Classification and measurement

IFRS 9: classification on the basis of notions about cash flow characteristics and business models

IAS 39: an eclectic and complex rules-based classification approach

Impairment

IFRS 9: point-in-time '**expected** loss' model (**notion**)

IAS 39: point-in-time '**incurred** loss' model (**notion**)

Hedge accounting (IAS 39's and IFRS 9's override 'normal' accounting)

IAS 39: an inflexible and complex rules-based approach

IFRS 9: aligns accounting with risk management practices (notion)

Classification of financial assets

IFRS 9: classification approach

- Classify whole instrument (ie no bifurcation of financial assets) on the basis of:
  - cash flow characteristics and
  - observable business model within which the financial assets are being managed (not based on intent for individual asset)
- Reclassify consistent with how the assets are being managed
  - reclassify only when the observable business model for managing financial assets changes

IFRS 9: classification and measurement

	Business model = hold to collect	Business model = hold to collect and sell	Other business models (eg held for trading)	**FVPL option** available to avoid an **accounting mismatch**	**FVOCI option** available for **equity** not held for trading
Cash flows: solely payments of principal and interest (SPPI)	Amortised cost (AC)	FV through other comprehensive income (OCI) (but with AC in PL)	FVPL	FVPL	
Other types of cash flows	Fair value (FV) through profit or loss (PL)	FVPL	FVPL		FVOCI

Classification: SPPI test

IFRS 9: cash flow characteristics
1st test: solely payments of principle and interest (SPPI)

» SPPI characteristics are when contractual cash flows are consistent with a basic lending arrangement

» Principal is the fair value of the financial asset at initial recognition

» Interest is consideration for:

  » time value of money and credit risk;
  » basic lending risks (for example, liquidity risks);
  » other associated costs (for example, administrative costs); and
  » a profit margin.

IFRS 9: contractual cash flow characteristics (test 1) example 1: SPPI on the principal amount outstanding?

Entity owns a three-year corporate bond with the following contractual cash flows:

» 01/01/2016 Entity pays $1,000,000

» 31/12/2018 Entity receives $1,331,000

Are the contractual cash flows solely payments of principle and interest? Choose one of:

1) Yes;
2) No; or
3) it depends (specify on what it depends).

Refer to paragraph B4.1.7A of IFRS 9

IFRS 9: contractual cash flow characteristics (test 1) example 2A: SPPI on the principal amount outstanding?

Entity with $ functional currency owns a GBP(£) denominated corporate bond maturing on 31/12/2020

» payments of principal and interest on the principal amount outstanding are linked to a relevant UK consumer price index provided by the UK government

» the inflation link is not leveraged and the principal is protected

Are the contractual cash flows solely payments of principle and interest? Choose one of:

1) Yes;
2) No; or
3) it depends (specify on what it depends).

Refer to paragraphs B4.1.7A and B4.1.13 of IFRS 9

IFRS 9: contractual cash flow characteristics (test 1) example 2B: SPPI on the principal amount outstanding?

Entity with $ functional currency owns a GBP(£) denominated corporate bond maturing on 31/12/2020

» payments of principal and interest on the principal amount outstanding are linked to the FTSE 250 stock market index

» the index link is not leveraged and the principal is protected

Are the contractual cash flows solely payments of principle and interest? Choose one of:

1) Yes;
2) No; or
3) it depends (specify on what it depends).

Refer to paragraphs B4.1.7A and B4.1.13 of IFRS 9

IFRS 9: contractual cash flow characteristics (test 1) example 2C: SPPI on the principal amount outstanding?

Entity with $ functional currency owns a euro denominated corporate bond maturing on 31 December 2020

» payments of principal and interest on the principal amount outstanding are linked to a relevant UK consumer price index provided by the UK government

» the inflation link is not leveraged and the principal is protected

Are the contractual cash flows solely payments of principle and interest? Choose one of:

1) Yes;
2) No; or
3) it depends (specify on what it depends).

Refer to paragraphs B4.1.7A and B4.1.13 of IFRS 9

IFRS 9: contractual cash flow characteristics (test 1) example 3A: SPPI on the principal amount outstanding?

Bank is party to a variable interest rate instrument maturing on 31 December 2020 that permits the counterparty (the borrower) to choose at each interest rate reset date to pay either:

- » three-month LIBOR for a three-month term; or
- » one-month LIBOR for a one-month term.

» The reset periods are conterminous with the rates (ie next reset after 1 month if elect one-month LIBOR and next reset after 3 months if elect three-month LIBOR)

Are the contractual cash flows solely payments of principle and interest?

