Issue 19, January 2014

cutting through complexity

“Most outstanding matters in the classification and measurement and impairment phases were resolved this month. We look forward to the start of the drafting process for a final standard and to a decision on its effective date.”

Chris Spall
KPMG’s global IFRS financial instruments leader

The future of IFRS financial instruments accounting

This edition of *IFRS Newsletter: Financial Instruments* highlights the IASB’s discussions in January 2014 on its financial instruments (IAS 39 replacement) project.

The IASB’s January meetings saw most of the outstanding issues on the classification and measurement and impairment phases of the financial instruments project resolved, pointing the way towards a final standard in the second quarter of 2014.

Highlights

Classification and measurement

- The IASB discussed the interaction between the classification and measurement of financial assets and the accounting for insurance contract liabilities.
- The Board also reached tentative decisions on:
  - presentation and disclosure;
  - the early application of IFRS 9 *Financial Instruments*; and
  - other transition issues.

Impairment

- The IASB reached tentative decisions on:
  - presentation and disclosure; and
  - transition for first-time adopters of IFRS.

A discussion paper on macro hedge accounting is still expected in the first quarter of 2014.

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MOST OUTSTANDING DECISIONS MADE

The story so far …

Since November 2008, the IASB has been working to replace its financial instruments standard (IAS 39 *Financial Instruments: Recognition and Measurement*) with an improved and simplified standard. The IASB structured its project in three phases:

- Phase 1: Classification and measurement of financial assets and financial liabilities
- Phase 2: Impairment
- Phase 3: Hedge accounting.

In December 2008, the FASB added a similar project to its agenda; however, the FASB has not followed the same phased approach as the IASB. In December 2013, the FASB tentatively decided not to pursue the same accounting model as the IASB on the classification and measurement and impairment of financial instruments.

Classification and measurement

The IASB issued IFRS 9 *Financial Instruments* (2009) and IFRS 9 (2010), which contain the requirements for the classification and measurement of financial assets and financial liabilities. In November 2012, the IASB issued an exposure draft (ED) on limited amendments to the classification and measurement requirements of IFRS 9 (the C&M ED).

The FASB issued a revised ED in February 2013 – the proposed Accounting Standards Update, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (the proposed ASU). In December 2013, the FASB decided that it would not continue to pursue the solely principal and interest ('solely P&I') model for assessing the contractual cash flow characteristics of financial assets, and would instead retain the current US GAAP guidance. Separate and joint redeliberations by the Boards on the classification and measurement proposals are ongoing. The IASB plans to issue a final standard during the second quarter of 2014.

Impairment

The IASB and the FASB (the Boards) were working jointly on a model for the impairment of financial assets based on expected credit losses, which would replace the current incurred loss model in IAS 39. At the July 2012 joint meeting, the FASB expressed concern about the direction of the joint project and in December 2012 issued an ED of its own impairment model, the current expected credit loss (CECL) model. Meanwhile, the IASB continued to develop separately its three-bucket impairment model, and issued a new ED in March 2013 (the impairment ED). In December 2013, the FASB decided to continue to refine the CECL model. Separate and joint redeliberations by the Boards on the impairment proposals are ongoing. The IASB plans to issue a final standard during the second quarter of 2014.

Hedge accounting

The IASB issued a new general hedging standard as part of IFRS 9 (2013) in November 2013, and is working towards issuing a discussion paper (DP) on macro hedging in the first quarter of 2014.

What happened in January 2014?

At the January 2014 meeting, the IASB continued its redeliberations on the classification and measurement and impairment phases of IFRS 9.

The Board discussed the interaction between the classification and measurement of financial assets and the accounting for insurance contract liabilities. In addition, it made tentative decisions on the presentation and disclosure requirements proposed in the C&M ED, the presentation of comparative information by first-time adopters, the early application of IFRS 9 and other transition issues.

In the impairment project, the IASB discussed presentation and disclosure requirements, as well as transition requirements for first-time adopters of IFRS.

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Classification and measurement

The IASB concluded that the reaffirmed C&M ED proposals would result in improved interaction between the classification and measurement of financial assets and the accounting for insurance contract liabilities. The Boards' decisions to date on this phase of the project will also provide a 'toolkit' that can be considered when finalising the insurance contracts project.

The Board also made the following tentative decisions.

- The disclosure and presentation requirements in IFRS 7 *Financial Instruments: Disclosures* and IAS 1 *Presentation of Financial Statements* would extend to reclassifications into and out of the fair value through other comprehensive income (FVOCI) category.
- The judgement involved in assessing an asset's contractual cash flow characteristics would 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.
- First-time adopters of IFRS would be given adequate lead time to prepare for the transition to IFRS 9.
- Entities would be able to early apply the completed version of IFRS 9, but not a previous version of IFRS 9, if their date of initial application is six months or more after the completed version of IFRS 9 is issued.
- If it is impracticable to assess a modified economic relationship on transition, then the contractual cash flow assessment should be made without taking into account the specific requirements for modified economic relationships.
- If it is impracticable to assess the significance of prepayment features on transition, then the contractual cash flow assessment should be made without taking into account the exception for certain prepayment features.
- On transition, entities would reconsider their fair value option designations only to the extent that either previous accounting mismatches no longer exist or new accounting mismatches are created.

