


August 2011

International Financial Reporting Standards



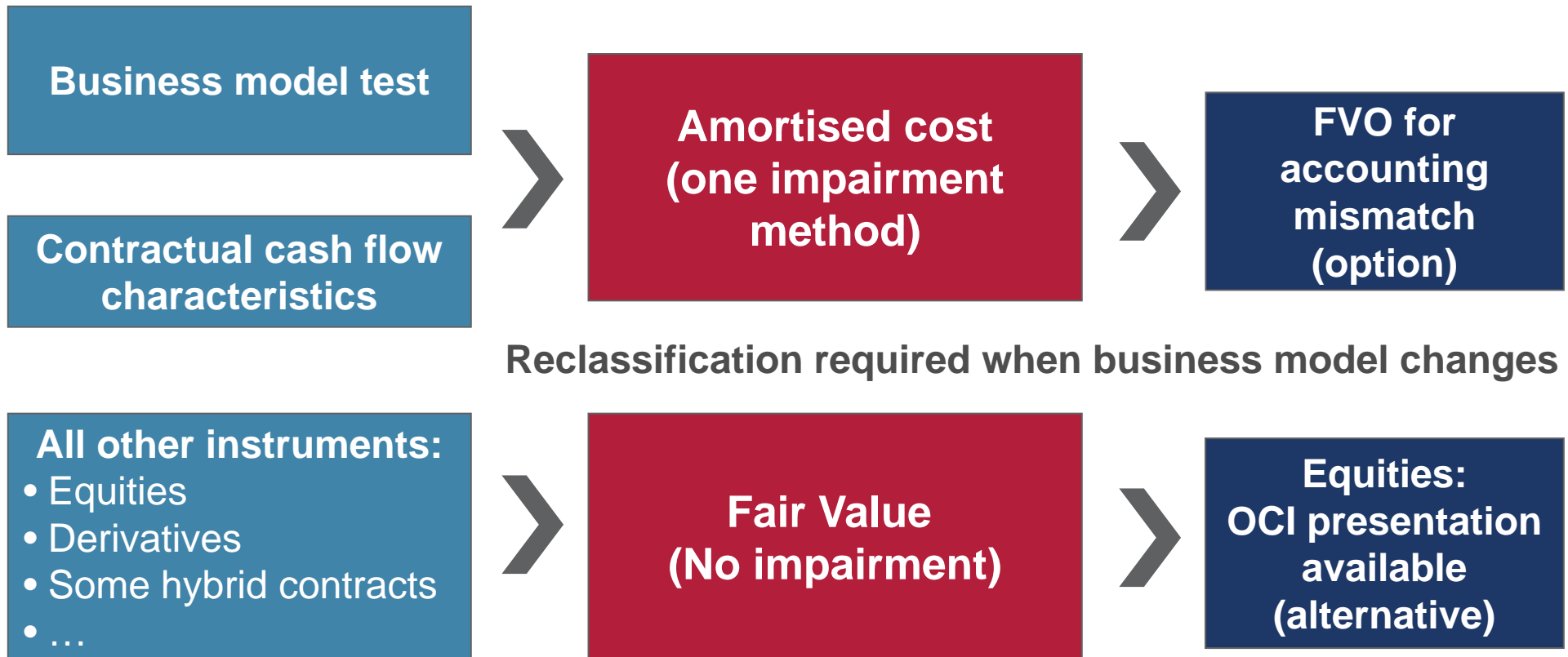
# Classification and Measurement of Financial Assets and Financial Liabilities

The views expressed in this presentation are those of the presenter,  
not necessarily those of the IASB or IFRS Foundation

# Overview of classification model

## - *for financial assets only*

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# Amortised cost

## – An entity's business model

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### Business model

- objective of holding instruments to collect or pay contractual cash flows rather than to sell prior to contractual maturity to realise fair value changes
- not an instrument by instrument approach to classification