Choose one of:

1) Yes; 2) No; or 3) it depends (specify on what it depends).

Refer to paragraphs B4.1.7A and B4.1.13 of IFRS 9

IFRS 9: contractual cash flow characteristics (test 1) example 3B: SPPI on the principal amount outstanding?

Bank is party to a variable interest rate instrument maturing on 31 December 2020 that permits the counterparty (the borrower) to choose at each interest rate reset date to pay either:

- » three-month LIBOR for a three-month term; or
- » one-month LIBOR for a one-month term.

The reset periods are <u>not</u> conterminous with the rates (ie reset each month irrespective of which rate was last elected by the borrower)

Are the contractual cash flows solely payments of principle and interest? Choose one of:

1) Yes; 2) No; or 3) it depends (specify on what it depends).

Refer to paragraphs B4.1.7A and B4.1.13 of IFRS 9

IFRS 9: contractual cash flow characteristics (test 1) example 4: SPPI on the principal amount outstanding?

Entity owns a £1 million corporate bond maturing on 31 December 2020 that pays interest at the lower of:

» LIBOR + 3%; and

» 5%.

Are the contractual cash flows solely payments of principle and interest? Choose one of:

1) Yes; 2) No; or 3) it depends (specify on what it depends).

Refer to paragraphs B4.1.7A and B4.1.13 of IFRS 9

IFRS 9: contractual cash flow characteristics (test 1) example 5: SPPI on the principal amount outstanding?

Entity is invested in an instrument that is a full recourse loan and is secured by collateral.

Are the contractual cash flows solely payments of principle and interest? Choose one of:

1) Yes;
2) No; or
3) it depends (specify on what it depends).

Refer to paragraphs B4.1.7A and B4.1.13 of IFRS 9

IFRS 9: contractual cash flow characteristics (test 1) example 6: SPPI on the principal amount outstanding?

Entity owns a bond that is convertible into a fixed number of equity instruments of the issuer.

Are the contractual cash flows solely payments of principle and interest? Choose 1 of:

1) Yes
2) No (because the total return is linked to the value of the equity of the issuer)
3) it depends (specify on what it depends)

Refer to paragraph B4.1.14 of IFRS 9

IFRS 9: contractual cash flow characteristics (test 1) example 7A: SPPI on the principal amount outstanding?

Entity purchases a bond issued by a regulated bank. The bond:

» is mandatorily redeemable on 31 December 2020

» pays a fixed interest rate and all contractual cash flows are non-discretionary.

The issuer is subject to legislation that permits the national resolving authority to write down the par amount of the instrument or to convert it into a fixed number of the issuer's ordinary shares if the national resolving authority determines that the issuer is:

» having severe financial difficulties;

» needs additional regulatory capital; or

» is 'failing'.

Are the contractual cash flows solely payments of principle and interest?

Choose one of: 1) Yes; 2) No; or 3) it depends (specify on what it depends).

Refer to paragraphs B4.1.7A and B4.1.13 of IFRS 9

IFRS 9: contractual cash flow characteristics (test 1) example 7B: SPPI on the principal amount outstanding?

Entity purchases a bond issued by a regulated bank. The bond:

- » is mandatorily redeemable on 31 December 2020
- » pays a fixed interest rate and all contractual cash flows are non-discretionary
- » permits the issuer to convert the bond into a fixed number of the issuer's ordinary shares if the issuer is:
  - » having severe financial difficulties;
  - » needs additional regulatory capital; or
  - » is 'failing'.

Are the contractual cash flows solely payments of principle and interest?

Choose one of: 1) Yes; 2) No; or 3) it depends (specify on what it depends).

Refer to paragraphs B4.1.7A, B4.1.13 and B4.1.14 of IFRS 9

IFRS 9: contractual cash flow characteristics (test 1) example 8: SPPI on the principal amount outstanding?

Entity owns a debt instrument that pays an inverse floating interest rate (ie the interest rate has an inverse relationship to market interest rates) that is mandatorily redeemable at its par amount on 31 December 2020.

Are the contractual cash flows solely payments of principle and interest? Choose one of:

1) Yes
2) No (because the interest amounts are not consideration for the time value of money on the principal amount outstanding)
3) it depends (specify on what it depends)

Refer to paragraphs B4.1.7A and B4.1.14 of IFRS 9

IFRS 9: contractual cash flow characteristics (test 1) example 9: SPPI on the principal amount outstanding?