Impairment

In relation to the presentation and disclosure of expected credit losses, the IASB tentatively decided to:

- confirm the presentation requirements in the impairment ED and the C&M ED;
- enhance the disclosure objectives;
- make certain changes to qualitative disclosure requirements;
- streamline the disclosure requirements on reconciliations of gross carrying amounts;
- improve the operability of quantitative disclosures on modifications;
- clarify that disclosure of the fair value of collateral is not required;
- clarify the notion of 'nominal amount' for disclosures of financial assets that have been written off;
- align credit risk rating disclosures more closely with risk management;
- incorporate the disclosure of the significant effect on the loss allowance in qualitative disclosures;
- remove the requirement to disclose the amount of financial assets assessed on an individual basis; and
- confirm the reduced disclosure requirements for trade receivables and lease receivables that are accounted for using the simplified approach.

The IASB also tentatively decided to extend the transitional requirements in the impairment ED to first-time adopters of IFRS.

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The IASB noted that the reaffirmed C&M ED proposals would result in improved interaction. The Board's decisions to date on this phase of the project will also provide a 'toolkit' that can be considered when finalising the insurance contracts project.

Interaction with the accounting for insurance contract liabilities

What's the issue?

One objective of including a third mandatory measurement category – FVOCI – in the C&M ED was to take into account the interaction of the classification and measurement model for financial assets with the IASB's project on insurance contracts.

Most respondents to the C&M ED who provided feedback in the area – including insurers and users of financial statements – welcomed the proposed FVOCI measurement category for financial assets. They said that the FVOCI measurement category is a critical element of accounting for financial assets for insurers, and would result in more relevant and useful information about insurers' performance. They also noted that the 'hold or sell' business model is one that is relevant for many entities that write insurance contracts.

However, many respondents – notably preparers who issue insurance contracts – asked the IASB to further reduce accounting mismatches or grant insurers more flexibility in accounting for their insurance contract liabilities and financial assets. They specifically made the following comments and suggestions.

- The accounting for financial assets and insurance contract liabilities should better reflect the asset-liability management that is central to the insurance business.
- The FVOCI measurement category should not be limited to financial assets with solely P&I cash flows. For example, some said that it should also be available for other types of financial assets – e.g. equity investments, derivatives, hybrid financial assets or even particular non-financial assets such as real estate.
- The FVOCI measurement category for financial assets should be optional.
- Insurers should be able to measure more items at fair value through profit or loss (FVTPL). Suggestions in this area included an unrestricted fair value option for financial assets, and FVTPL accounting for insurance contract liabilities.

The staff noted that further changes would entail a fundamental reconsideration of the C&M principles, and that users of financial statements have consistently opposed permitting too much optionality in accounting requirements.

What did the staff recommend?

The staff noted that the IASB's objective was to improve the interaction between the classification and measurement of financial assets and the accounting for insurance contract liabilities – rather than to fully align the two accounting models.

However, they noted that some of the specific requests and suggestions made by respondents on further aligning the two models would entail a fundamental reconsideration of the classification and measurement principles for financial assets under IFRS 9.

For example, broadening the FVOCI measurement category – or providing an option to measure assets at FVOCI – would significantly undermine one of the primary benefits of IFRS 9, namely that the classification of financial assets is based on clear criteria that enhance users' understanding of the financial statements.

Similarly, the staff did not believe that broadening the use of the fair value option for financial assets would be appropriate or desirable, as it would significantly undermine the business model assessment as a basis for measurement in IFRS 9. They noted that users of financial statements have consistently opposed permitting too much optionality in accounting requirements and have advocated consistency and comparability.

The staff did not propose making any further changes in this regard.

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Most respondents welcomed the FVOCI category, but also asked for a further reduction of accounting mismatches.

What conclusion did the IASB reach?

The Board concluded that the proposals in the C&M ED, as reaffirmed, would result in improved interaction between the classification and measurement of financial assets and the accounting for insurance contract liabilities. The tentative decisions reached by the Board to date will also provide a 'toolkit' that the Board can consider when finalising the accounting model for insurance contract liabilities. The Board also noted that it will consider the feedback on the accounting model for insurance contract liabilities, and whether that model should be modified to reflect the interaction with the classification and measurement of financial assets, during redeliberations in the insurance contracts project.

KPMG insight

The IASB and the FASB have started to redeliberate their 2013 insurance contracts proposals. At their joint meeting in January, the staff presented constituent feedback on proposals to use OCI to present the effects of changes in discount rates.

The vast majority of respondents to the insurance contracts proposals believed that this should be optional, and almost all said that they were concerned about accounting mismatches that may arise. A variety of alternatives were proposed.

For more on the insurance contracts discussions, see our IFRS Newsletter: Insurance.

Presentation and disclosure – Reclassification into and out of FVOCI

What's the issue?

IFRS 7 sets out the disclosure requirements that apply when an entity reclassifies a financial asset between the two existing measurement categories – amortised cost and FVTPL.

The C&M ED also proposed extending the disclosure and presentation requirements in IFRS 7 and IAS 1 to reclassifications into and out of the newly introduced FVOCI measurement category. The following table summarises the relevant proposals.