**Will only assess contractual terms of instruments within such a business model**

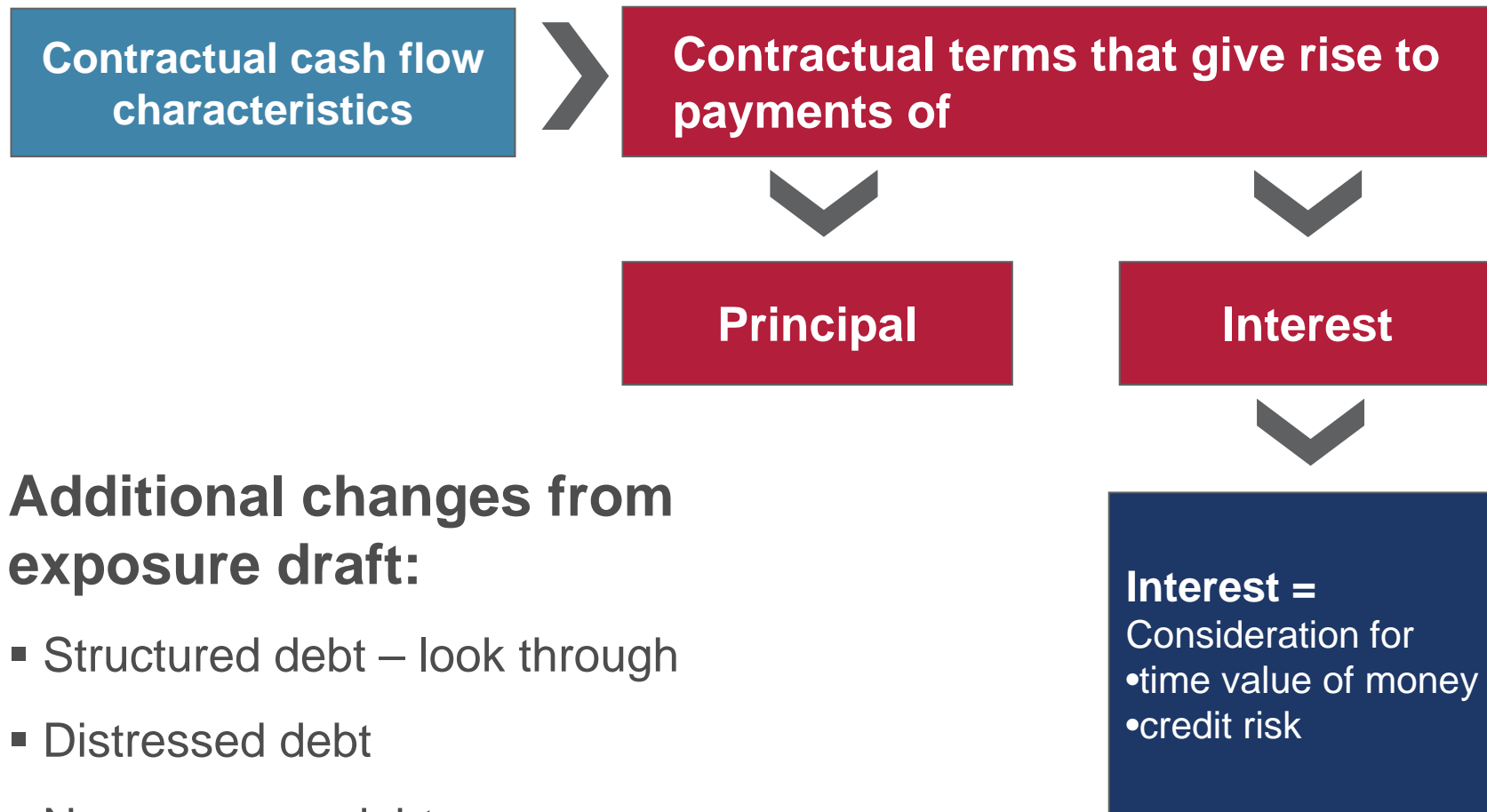
**No 'tainting' rules for assets at amortised cost**