Entity owns a perpetual debt instrument that the issuer may call at any point and pay the holder the par amount plus accrued interest due.

The instrument pays market interest rate but payment of interest cannot be made unless the issuer is able to remain solvent immediately afterwards.

Deferred interest does not accrue additional interest.

Are the contractual cash flows solely payments of principle and interest? Choose one of:

1) Yes
2) No (because the issuer may be required to defer interest payments and additional interest does not accrue on those deferred interest amounts)
3) No (because the instrument is perpetual)
4) No (because the instrument is callable by the issuer)
5) it depends (specify on what it depends)

Refer to paragraphs B4.1.7A and B4.1.14 of IFRS 9

Classification: business model test

IFRS 9: business models determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective

» Hold to collect (accounting = amortised cost)
  » generate value by collecting contractual cash flows
  » consider past sales information and future expectations
  » some sales may be consistent if infrequent or insignificant

» Hold to collect and sell (accounting = fair value through other comprehensive income (FVOCI))
  » generate value by:
    » collecting contractual cash flows; and
    » selling
  » involves greater frequency and volume of sales
    » for example, liquidity needs, interest yield management, asset/liability management

» Other (accounting = fair value through profit or loss)

Source: paragraphs B4.1.2C, B4.1.13, B4.1.13A, B4.1.14A, B4.1.14B and B4.1.15 of IFRS 9

IFRS 9: business model (test 2) example 1: which business model?

- » Entity holds investments to collect their contractual cash flows
- » To minimise credit losses Entity performs credit risk management activities
  - » Sales usually occur when assets' credit risk has increased (ie credit criteria specified in the entity's documented investment policy are no longer met)
  - » Infrequent sales also occur as a result of unanticipated funding needs
  - » Reports to key management personnel focus on the credit quality of the financial assets and the contractual return
  - » Entity also monitors fair values of the financial assets, among other information.

Entity's business model is? Choose one of:

1) Hold to collect the contractual cash flows (accounting = amortised cost);
2) Hold to collect and sell (accounting = fair value through OCI)
3) Other (accounting = fair value through profit or loss)?

Source: paragraph B4.1.4 of IFRS 9

IFRS 9: business model (test 2)
example 2: which business model?

- Financial Institution holds financial assets to meet liquidity needs in a ‘stress case’ scenario
  - no sale is anticipated except in such scenarios
  - Financial Institution monitors credit quality of the financial assets
  - objective in managing the financial assets: collect the contractual cash flows
- Financial Institution also monitors fair value of financial assets from a liquidity perspective
  - objective: cash amount that would be realised in a stress case scenario would be sufficient to meet the entity’s liquidity needs.

Source: paragraph B4.1.4 of IFRS 9

IFRS 9: business model (test 2) example 2 (continued): which business model?

Scenario A: Periodically, the entity makes sales that are insignificant in value to demonstrate liquidity. Entity's business model is? Choose 1 of:

1) Hold to collect the contractual cash flows (accounting = amortised cost);
2) Hold to collect and sell (accounting = fair value through OCI); or
3) Other (accounting = fair value through profit or loss)?

Scenario B: Same as Scenario A, except that sales were significant in value in order to meet its liquidity needs. Entity's business model is? Choose 1 of:

1) Hold to collect the contractual cash flows (accounting = amortised cost);
2) Hold to collect and sell (accounting = fair value through OCI); or
3) Other (accounting = fair value through profit or loss)?

IFRS 9: business model (test 2)
example 3: which business model?

- Bank holds financial assets to meet its everyday liquidity needs
- Bank seeks to minimise the costs of managing those liquidity needs and therefore actively manages the return on the portfolio
  - **return** = collecting contractual payments + gains and losses from the sale of financial assets
- Bank holds financial assets to collect contractual cash flows and sells financial assets to reinvest in higher yielding financial assets or to better match the duration of its liabilities
  - this strategy has resulted in frequent sales activity of significant value
  - this activity is expected to continue in the future

Source: paragraph B4.1.4C of IFRS 9

IFRS 9: business model (test 2) example 3 (continued): which business model?

Bank's business model is? Choose 1 of:

1) Hold to collect the contractual cash flows (accounting = amortised cost);
2) Hold to collect and sell (accounting = fair value through OCI); or
3) Other (accounting = fair value through profit or loss)?

Financial asset classification options

IFRS 9: classification option exception for qualifying debt instruments

- An entity is permitted to, at initial recognition, irrevocably designate a financial asset as measured at fair value through profit or loss (FVPL) if doing so eliminates or significantly reduces an 'accounting mismatch'.
  - Note: paragraph 4.2.2 specifies a similar exception to measure qualifying financial liabilities at FVPL.