	Existing requirements	Proposals in the C&M ED
IFRS 7, paragraph 12B	General information about the reclassification.	Extend to reclassifications into and out of FVOCI.
IFRS 7, paragraph 12C	Information about the effective interest rate (EIR) for assets reclassified from FVTPL to amortised cost.	Extend to reclassifications from FVTPL to FVOCI.
IFRS 7, paragraph 12D	Fair value information for a limited period if an entity has reclassified financial assets so that they are measured at amortised cost since its last annual reporting date.	Extend to: • reclassifications from FVTPL to FVOCI; and • reclassifications from FVOCI to amortised cost.
IAS 1, paragraph 82(ca)	Separate presentation of amounts recognised in P&L at the reclassification date.	Extend to reclassifications from FVOCI to FVTPL.

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The disclosure and presentation requirements in IFRS 7 and IAS 1 would extend to reclassifications into and out of the FVOCI category.

What did the staff recommend?

In November 2013, when the IASB tentatively decided to confirm its proposal in the C&M ED to introduce FVOCI into IFRS 9 as a mandatory measurement category, it also tentatively decided to confirm that when an entity changes its business model for managing its financial assets it would reclassify all affected financial assets according to the reclassification mechanics set out in IFRS 9 and the C&M ED.

The staff therefore recommended that the IASB confirm the related proposals for presentation and disclosures, as noted in the table above.

What did the IASB decide?

The Board agreed with the staff recommendation.

The judgement involved in assessing an asset's contractual cash flow characteristics would 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.

Presentation and disclosure – Other disclosure requirements

What's the issue?

IAS 1 requires an entity to disclose the judgements that management has made in applying the accounting policies that have the most significant effect on the amounts recognised in its financial statements.

The C&M ED proposed that the judgement involved in assessing an asset's contractual cash flow characteristics should be added to IAS 1 as an example of such a judgement.

The respondents who commented on this issue agreed with the proposal, and said that it would enhance transparency and help users to understand the financial statements.

What did the staff recommend?

The staff recommended that the Board confirm the proposal in the C&M ED.

What did the IASB decide?

The Board agreed with the staff recommendation.

First-time adopters would be given adequate lead time to prepare for the transition to IFRS 9.

Comparative information and related disclosures for first-time adopters of IFRS

What's the issue?

The C&M ED did not propose amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*, but specifically requested comments on transition to IFRS 9 by first-time adopters, to make sure that they:

- are given adequate lead time to apply IFRS 9; and
- are not at a disadvantage in comparison to existing IFRS preparers.

Under IFRS 9 and IFRS 1:

- an existing IFRS preparer *is not currently required* to restate comparative information on transition to IFRS 9, but is required by IFRS 7 to provide disclosures about the transition from IAS 39 to IFRS 9; and

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- a first-time adopter *is currently required* to restate comparative information; in addition, the general IFRS 1 disclosure requirements on transition to IFRS by a first-time adopter would apply.

What did the staff recommend?

The staff recommended that first-time adopters should:

- not be required to present comparative information if the beginning of their first IFRS reporting period is earlier than the mandatory effective date of IFRS 9 *plus one year*;
- be required to provide additional disclosures if the comparative financial information does not comply with IFRS 9; and
- be required to present comparative information that complies with a previous version of IFRS 9 if they choose to early apply that previous version.

What did the IASB decide?

The Board agreed with the staff recommendation.

KPMG insight

The question of allowing adequate lead time for first-time adopters does not seem to have been high on the agenda for most constituents. The Board received only limited feedback in response to this issue, with most respondents who did comment on it saying that they were not aware of any unique considerations for first-time adopters.

However, a few specifically requested that the IASB provide relief to first-time adopters from presenting comparative information that complies with IFRS 9 – for the same reasons that the IASB provided such relief to existing IFRS preparers – to give first-time adopters adequate lead time to prepare for the transition to IFRS 9, and to ensure that they are not at a disadvantage compared to existing IFRS preparers.

Entities would be able to early apply the completed version of IFRS 9, but not a previous version of IFRS 9, if their date of initial application is six months or more after the completed version of IFRS 9 is issued.

Early application of IFRS 9

What's the issue?

Currently, first-time adopters and existing IFRS preparers may choose to early apply any version of IFRS 9 – i.e. IFRS 9 (2009), IFRS 9 (2010) or IFRS 9 (2013).

The C&M ED proposed that entities would:

- be permitted to early apply the completed version of IFRS 9; and
- not be permitted to early apply a previous version of IFRS 9 if their date of initial application is six months or more after the completed version of IFRS 9 is issued.

The rationale for providing this six-month window was to minimise the cost and disruption to entities that are preparing to apply IFRS 9 when the completed version of the standard is issued.

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What did the staff recommend?

Of the respondents who commented on these proposals, nearly all agreed with them. Many noted that they would increase comparability compared to the phased early application that IFRS currently permits.

Almost all agreed that the six-month lead time proposed by the C&M ED is appropriate.

The staff therefore recommended that the IASB reaffirm the proposals in the C&M ED.

What did the IASB decide?

The Board agreed with the staff recommendation.

If it is impracticable to assess a modified economic relationship on transition, then the contractual cash flow assessment should be made without taking into account the specific requirements for modified economic relationships.

Other transition issues – Modified economic relationships

What's the issue?

The C&M ED proposed clarifying that a financial asset with a modified economic relationship between:

- the principal; and
- the consideration for the time value of money and the credit risk

would not meet the solely P&I condition in IFRS 9 if the modification could result in cash flows that are *more than insignificantly* different from the benchmark cash flows.

It proposed that, if it is impracticable[1] on transition to IFRS 9 for an entity to assess a modified economic relationship based on the facts and circumstances that existed at the initial recognition of the financial asset, then the entity would assess the contractual cash flow characteristics of that financial asset *without taking into account* the specific requirements for modified economic relationships.