- gains or losses from derecognising such items to be presented separately with additional disclosures

# Amortised cost

## - Contractual cash flow characteristics

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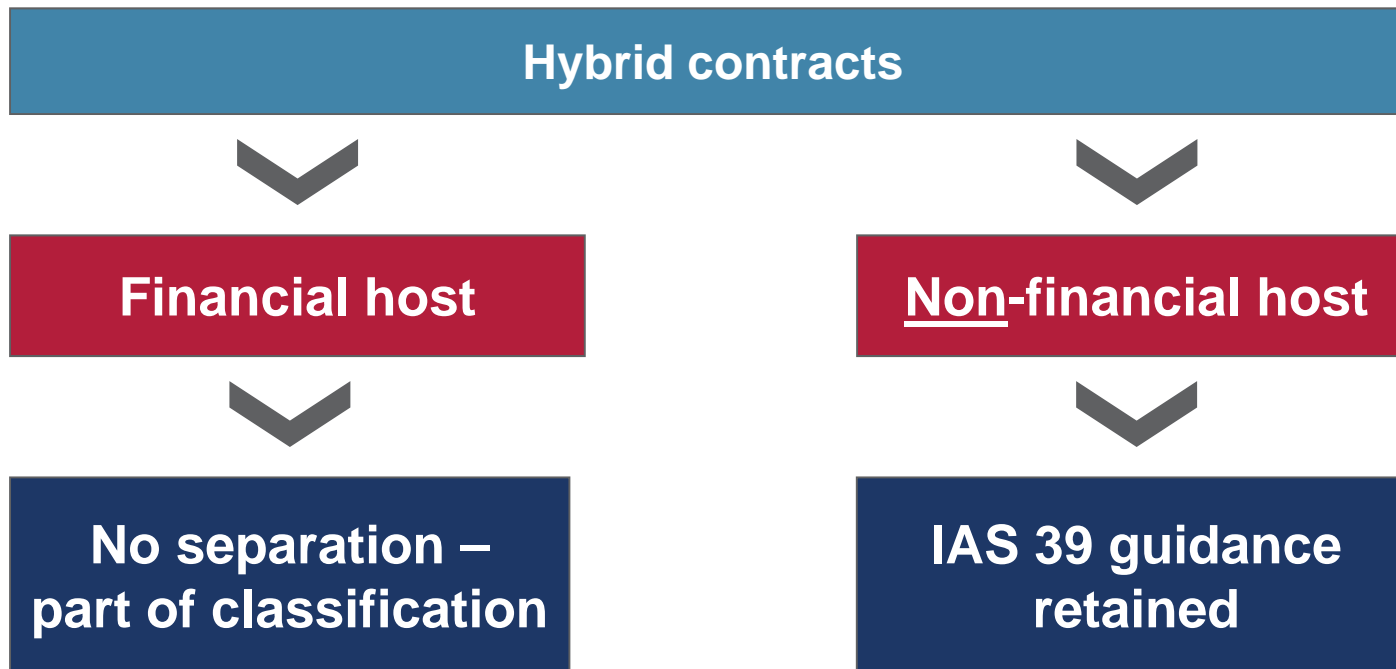


### Additional changes from exposure draft:

- Structured debt – look through
- Distressed debt
- Non-recourse debt

# Amendments to embedded derivatives (applicable only to financial assets)

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## Alternative presentation of fair value changes in other comprehensive income (OCI)

### Scope

- investments in equity instruments not held for trading

### Features

- alternative available instrument by instrument
- **dividends recognised in P&L**
- no recycling, impairment or change in presentation

# Fair value option (FVO) for financial assets

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# Compared with IAS 39?