References: paragraphs 4.1.5 and B4.1.29 to B4.1.32 of IFRS 9

IFRS 9: classification option example: exception for qualifying debt instruments

- Entity's functional currency is $
- On 1 January 2016:
  - Entity pays $1 million to purchase a F$1 million (foreign currency denominated) debt instrument at its fair value
  - $1 = 1 F$.
- The counterparty is contractually obliged to pay Entity:
  - F$100,000 interest on 31 December each year 2016 to 2025 (10 years); and
  - F$1million redemption on 31/12/2025.

References: paragraphs 4.1.1 to 4.1.5 and B4.1.1 to B4.1.36 of IFRS 9

IFRS 9: classification option
example: exception for qualifying debt instruments

Which classification of financial asset must Entity apply in accounting for the debt instrument? Choose one of:

1) subsequently measured at amortised cost
2) subsequently measured at fair value through profit or loss (FVPL)
3) subsequently measured at fair value through other comprehensive income (FVOCI)
4) the classification 1), 2) or 3) depends on Entity's business model
5) the classification 1), 2) or 3) depends on Entity's business model and whether the entity has invoked the fair value option to avoid 'an accounting mismatch'

References: paragraphs 4.1.1 to 4.1.5 and B4.1.1 to B4.1.36 of IFRS 9

IFRS 9: business models
exception for qualifying investments in equity instruments

Instrument-by-instrument optional election to irrevocably designate at inception qualifying investments in equity instruments as 'accounted for at fair value through OCI' (paragraphs 4.1.4 and B5.7.1)

» Qualifying investments are neither held for trading nor contingent consideration to which IFRS 3 applies (paragraph 5.7.5)

» Definition of held for trading (Appendix A of IFRS 9):

  » acquired or incurred principally for the purpose of selling or repurchasing it in the near term

  » part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking

  » derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument)

Source: paragraphs 4.1.4, 5.7.5, B5.7.1 and Appendix A of IFRS 9

Measurement

Measurement of financial assets at initial recognition

Financial assets: measurement at initial recognition the basics

- At initial recognition measure a financial asset at its fair value (normally = transaction price).
- However, add transactions costs to the financial asset’s initial measurement (ie its fair value) if:
  - it is subsequently measured at amortised cost; or
  - in accordance with IFRS 9, it is subsequently measured at fair value through other comprehensive income (FVOCI).
- Exceptions apply. For example:
  - when in accordance with IFRS 15 *Revenue from Contracts with Customers* trade receivables are measured initially at their transactions price which differs from fair value (for example, when paragraph 63 of IFRS 15 applies).

Financial assets: measurement at initial recognition example: transaction costs

Bank paid $100 million (and incurs $1 million transactions cost) in acquiring an investment.

What amount must Bank measure its investment asset on initial recognition? (choose the most correct answer from the alternatives presented below)

1) $100 million
2) $101 million
3) $100 million if subsequently measured at fair value, otherwise $101 million
4) $100 million if subsequently measured at fair value through profit or loss (FVPL), otherwise $101 million
5) $100 million if investment asset is classified FVPL or is a <u>debt</u> instrument classified at fair value through other comprehensive income (FVOCI), otherwise $101 million
6) $100 million if investment asset is classified FVPL or is an <u>equity</u> instrument classified FVOCI, otherwise $101 million

Financial assets: measurement at initial recognition what if fair value (FV) differs from transaction price?

If part of the consideration is for something other than the financial instrument:

- measure the financial instrument at its fair value; and
- recognise any additional amount lent (ie the difference between fair value and transaction price) as an expense or a reduction of income, unless it qualifies for recognition as:
  - some other type of asset (eg intangible asset); or
  - equity (in a transaction with owners in their capacity as owners).

Financial assets: measurement at initial recognition example 1: transaction price does not = fair value

To enhance its standing in the community New Bank advances a $1,331,000 interest-free three-year loan to Wildlife Protection Agency. At market interest rates the loan would have borne interest at 10% per year.

What amount should New Bank measure its loan asset on initial recognition? Choose one of:

1) $1,000,000;
2) $1,331,000; or
3) another amount.

Financial assets: measurement at initial recognition what if fair value (FV) differs from transaction price?