In September 2013, the IASB tentatively decided that a financial asset whose interest rate has a modified time value of money component would meet the solely P&I condition if its contractual cash flows could not be significantly different from the benchmark instrument's cash flows.

What did the staff recommend?

In the staff's view, the IASB's tentative decision to replace the 'not more than insignificant' threshold with a 'not significant' threshold does not affect the rationale for the related transition and disclosure requirements that were proposed in the C&M ED.

Accordingly, the staff recommended that the IASB reaffirm these transition and disclosure proposals.

What did the IASB decide?

The Board agreed with the staff recommendation.

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1 As defined by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

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If it is impracticable to assess the significance of prepayment features on transition, then the contractual cash flow assessment should be made without taking into account the exception for certain prepayment features.

Other transition issues – A financial asset that is acquired or originated at a significant premium or discount

What's the issue?

Under IFRS 9, a financial asset would be classified as at FVTPL if it has a prepayment feature that could result in contractual cash flows that are not solely P&I (unless that feature is not genuine).

In redeliberating the C&M ED, the IASB tentatively decided to provide an exception for financial assets that meet the following conditions:

- the financial asset is acquired or originated with a significant premium or discount;
- the financial asset is prepayable at the amount that represents par plus accrued and unpaid interest (and may include reasonable additional compensation for the early termination of the contract); and
- the fair value of the prepayment feature on initial recognition of the financial asset is insignificant.

Such financial assets would be eligible for classification at other than FVTPL (subject to the business model assessment).

What did the staff recommend?

On transition to IFRS 9, an entity would need to assess whether a financial asset meets the conditions set out above, based on the facts and circumstances that existed at the initial recognition of the financial asset, including whether the fair value of the prepayment feature was insignificant.

The staff recommended that, if it is impracticable[2] for an entity, on transition to IFRS 9, to make that assessment, then the entity should assess the contractual cash flow characteristics of that financial asset *without taking into account* the exception for certain prepayment features.

What did the IASB decide?

The Board agreed with the staff recommendation.

On transition, entities would reconsider their fair value option designations only to the extent that either previous accounting mismatches no longer exist or new accounting mismatches are created.

Other transition issues – Fair value option designations for entities that have already applied a previous version of IFRS 9

What's the issue?

Under IFRS 9, entities can designate a financial asset or a financial liability as measured at FVTPL under the fair value option if doing so eliminates or significantly reduces a measurement or recognition inconsistency ('an accounting mismatch').

The C&M ED also proposed that, on initial application of the completed version of IFRS 9, an entity that has already applied a previous version of IFRS 9 would reconsider its fair value option designations only to the extent that either:

- previous accounting mismatches no longer exist, or
- new accounting mismatches are created

as a result of applying the limited amendments.

2 As defined by IAS 8.

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What did the staff recommend?

The staff recommended that the IASB confirm the transition proposals in the C&M ED.

Specifically, entities that have already applied a previous version of IFRS 9 would be required to revoke previous fair value option elections if the accounting mismatch that formed the basis for the previous designation no longer exists at initial application of the completed version of IFRS 9 as a result of the amended C&M requirements, but would not be able to revoke previous fair value option elections if the accounting mismatch continues to exist.

They may also apply the fair value option for new accounting mismatches that are created by the initial application of the amended C&M requirements, but would not be able to newly apply the fair value option for accounting mismatches that already existed before initial application.

What did the IASB decide?

The Board agreed with the staff recommendation.

Next steps

At its February 2014 meeting, the IASB will discuss the effective date of the completed version of IFRS 9. It will also consider whether it has complied with its due process requirements, and whether the staff should proceed with drafting.

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IMPAIRMENT

The presentation requirements in the impairment ED and the C&M ED would be confirmed.

Presentation requirements

What's the issue?

The impairment ED proposed that interest revenue and impairment losses (including reversals) would be presented as separate line items in the statement of profit or loss and OCI.

The C&M ED proposed that no accumulated impairment amount would be presented in the statement of financial position for assets that are mandatorily measured at FVOCI. However, the loss allowance amount would be disclosed.

The vast majority of respondents agreed with the proposed presentation requirements.

What did the staff recommend?

The staff recommended that the presentation requirements in the impairment ED and the C&M ED be confirmed.

What did the IASB decide?

The Board did not object to the staff recommendation.

The disclosure objectives would be enhanced.

Disclosure objectives

What's the issue?

An overall objective of the impairment ED was to require entities to disclose information that identifies and explains:

- the amounts in the financial statements arising from expected credit losses; and
- the effect of deteriorations and improvements in the credit quality of financial instruments that are in the scope of the proposals.

Some respondents commented that the proposed disclosure objectives are not clear enough, and recommended that they be clarified or improved to demonstrate the relevance and usefulness of the information provided to users of financial statements.

What did the staff recommend?

The staff recommended that the IASB confirm and expand upon the disclosure objectives in the impairment ED, to emphasise that the information provided should enable a user of the financial statements to understand:

- how an entity manages credit risk;
- the methods, assumptions and information used to estimate expected credit losses;
- an entity's credit risk profile – i.e. the credit risk inherent in the financial instruments – including significant credit concentrations; and
- changes, and the reasons for the changes, in the estimate of expected credit losses during the period.