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- One classification approach
  - designed to provide users with information to assist in predicting future cash flows
- Ensures assets are measured in an appropriate way
- One impairment method used
- Reduced complexity
  - One classification approach used
  - Elimination of bifurcation
  - Elimination of anti-avoidance rules



## Feedback on June 2009 ED:

- Financial liabilities ‘not broken’
- Financial liabilities less urgent
- Need to address ‘own credit’



**Excluded financial liabilities from the scope of IFRS 9 for 2009 year ends**

To  
seek input on best  
way to address  
‘own credit’

# 'Own credit'?

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- What is 'own credit'?
  - fair value changes in liability arising from changes in the issuer's credit quality
- How is it measured?
  - often measured as change in margin over a benchmark interest rate
- What is the concern?
  - Gain when credit quality deteriorates, loss when credit quality improves
  - Reporting such gains and losses is not useful
    - Board's Request for Information on measurement of liabilities
    - ED on classification and measurement

# FVO and own credit – targeted change

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## To address ‘own credit risk’ :

- Retain IAS 39 measurement requirements for financial liabilities:
  - held for trading → fair value through P&L
  - hybrid liabilities → bifurcation requirements in IAS 39
  - ‘vanilla’ liabilities → amortised cost
  - maintain FVO (with current eligibility conditions)

### BUT

- Separate out ‘own credit risk’ for FVO
- ‘Own credit risk’ portion would be separated in a manner similar to that previously used in IFRS 7 for disclosure (IFRS 7 B4)

# FVO and own credit – targeted change

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## Profit or Loss (liabilities under FVO)

Change in FV attributable to all factors except 'own credit risk'	(X)
Profit	XXX

Mandatory for all liabilities under the FVO *unless* this would create or enlarge an accounting mismatch

Financial liability on statement of financial position at (full) fair value

## Statement of Comprehensive Income (liabilities under FVO)

<i>Other Comprehensive Income:</i>	
Change in FV attributable to 'own credit'*	X

\* Not recycled

# Why this approach?

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- Many alternatives explored during outreach. No consensus as to 'best' approach.
- Minimise disruption
  - Most entities bifurcate and will likely continue
  - Bifurcation method: IAS 39 similar outcomes to IFRS 9
- But addresses 'own credit'
  - Separate 'own credit' only if use FVO
  - Have to do that today for disclosure purposes

# Changes from the May 2010 ED

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1. Own credit amounts presented in OCI unless that creates an accounting mismatch in P&L, in which case amounts presented in P&L
2. Own credit amounts presented directly in OCI ('one-step approach')
3. Additional application guidance on the meaning of 'own credit risk'

## Transition

- Generally fully retrospective with some exceptions
- Comparatives only required for adopters from 1/1/12

## Effective date

- Financial assets available for voluntary application in 2009 year end financial statements
- Mandatory adoption – 1 January 2013
- Noted mandatory date may require subsequent reconsideration (to later date) depending on impairment and insurance Phase II

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# Implementing IFRS 13

## *Fair Value Measurement*

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- Overview and background
- Fair value measurement principles
- Disclosures about fair value
- Comparison with Topic 820 in US GAAP
- Effective date and transition

# Overview and background

## IFRS 13 :

- ✓ Defines fair value with a clear measurement objective
- ✓ Is a single source of measurement guidance
- ✓ Requires enhanced disclosures about fair values
- ✗ Does **not** introduce new requirements to measure an asset or liability at fair value

# Overview and background continued

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IFRSs	US GAAP
Existing fair value measurement guidance in various standards	Topic 820 (codified SFAS 157)