If the consideration is all for the financial instrument, in accordance with IFRS 9:

» recognise 'day 1' gain or loss in profit or loss only if FV is evidenced by a **quoted price in an active market for an identical asset** (ie Level 1) or is based on valuation technique that uses only data from observable markets (ie some Level 2)

» in all other cases (ie Level 3 and some Level 2):

  » **at initial recognition (day 1):** defer the difference

  » **after initial recognition:** recognise that deferred difference as a gain or loss only to the extent that it arises from a change in a factor that market participants take into account

Financial assets: measurement at initial recognition example 2: transaction price does not = fair value

Bank that applies IFRS 9 has access to the wholesale market (which is the principal market) for interest rate swaps. On 1 December 2016 Bank:

» enters into an interest rate swap contract (IRSC) with Manufacturer for no initial cash consideration

» using a valuation technique measures the fair value of the IRSC asset in the wholesale market at $5.

What amount should Bank measure its IRSC asset at initial recognition? Choose one of:

1) $5;
2) nil;
3) $5 if all the inputs used in the valuation technique are observable and nil if the valuation technique uses inputs that are not observable.

Measurement of financial assets after initial recognition and presentation of financial performance

IFRS 9: financial asset measurement models and presentation of financial performance

Measurement model	Interest or dividends	Impairment	Foreign exchange	Change in FV	Recycling OCI to PL?
Amortised cost	PL: effective interest rate	PL	PL		
Fair value (FV) profit or loss (PL)	PL	PL	PL	PL (incl. forex and 'impairment')	
FVOCI: debt	PL: effective interest rate	PL (on basis of amortised cost)	PL (on basis of amortised cost)	OCI (FV change adjusted for AC accounting)	Yes
FVOCI: equity	PL: dividends	OCI	OCI	OCI (incl. forex and 'impairment')	No

IFRS 9: presentation of financial performance example 1: debt instrument

- 1 January 2016: Entity (functional currency $) pays $1 million to purchase a F$1 million (foreign currency denominated) debt instrument at its fair value (when 1$ = 1F$).
  - The counterparty is contractually obliged to pay F$100,000 interest on 31 December each year 2016 to 2025 (10 years) and F$1million redemption on 31/12/2025.
  - Entity determines that the asset is not purchased or originated credit-impaired.
- 31 December 2016:
  - the fair of the instrument decreased to $880,000 ($100,000 decrease as as a result of changes in currency exchange rates (assume: exchange rate change occurred on 02/01/2016) and $20,000 decrease as a result of changes in market interest rates).
  - Entity receives F$100,000 (which its immediately exchanges for $90,000)
  - Entity determines that there has not been a significant increase in credit risk since initial recognition and that expected credit losses should be measured at an amount equal to 12-month expected credit losses (ECL), which amounts to F$10,000 (ie $9,000).
- 1 January 2017: Entity sells the instrument for F$977,778 million (ie $880,000).

IFRS 9: presentation of financial performance example 1: debt instrument continued

Which classification of financial asset must Entity apply in accounting for the debt instrument?

Choose one of:

1) subsequently measured at amortised cost
2) subsequently measured at fair value through profit or loss (FVPL)
3) subsequently measured at fair value through other comprehensive income (FVOCI)
4) the classification 1), 2) or 3) depends on Entity's business model
5) the classification 1), 2) or 3) depends on Entity's business model and whether the entity has invoked the fair value option to avoid 'an accounting mismatch'

Reference: paragraphs 4.1.1 to 4.1.5

IFRS 9: presentation of financial performance example 1: debt instrument (continued)

	Amortised cost		Fair value PL		Fair value OCI	
1 January 2016						
Financial asset	$1,000,000		$1,000,000		$1,000,000	
Cash		$1,000,000		$1,000,000		$1,000,000
Purchase of the financial asset						
31 December 2016						
Cash	$90,000		$90,000		$90,000	
Profit or loss: finance income		$90,000		$90,000		$90,000
Finance income earned and received in 2016						

IFRS 9: presentation of financial performance example 1: debt instrument (continued)

	Amortised cost		Fair value PL		Fair value OCI	
31 December 2016						
Profit or loss: forex loss	$100,000				$100,000	
Profit or loss: impairment	$9,000				$9,000	
Profit or loss: FV change			$120,000			
OCI: FV change					$11,000	
Financial asset		$109,000		$120,000		$120,000
To recognise part (amortised cost) or all (fair value PL and fair value OCI) of the change in fair value of the debt instrument that occurred in 2016						

IFRS 9: presentation of financial performance example 1: debt instrument (continued)