The staff noted that this approach is consistent with Recommendation 26 of the Enhanced Disclosure Task Force (EDTF), as published in its report Enhancing the Risk Disclosures of Banks in October 2012.[3]

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3 For more information on this report, see our In the Headlines – FSB Enhanced Disclosure Taskforce publishes its recommendations for banks.

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What did the IASB decide?

The Board agreed with the staff recommendation.

Certain changes to qualitative disclosures would be made.

Qualitative disclosures

What's the issue?

Under the disclosure requirements proposed in paragraphs 39 and 42 of the impairment ED, entities would disclose qualitative information on:

- estimates of 12-month and lifetime expected credit losses;
- the assessment of significant increases in credit risk since initial recognition; and
- the determination of whether there is objective evidence of impairment.

This information would include explanations of:

- the inputs, assumptions and estimation techniques used; and
- the changes in estimates or estimation techniques and their causes.

Other specific qualitative disclosures required by the impairment ED included the write-off policy, discount rates and application of the 'more than 30 days past due' presumption.

Many respondents said that they would prefer these disclosures to be principles-based and qualitative in nature, and that detailed quantitative information should not be prescribed.

What did the staff recommend?

The staff noted that the requirements proposed in paragraphs 39 and 42 of the impairment ED were intended to be qualitative and principles-based.

They recommended the following changes to the qualitative disclosures:

- adding requirements to explain:
  - the entity's policy on the modification of financial assets, including how an entity assesses that the credit risk of modified financial assets is no longer considered to have 'significantly increased' since initial recognition; and
  - how macroeconomic information has been incorporated in the estimates[4]; and
- removing the requirement to disclose information about the discount rate selected, because it is obsolete in view of the Board's earlier decisions on the discount rate to be used.

What did the IASB decide?

The Board agreed with the staff recommendations.

4 This follows the IASB's tentative decision in September 2013 that macroeconomic information needs to be considered when assessing whether there has been a significant increase in credit risk.

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KPMG insight

Although these proposed disclosures are qualitative in nature, they go beyond the current requirements under IFRS 7.

The IASB's tentative decision to require disclosure of the policy on the modification of financial instruments is consistent with the recent focus from regulators and other stakeholders relating to banks' forbearance activities.[5] Banks may therefore already disclose similar information.

The disclosure of reconciliations of gross carrying amounts would be streamlined.

Quantitative disclosures – Reconciliations

What's the issue?

The impairment ED proposed that entities would provide reconciliations from the opening balance to the closing balance for:

- financial assets, the gross carrying amounts and the associated impairment allowances separately for:
  - assets for which 12-month expected credit losses are recognised;
  - assets for which lifetime expected credit losses are recognised;
  - purchased or originated credit-impaired (POCI) assets; and
  - other credit-impaired assets; and
- the carrying amounts of provisions for loan commitments and financial guarantee contracts.

Also, for POCI assets, an entity would disclose the total amount of undiscounted expected credit losses at initial recognition.

Many respondents opposed the requirements for the reconciliations of gross carrying amounts, because they would be extremely onerous and costly to produce. Some respondents also questioned their usefulness. Furthermore, respondents noted that the information is not readily available, because it is not used for current credit risk management purposes. The majority of respondents noted that a reconciliation of the loss allowance would be more operational and would provide useful information.

What did the staff recommend?

The staff took the view that the reconciliation of both the gross carrying amount and the loss allowance as proposed in the impairment ED would provide the most useful information to users of financial statements. However, based on the feedback received on operational difficulties, they suggested the following alternatives to modify the proposals on the reconciliation of the gross carrying amounts.

- Alternative A: a full reconciliation only for assets with lifetime expected credit losses, and a simplified one for assets with 12-month expected credit losses.
- Alternative B: a reconciliation for all financial assets, focusing on the key drivers for changes in the loss allowance.

5 See our In the Headlines – Regulators focus on forbearance, which looks at the public statement issued on this subject by the European Securities and Market Authority (ESMA) in December 2012; and also Recommendation 27 of the EDTF report.

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What did the IASB discuss?

During the IASB meeting, a staff member noted that – during outreach activities – two main concerns had been raised in respect of the reconciliation requirements:

- in practice, a collective assessment of credit risk is performed on a snapshot basis – e.g. 10 percent of receivables at the reporting date and 12 percent at the next reporting date, therefore the difference of two percent could reflect net rather than gross movement; and
- roll-forward for accounting purposes might not reconcile to risk management.

In considering this feedback, the staff believed that most of the concerns could be addressed by adopting Alternative B.

One Board member agreed with Alternative B, on the basis that a collective assessment of credit risk in Stage 2 would be performed at the beginning and end of the period, and that it would therefore be impossible to carry out a gross reconciliation as required by the impairment ED in such cases.

Another Board member noted that a distinction should be made in the disclosures between short-term instruments that may be originated and repaid in full within a period – e.g. credit card balances – and other instruments that are originated and repaid in different periods. A staff member agreed that, for credit cards, disclosing all of the information on draw-downs and repayments would not necessarily be helpful.

What did the IASB decide?

The Board tentatively confirmed that the proposals in the impairment ED would require a reconciliation between the opening balance and the closing balance of the gross carrying amount and the loss allowance. However, the Board also tentatively supported Alternative B – i.e. amending the requirement such that the reconciliation of the gross carrying amounts for all financial assets would focus on the key drivers for changes in the gross carrying amount, to the extent that the changes relate to changes in the loss allowance during the period.