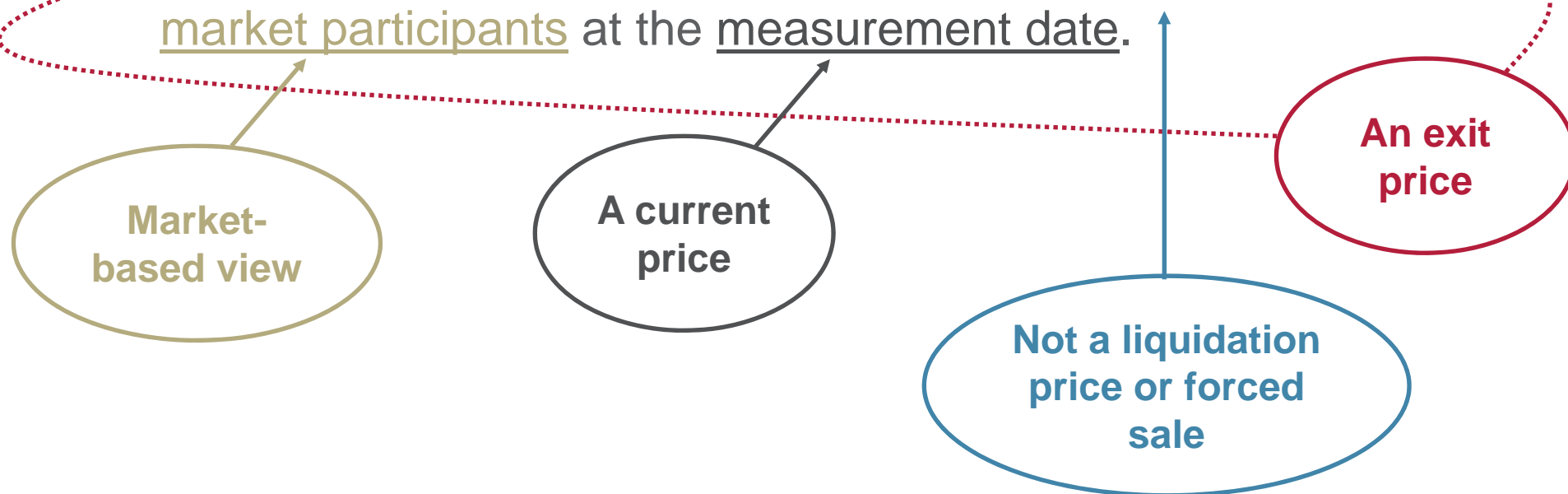


**Objective:**  
Common (identical) fair value measurement and disclosure requirements

# Fair value measurement principles

## What is the measurement objective?

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.



## What am I measuring?

- Specified in other IFRSs—some examples:

Standard	What?	Unit of account
IAS 36 <i>Impairment of Assets</i>	Cash-generating unit	The individual CGU
IAS 39 <i>Financial Instruments: Recognition and Measurement</i> or IFRS 9 <i>Financial Instruments</i>	Financial asset	The individual financial asset
IAS 40 <i>Investment Property</i>	Investment property building	The individual building, made up of the building and the associated lease contracts

## What am I measuring?

- What are the characteristics of the asset or liability?
  - age and remaining economic life
  - condition
  - location
  - restrictions on use or sale
- What characteristics would a market participant consider when pricing the asset or liability?
  - in most cases, they are the same as what the reporting entity would assume



## What am I measuring?

- The use of a non-financial asset by market participants that maximises the value of the asset
  - physically possible
  - legally permissible
  - financially feasible
- Highest and best use is usually (but not always) the current use
- Does not apply to financial instruments or liabilities

## What am I measuring?

- A non-financial asset either:
  - provides maximum value through its use in combination with other assets and liabilities as a group, or
  - provides maximum value through its use on a stand-alone basis
- Does not apply to financial instruments or liabilities