	Amortised cost		Fair value PL		Fair value OCI	
1 January 2017						
Cash	$880,000		$880,000		$880,000	
Profit or loss: loss on disposal	$11,000					
Financial asset		$891,000		$880,000		$880,000
Profit or loss: 'recycling' prior period FV losses					$11,000	
OCI: 'recycling' FV losses						$11,000
To derecognise the debt instrument on its disposal by sale (and amortised cost: recognising previously unrecognised prior period unrealised losses) (and fair value OCI: reclassifying prior period losses that were presented in prior period OCI to profit or loss for 2017)						

IFRS 9: presentation of financial performance example 2: equity instrument

- 1 January 2016: Entity (functional currency $) pays $1 million to purchase a F$1 million (foreign currency denominated) equity instrument at its fair value (when 1$ = 1F$).
- 31 December 2016:
  - receives F$100,000 dividend (which it immediately exchanges for $90,000)
  - the fair of the instrument decreased to $880,000 (ie F$977,778, assume the exchange rate change occurred on 2 January 2016).
- 1 January 2017: Entity sells the instrument for F$977,778 (which it immediately exchanges for $880,000).

IFRS 9: presentation of financial performance example 2: equity instrument (continued)

Which classification of financial asset must Entity apply in accounting for the equity instrument?

Choose one of:

1) subsequently measured at amortised cost
2) subsequently measured at fair value through profit or loss (FVPL)
3) subsequently measured at fair value through other comprehensive income (FVOCI)
4) the classification 2) or 3) depends on Entity's business model
5) the classification 2) or 3) depends on Entity's business model and whether the entity has invoked the fair value OCI option

References: paragraphs 4.1.1 to 4.1.5 and B4.1.1 to B4.1.36 of IFRS 9

IFRS 9: presentation of financial performance example 2: equity instrument (continued)

	Fair value PL		Fair value OCI	
1 January 2016				
Financial asset	$1,000,000		$1,000,000	
Cash		$1,000,000		$1,000,000
Purchase of the financial asset				
31 December 2016				
Cash	$90,000		$90,000	
Profit or loss: dividend income		$90,000		$90,000
Dividend income earned and received in 2016				

IFRS 9: presentation of financial performance example 2: equity instrument (continued)

	Fair value PL		Fair value OCI	
31 December 2016				
Profit or loss: FV change	$120,000			
OCI: FV change			$120,000	
Financial asset		$120,000		$120,000
To recognise the change in fair value of the equity instrument that occurred in 2016				

	Fair value PL		Fair value OCI	
1 January 2017				
Cash	$880,000		$880,000	
Financial asset		$880,000		$880,000
To derecognise the debt instrument on its disposal by sale (note: no 'recycling' for FVOCI equity)				

Reclassification of financial assets

IFRS 9: change of business model reclassification of financial assets

- Reclassify all affected financial assets when, and only when business model for managing financial assets changes. Such changes are:
  - expected to be very infrequent
  - determined by the entity's senior management as a result of external or internal changes and must be significant to the entity's operations and demonstrable to external parties
  - occur only when an entity either begins or ceases to perform an activity that is significant to its operations (eg, when the entity acquires, disposes of or terminates a business line)

Source: paragraphs 4.4.1, 5.6.1 and B4.4.1of IFRS 9

IFRS 9: change of business model reclassification of financial assets

- Account for a reclassification **prospectively** from the reclassification date (ie the first day of the first reporting period following the change in business model that results in an entity reclassifying financial assets)
  - must not restate any previously recognised gains, losses (including impairments) or interest

Source: paragraphs 4.4.1, 5.6.1 and B4.4.1of IFRS 9

IFRS 9: change of business model? example 1

- Entity has a portfolio of commercial loans that for many years it held to sell in the short term.
- On 1 July 2016 Entity acquires a company that manages commercial loans and has a business model that holds the loans in order to collect the contractual cash flows. Entity's portfolio of commercial loans is no longer for sale (it is now managed together with the acquired commercial loans and all are held to collect the contractual cash flows).

From 1 July 2016 how must Entity classify its original portfolio of loans? Choose one of:

1) Hold to collect the contractual cash flows (accounting = amortised cost)
2) Hold to collect and sell (accounting = fair value through OCI)
3) Other (accounting = fair value through profit or loss)

References: paragraphs 4.4.1, 5.6.1 and B4.4.1of IFRS 9

IFRS 9: change of business model? example 2A

» Entity provides a wide range of financial services.