KPMG insight

The IASB did not clarify the scope of the requirements in the impairment ED to disclose the total amount of undiscounted expected credit losses at initial recognition for POCI financial assets. At present, it is unclear whether the requirements apply:

- only to assets acquired during the reporting period; or
- to all assets recognised in the statement of financial position at the reporting date, irrespective of when they were acquired.

If the disclosure requirements apply to the latter, then calculating the relevant amounts would be much more challenging for preparers.

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The operability of quantitative disclosures on modifications would be improved.

Quantitative disclosures – Modifications

What's the issue?

The impairment ED proposed disclosures for financial assets that have been modified, as summarised in the table below.

Type of modified asset to which the disclosure applies	Disclosure required in the period of modification	Disclosure required for each reporting period throughout the remaining life until derecognition
Financial assets modified while subject to lifetime expected credit loss allowance	• Amortised cost • Modification gain or loss	Gross carrying amount for which the measurement for the credit loss allowance has changed from lifetime expected credit losses to 12-month expected credit losses
Financial assets modified while in default	• No additional disclosures required in the period of modification	Re-default rate – i.e. the percentage of financial assets that defaulted again after the modification

Some respondents commented that it would be onerous to require entities to disclose the gross carrying amount of modified financial assets for which the expected loss measurement has changed from lifetime to 12-month expected credit losses *during the entire remaining life* of the assets. This is because entities would be required to track individual assets that have returned to a performing status, but these assets would no longer be closely monitored for credit risk management purposes. Respondents also noted that this information would become less useful over time.

Several respondents commented that it is not clear whether the term 're-default' refers to assets that have moved from Stage 1 to Stage 2 or 3, or to another population.

What did the staff recommend?

The staff acknowledged the operational concerns, and recommended that the disclosure of the gross carrying amount of modified financial assets for which the measurement for the credit loss allowance has changed from lifetime expected credit losses to 12-month expected credit losses should be required *only in the period of change*.

The staff also acknowledged the concerns about the meaning of the term 're-default'. They therefore recommended that the IASB clarify this requirement by referring to the deterioration rate – i.e. the percentage – of financial assets, disclosed in accordance with the above paragraph, for which credit risk has subsequently increased significantly, resulting in the measurement of the loss allowance reverting to lifetime expected credit losses.

What did the IASB decide?

The Board agreed with the staff recommendations.

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KPMG insight

The IASB's tentative decision to limit the disclosure of the gross carrying amount of modified financial assets only to the period of change is a welcome simplification. Again, the proposed disclosure requirements reflect the recent focus from stakeholders on banks' forbearance activities.[6]

Disclosure of the fair value of collateral would not be required.

Quantitative disclosures – Collateral and credit risk mitigation

What's the issue?

The impairment ED proposed the following disclosures in respect of collateral and credit mitigation:

- a description of the collateral held as security and other credit enhancements, including:
  - a discussion of the quality of collateral held – e.g. the stability of the asset value and liquidity; and
  - an explanation of any changes in quality as a result of deterioration or changes in the collateral policies of the entity;
- the gross carrying amount of financial assets that have an expected credit loss of zero because of collateral; and
- for financial instruments that have objective evidence of impairment at the reporting date, quantitative information about the extent to which collateral and other credit enhancements reduce the severity of expected credit losses.

A number of respondents expressed concern about the operational difficulty of providing this quantitative information about collateral, and said that the requirements should generally be more qualitative and consider a wider range of credit risk mitigation factors.

What did the staff recommend?

The staff noted that paragraph 36(b) of IFRS 7 currently requires entities to disclose a description of collateral held as security and other credit enhancements, and their financial effect. They also noted that, in the basis for conclusions to IFRS 7 (paragraph BC55A), the IASB states that information about the financial effect of collateral is useful to users. Furthermore, the staff noted that Recommendation 30 of the EDTF report recommends that entities provide qualitative information on credit risk mitigation, and also quantitative information where meaningful.

However, in response to the comments received, the staff proposed that the wording be changed by removing the word 'quantitative'. The requirement relating to financial instruments that have objective evidence of impairment at the reporting date would therefore be to disclose 'information' – rather than 'quantitative information' – about the extent to which collateral and other credit enhancements reduce the severity of expected credit losses. Also, to enhance the usefulness of the disclosures, the staff proposed expanding these disclosures to all financial instruments.

In addition, the staff believed that the requirement to disclose the gross carrying amount of financial assets that have an expected credit loss of zero because of collateral was not intended to refer to individual financial assets, but to asset classes. Therefore, the staff proposed clarifying that this disclosure requires entities to provide information about asset classes where there might have been a significant increase in credit risk resulting in:

6 See our In the Headlines – Regulators focus on forbearance.

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- the measurement objective changing to lifetime expected credit losses; but
- no increase in the actual loss allowance due to the value of the collateral.

What did the IASB discuss?

During the meeting, a staff member explained that, in the feedback received, users thought it was essential that quantitative information, as proposed in the impairment ED, be provided for financial instruments that are in Stage 3 – i.e. those that have objective evidence of impairment.

What did the IASB decide?

The Board tentatively confirmed the proposals in the impairment ED for disclosures about collateral or other credit enhancements, subject to clarifications that:

- qualitative information should be disclosed about how collateral and other credit enhancements have been incorporated into the measurement of expected credit losses on all financial instruments; and
- quantitative information about the extent to which collateral or other credit enhancements affect the expected credit loss allowance (or provision) does not require information about the fair value of collateral.