## Where would a transaction take place?

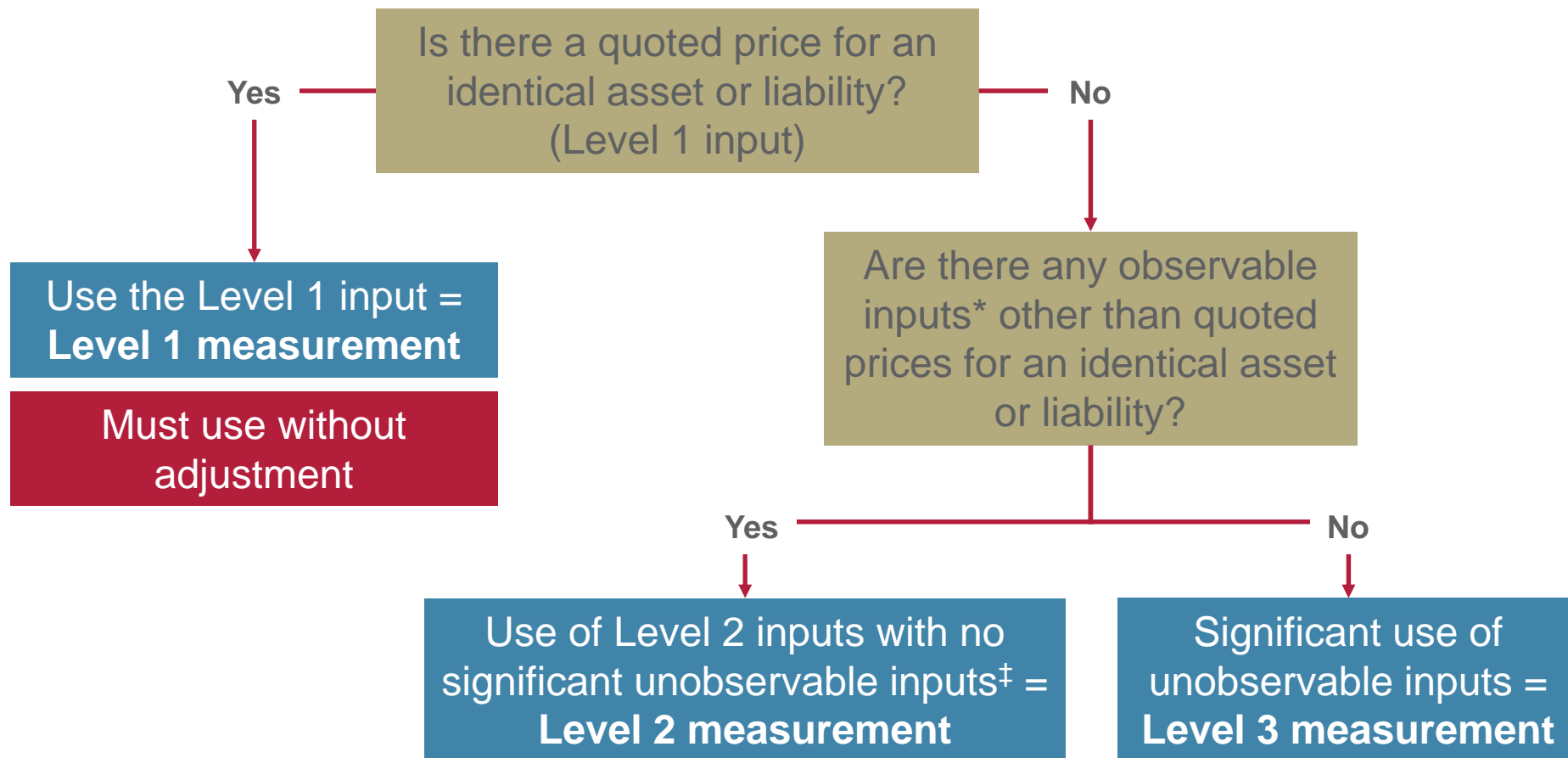
- In the principal market
  - the market with the greatest volume and level of activity for the asset or liability
- Or (if no principal market) in the most advantageous market:
  - the market that maximises the amount that would be received to sell the asset and minimises the amount that would be paid to transfer the liability

## Who would enter into a transaction?

- Market participants are:
  - **independent** of each other
  - **knowledgeable** and sufficiently informed about the asset or liability and the transaction
  - **able** to enter into a transaction for the asset or liability
  - **willing** to enter into a transaction for the asset or liability (not forced)

# Fair value hierarchy

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\* Observable inputs include market data (prices and other information) that is publicly available

‡ Unobservable inputs include the entity's own data (eg budgets, forecasts)

# Inputs to valuation techniques

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- Use the assumptions that a market participant would use when pricing the asset or liability
  - including assumptions about risk
- Maximise observable inputs, minimise unobservable inputs