» On 1 July 2016 Entity decides to shut down its retail mortgage business and consequently, Entity:

  » no longer undertakes new retail mortgage business

  » commences actively marketing its pre-existing mortgage loan portfolio for sale

From 1 July 2016 how must Entity classify its original mortgage loan portfolio? Choose one of:

1) Hold to collect the contractual cash flows (accounting = amortised cost)
2) Hold to collect and sell (accounting = fair value through OCI)
3) Other (accounting = fair value through profit or loss)

References: paragraphs 4.4.1, 5.6.1 and B4.4.1of IFRS 9

IFRS 9: change of business model? example 2B

» Entity provides a wide range of financial services.

» On 1 July 2016 Entity decides to shut down its retail mortgage business. However, Entity:

  » continues to undertakes new retail mortgage business

  » does not actively marketing its mortgage loan portfolio for sale

From 1 July 2016 how must Entity classify its original mortgage loan portfolio? Choose one of:

1) Hold to collect the contractual cash flows (accounting = amortised cost)
2) Hold to collect and sell (accounting = fair value through OCI)
3) Other (accounting = fair value through profit or loss)

References: paragraphs 4.4.1, 5.6.1, B4.4.1and B4.4.3 of IFRS 9

IFRS 9: reclassification of financial assets an overview of the transfer requirements

		Reclassification to		
		FVPL	**FVOCI**	**AC**
Reclassification from	**Fair value through profit or loss (FVPL)**		Transfer at reclassification-date FV and determine effective interest rate (EIR) using reclassification-date FV (ie treat like a new acquisition) (AC: FV = 'new' gross carrying amount)	
	Fair value through other comprehensive income (FVOCI)	Transfer at reclassification-date FV and 'recycle' accumulated OCI to PL		Transfer at reclassification-date FV and adjust accumulated OCI against the carrying amount (FV) of the transferred asset (ie affects OCI not PL)
	Amortised cost (AC)	Difference between reclassification-date AC and FV presented in PL	Difference between reclassification-date AC and FV presented in OCI	

References: paragraphs 5.6.1 to 5.6.7 and B5.6.1 to B5.6.2 of IFRS 9

IFRS 9: reclassification of financial assets example 1: debt instrument from amortised cost to fair value

- On 1 January 2016:
  - Entity changes the business model for managing its portfolio of bonds
  - the fair value of the portfolio is $980,000
  - 12-month expected credit losses = $8,000
- The portfolio was measured at amortised cost and presented in Entity’s 31 December 2015 financial statements as follows:
  - $1,000,000 gross carrying amount
  - loss allowance $12,000 (lifetime expected credit losses because there has been a significant increase in credit risk since initial recognition)

IFRS 9: reclassification of debt instruments example 1A: amortised cost (AC) to fair value through profit or loss (FVPL)

Which journal entry records the change from AC to FVPL?

Choose one of:	1)	2)	3)	4)
Asset: Bonds FVPL	$988,000		$980,000	
Asset: Bonds FVOCI		$988,000		$980,000
Asset: Bonds AC (gross carrying amount)	($1,000,000)	($1,000,000)	($1,000,000)	($1,000,000)
Asset: Bonds AC (loss allowance)	$12,000	$12,000	$12,000	$12,000
Profit or loss: on reclassifying bonds from AC to FVPL			$8,000	
Other comprehensive income : on reclassifying bonds from AC to FVOCI (calculation: $20,000 cumulative FV changes net of $12,000 loss allowance presented in prior period profit or loss)				$8,000

Reference: paragraph 5.6.2 of IFRS 9

IFRS 9: reclassification of debt instruments example 1B: amortised cost (AC) to fair value through OCI (FVOCI)

Which journal entry records the change from AC to FVOCI?

Choose one of:	1)	2)	3)	4)
Asset: Bonds FVPL	$988,000		$980,000	
Asset: Bonds FVOCI		$988,000		$980,000
Asset: Bonds AC (gross carrying amount)	($1,000,000)	($1,000,000)	($1,000,000)	($1,000,000)
Asset: Bonds AC (loss allowance)	$12,000	$12,000	$12,000	$12,000
Profit or loss: on reclassifying bonds from AC to FVPL			$8,000	
Other comprehensive income : on reclassifying bonds from AC to FVOCI (calculation: $20,000 cumulative FV changes net of $12,000 loss allowance presented in prior period profit or loss)				$8,000

Reference: paragraphs 5.6.4 and B5.6.1of IFRS 9

IFRS 9: reclassification of financial assets example 2: debt instrument from fair value to amortised cost

- At 31 December 2015 Entity measured its portfolio of bonds in its statement of financial position at $980,000 (ie fair value)
- On 1 January 2016
  - Entity changes the business model for managing its portfolio of bonds
  - 12-month expected credit losses are $8,000
- If Entity had applied amortised cost accounting it would have presented the bonds in its 31 December 2015 financial statements as follows:
  - $1,000,000 gross carrying amount
  - loss allowance $12,000 (reflecting a significant increase in credit risk since initial recognition and thus the measurement of lifetime expected credit losses)

IFRS 9: reclassification of debt instruments example 2A: fair value through profit or loss (FVPL) to amortised cost (AC)

Which journal entry records the change from FVPL to AC?