In addition, the Board did not object to the staff recommendation on the requirement to disclose the gross carrying amount of financial assets that have an expected credit loss of zero because of collateral.

KPMG insight

The IASB did not clarify whether the requirement to disclose any changes in the quality of collateral as a result of deterioration refers to changes:

- since the beginning of the reporting period; or
- since the initial recognition of the collateralised financial instrument.

The term 'nominal amount' for disclosures of financial assets written off would be clarified, and the disclosure of it would be required only for write-offs during the period.

Other disclosures – Write-offs

What's the issue?

The impairment ED proposed disclosure of the nominal amount of financial assets written off that are still subject to enforcement activity. Several respondents questioned the meaning of the term 'nominal amount', because they were uncertain whether it refers to:

- the gross or net carrying amount at write-off;
- the original amount of principal; or
- the amount that is legally recoverable.

What did the staff recommend?

The staff noted that the term 'nominal amount' is used in other standards to refer to the contractual amount outstanding, and recommended clarifying this in the wording of the standard. They further recommended clarifying that the requirement to disclose the nominal amount of assets subject to enforcement activity would only apply to financial assets that have been written off during the period, whereas narrative information would need to be provided for financial assets that have previously been written off but that are still subject to enforcement activity.

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What did the IASB decide?

The Board agreed with the staff recommendations.

Credit risk rating disclosures would be aligned more closely to risk management.

Other disclosures – Credit risk disaggregation

What's the issue?

The impairment ED proposed that an entity would disclose, by credit risk rating grade:

- the gross carrying amount of financial assets;
- the provision for loan commitments; and
- the provision for financial guarantee contracts.

This information would be disclosed separately for:

- 12-month expected credit losses;
- lifetime expected credit losses;
- trade and lease receivables; and
- POCI financial assets.

The impairment ED emphasised that the number of credit risk rating grades used for this disclosure:

- should be sufficient to enable users to assess the entity's exposure to credit risk; but
- should not exceed the number used for internal credit risk management purposes, except that an entity should always disaggregate its portfolio across at least three grades.

Some respondents commented that the requirement to disclose credit risk rating grades would not be consistent with some credit risk management practices for some asset classes and for non-financial entities. Others expressed concern about the requirement to disaggregate the portfolio across at least three grades for entities that use fewer grades internally.

What did the staff recommend?

The staff acknowledged the comments that these disclosures should be aligned with internal credit risk management. They therefore recommended:

- expanding the requirement to allow the use of an ageing analysis for financial assets for which delinquency information is the only borrower-specific information available to assess significant increases in credit risk; and
- removing the requirement for the minimum number of credit risk grades but instead requiring credit risk disaggregation to be aligned with the way credit risk is managed internally.

What did the IASB decide?

The Board agreed with the staff recommendation.

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The disclosure of the significant effect on the loss allowance would be incorporated in qualitative disclosures.

Other disclosures – Significant effect on the loss allowance

What's the issue?

The impairment ED proposed that an entity should disclose quantitative and qualitative analyses of significant positive or negative effects on the loss allowance that are caused by a particular portfolio or geographical area. Some respondents questioned the usefulness of this proposal because this information is already captured by other disclosure requirements.

What did the staff recommend?

The staff agreed that this requirement is already broadly captured by other disclosure requirements and therefore recommended that it should be incorporated into the qualitative disclosures discussed in the section 'Qualitative disclosures' – i.e. that entities should disclose information about significant effects on the loss allowance that are due to a particular factor.

What did the IASB decide?

The Board did not object to the staff recommendation.

The requirement to disclose the amount of financial assets assessed on an individual basis would be removed.

Other disclosures – The amount of financial assets assessed on an individual basis

What's the issue?

The impairment ED proposed that entities should disclose:

- the gross carrying amount of financial assets; and
- the amount recognised as a provision for loan commitments and financial guarantee contracts that are evaluated on an individual basis and meet the criterion for the recognition of lifetime expected credit losses.

Several respondents thought that this requirement is unnecessary, as it is not relevant in an expected credit loss model; this is because an impairment allowance does not result from objective evidence of impairment on an individual asset.

What did the staff recommend?

Overall, the staff thought that this disclosure requirement has limited usefulness and therefore suggested removing it from the final standard.

What did the IASB decide?

The Board did not object to the staff recommendation.

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The reduced disclosure requirements for trade receivables and lease receivables that are accounted for using the simplified approach would be confirmed.

Receivables assessed using the simplified approach

What's the issue?

The impairment ED proposed reduced disclosure requirements for trade receivables and lease receivables that are accounted for using the simplified approach, under which the loss allowance for those assets is always measured as lifetime expected credit losses.

What did the staff recommend?

The staff recommended that the disclosure requirements be confirmed, because:

- limited feedback has been received on the issue; and
- the staff thought that the simplified disclosure requirements for those assets were consistent with the intention to reduce operational complexity.

What did the IASB decide?

The Board did not object to the staff recommendation.

Transitional requirements in the final standard would apply to first-time adopters.

Transition requirements for first-time adopters of IFRS

What's the issue?

In its December 2013 meeting, the IASB discussed the transitional requirements of the impairment ED[7]. In January, the Board discussed whether the same transition provisions should be applied for first-time adopters of IFRS.

What did the staff recommend?