In Level 3, the reporting entity can (and should) start with its own assumptions, but cannot ignore the need for adjustments

Topic	Description
Liabilities (+ own equity)	<ul style="list-style-type: none"><li>• Fair value of liability = fair value of corresponding asset</li><li>• If no corresponding asset = price to fulfil obligation</li></ul>
Financial instruments within a portfolio	<ul style="list-style-type: none"><li>• May reflect offsetting market risks or credit risk</li><li>• Need evidence managed on a net risk exposure basis</li></ul>
Premiums and discounts	<ul style="list-style-type: none"><li>• Block discounts prohibited</li><li>• Other premiums and discounts must be consistent with unit of account</li></ul>
Inactive markets	<ul style="list-style-type: none"><li>• Indicators of decline in market activity</li><li>• Indicators that transaction not orderly</li></ul>
Valuation techniques and inputs	<ul style="list-style-type: none"><li>• Market, income and cost approaches can be used</li><li>• Must use (estimates of) market participant assumptions</li></ul>

# Disclosures about fair value



## More information for Level 3:

- Quantitative disclosure of unobservable inputs and assumptions used
- Description of valuation process in place
- Discussion of:
  - sensitivity to changes in unobservable inputs
  - inter-relationships between inputs that magnify or mitigate the effect on the measurement

- Disclosure by class (aggregate/disaggregate to provide meaningful information)
- Policy for transfers between levels
- Level of hierarchy for items disclosed but not recognised at fair value
- Difference between highest and best use and current use

# Comparison with Topic 820 in US GAAP

# Differences between IFRS 13 and Topic 820

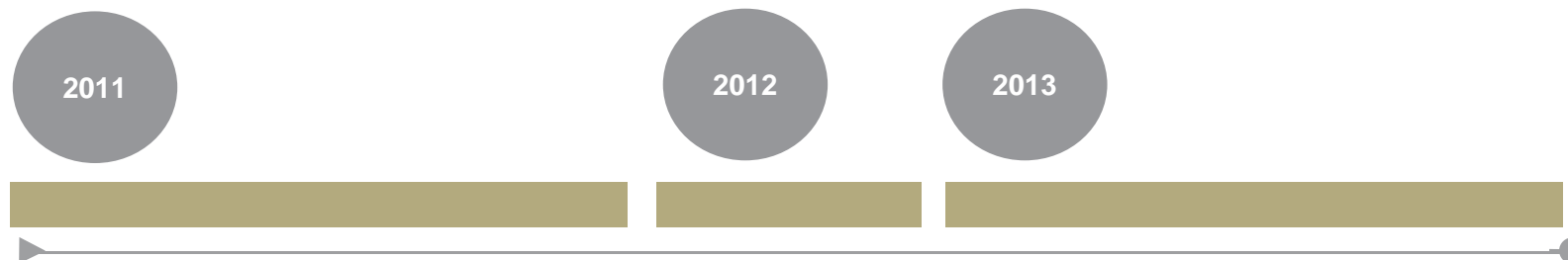
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Topic	Reason for difference
NAV practical expedient	Different accounting for investment companies (which in IFRSs may or may not mean investments are measured in accordance with IFRS 13) means IASB cannot yet allow a practical expedient.
Deposit liabilities	Different requirements in IFRSs and US GAAP (in different locations) for measuring fair value of deposit liabilities
Disclosures	<ul style="list-style-type: none"><li>• IFRS does not allow net presentation of derivatives</li><li>• IFRS requires quantitative sensitivity analysis for financial instruments</li><li>• In IFRS non-publicly accountable entities are covered by SME standard</li></ul>

# Effective date and transition

# Effective Dates and Transition

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## **May 2011**

Common IFRS and US GAAP fair value measurement standards

ASU No. 2011-04  
IFRS 13

## **15 December 2011**

ASU No. 2011-04 effective

## **1 January 2013**

IFRS 13 effective

Prospective transition  
Earlier application permitted

# Questions or comments?

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Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.