Choose one of:	1)	2)	3)	4)
Asset: Bonds FVPL	($980,000)	($980,000)	($980,000)	($980,000)
Asset: Bonds AC (gross carrying amount)	$1,000,000	$1,000,000	$980,000	$980,000
Asset: Bonds AC (loss allowance)	($12,000)	($8,000)	($8,000)	($12,000)
Profit or loss: impairment loss recognised when reclassifying bonds from FVPL to AC	($8,000)	($12,000)	$8,000	$12,000

Reference: paragraphs 5.6.3 and B5.6.2 of IFRS 9

IFRS 9: reclassification of debt instruments example 2B: fair value through profit or loss (FVPL) to FVOCI

Which journal entry records the change from FVPL to FVOCI?

Choose one of:	1)	2)	3)	4)
Asset: Bonds FVPL	($980,000)	($980,000)	($980,000)	($980,000)
Asset: Bonds FVOCI	$1,000,000	$1,000,000	$980,000	$980,000
Profit or loss: impairment loss recognised when reclassifying bonds from FVPL to FVOCI	($20,000)	($12,000)	$8,000	$12,000
Other comprehensive income: on reclassifying bonds from FVPL to FVOCI (12-month expected credit loss at 1 January 2016)			($8,000)	
Other comprehensive income: on reclassifying bonds from FVPL to FVOCI (lifetime expected credit loss at 31 December 2015)				($12,000)
Other comprehensive income: on reclassifying bonds from FVPL to FVOCI (calculation: $20,000 cumulative FV changes net of $12,000 lifetime expected credit loss at 31 December 2015)		($8,000)		

Reference: paragraphs 5.6.6 and B5.6.2 of IFRS 9

IFRS 9: reclassification of debt instruments example 2C: fair value through OCI (FVOCI) to amortised cost (AC)

Which journal entry records the change from FVOCI to AC?

Choose one of:	1)	2)	3)	4)
Asset: Bonds FVOCI	($980,000)	($980,000)	($980,000)	($980,000)
Asset: Bonds AC (gross carrying amount)	$1,000,000	$1,000,000	$980,000	$980,000
Asset: Bonds AC (loss allowance)	($12,000)	($12,000)	($8,000)	($8,000)
Profit or loss: impairment loss on reclassifying bonds from FVPL to AC	($8,000)			
Other comprehensive income: on reclassifying bonds from FVOCI to AC (calculation: $20,000 cumulative FV changes net of $12,000 loss allowance presented in prior period profit or loss)		($8,000)		$8,000
Equity: on reclassifying bonds from FVOCI to AC			$8,000	

Reference: paragraphs 5.6.5 and B5.6.1of IFRS 9

IFRS 9: reclassification of debt instruments example 2D: fair value through OCI (FVOCI) to FVPL

Which journal entry records the change from FVOCI to FVPL?

Choose one of:	1)	2)	3)
Asset: Bonds FVPL	$980,000	$980,000	$980,000
Asset: Bonds FVOCI	($980,000)	($980,000)	($980,000)
Profit or loss: on reclassifying bonds from FVOCI to FVPL, 'recycling' prior period fair value changes presented in OCI (calculation: $20,000 cumulative FV changes net of $12,000 loss allowance presented in prior period profit or loss)		$8,000	$8,000
Other comprehensive income: on reclassifying bonds from FVOCI to FVPL, 'recycling' prior period fair value changes presented in OCI		($8,000)	
Equity: on reclassifying bonds from FVOCI to FVPL			($8,000)

Reference: paragraph 5.6.7 of IFRS 9

Selected financial asset classification and measurement judgements (excluding impairment)

Financial assets
selected classification and measurement judgements

- determining the appropriate classification of some financial assets
  - SPPI test when effects are more subjective
  - Business model test when the business model is unclear
- measuring the fair value of financial assets that do not trade in active markets