The staff noted that the transition provisions on initial application of the expected credit loss model are relevant for first-time adopters. They recommended therefore that first-time adopters should also be required to apply the transitional requirements of the impairment ED.

What did the IASB decide?

The Board agreed with the staff recommendation.

Next steps

This meeting concluded the IASB's redeliberations on the technical aspects of the impairment ED.

At a future meeting, the IASB will discuss:

- the mandatory effective date of IFRS 9 as a whole;
- any potential sweep issues; and
- due process considerations.

The Board will also consider whether re-exposure is necessary, and the staff will request permission to ballot.

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7 For more information, see Issue 18 of this newsletter from December 2013.

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APPENDIX A: SUMMARY OF IASB'S REDELIBERATIONS ON THE CLASSIFICATION AND MEASUREMENT ED

Note: Decisions made in January 2014 are shaded.

What did the IASB discuss?		What did the IASB tentatively decide?	Is there an identified change to IFRS 9?	Is there an identified change to the C&M ED?
The solely principal and interest ('solely P&I') criterion	Meaning of 'principal'	'Principal' is the amount transferred by the current holder for the financial asset.	Yes	Yes
	Meaning of 'interest'	The IASB tentatively decided: • to clarify that *de minimis* features should be disregarded for classification; • to emphasise the underlying conceptual basis for the 'solely P&I' condition – i.e. the notion of a basic lending-type return; • to confirm that time value of money and credit risk are typically the most significant components of a basic lending-type return, but not the only possible components; • to clarify that a basic lending-type return also generally includes consideration for liquidity risk, profit margin and consideration for costs associated with holding the financial asset over time – e.g. servicing costs; • to emphasise what are not the components of a basic lending-type return and why – e.g. indexation to equity prices; and • to clarify the meaning of the time value of money – specifically: – to clarify the objective of the consideration for the time value of money – i.e. to provide consideration for *just* the passage of time, in the absence of return for other risks and costs associated with holding the financial asset over time; – to articulate the factors relevant to providing consideration for the passage of time – notably, the tenor of the interest rate and the currency of the instrument; – to clarify that both qualitative and quantitative approaches could be used to determine whether the interest rate provides consideration for just the passage of time, if the time value of money component of the interest rate is modified – e.g. by an interest rate tenor mismatch feature – but not to prescribe when each approach should be used; and – to not allow a fair value option in lieu of the quantitative assessment;	Yes	Yes

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What did the IASB discuss?		What did the IASB tentatively decide?	Is there an identified change to IFRS 9?	Is there an identified change to the C&M ED?
The solely principal and interest ('solely P&I') criterion (continued)	**Meaning of 'interest' (continued)**	• to accept regulated interest rates as a proxy for the consideration for the time value of money if those rates provide consideration that is broadly consistent with consideration for the passage of time and do not introduce exposure to risks or volatility in cash flows that are inconsistent with the basic lending-type relationship; and • to provide guidance on how the quantitative assessment of a financial asset with a modified time value of money component should be performed – i.e. by considering the contractual (undiscounted) cash flows of the instrument relative to the benchmark instrument – and to replace the 'not more than insignificant' threshold in the C&M ED with the 'not significant' threshold – i.e. a financial asset with the 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.		
	Contingent features	The nature of the contingent trigger event in itself does not determine the classification of the financial asset. A contingent feature that results in contractual cash flows that are not solely P&I is inconsistent with the 'solely P&I' condition unless the feature is non-genuine.	Yes	Yes
	Prepayment and extension features	No distinction should be made between contingent prepayment and extension features and other types of contingent features. A prepayment feature that results in contractual cash flows that are not solely P&I is inconsistent with the 'solely P&I' condition unless the feature is non-genuine – with an exception for financial assets that meet the following conditions: • the financial asset is acquired or originated with a significant premium or discount; • the financial asset is prepayable at the amount that represents par and accrued and unpaid interest (and may include reasonable additional compensation for the early termination of the contract); and • the fair value of the prepayment feature on initial recognition of the financial asset is insignificant. Financial assets meeting the conditions for this exception would be eligible for classification at other than FVTPL (subject to the business model assessment).	Yes	Yes

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	What did the IASB discuss?	What did the IASB tentatively decide?	Is there an identified change to IFRS 9?	Is there an identified change to the C&M ED?
Business model	**Meaning of 'business model'**	The term 'business model' should refer to the way in which financial assets are managed in order to generate cash flows and create value for the entity. The business model assessment should result in financial assets being measured in a way that would provide the most relevant and useful information about how activities and risks are managed to create value.	Yes	Yes
	Level at which a business model is assessed	The business model should be assessed at a level that reflects groups of financial assets that are managed together to achieve a particular objective. In short, this assessment should reflect the way in which the business is managed.	Yes	Yes
	Information that should be considered when assessing business model	The final standard would make the following clarifications. • The business model is often observable through particular activities that are undertaken to achieve the objectives of that business model. • These business activities usually reflect: – the way in which the performance of the business is evaluated and reported – i.e. key performance indicators; – the risks that typically impact the performance of the business model; and – how those risks are managed. • An entity should consider all relevant and objective information, but not every 'what if' or worst-case scenario.	Yes	Yes

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<table>
<tr><th colspan="2">What did the IASB discuss?</th><th>What did the IASB tentatively decide?</th><th>Is there an identified change to IFRS 9?</th><th>Is there an identified change to the C&M ED?</th></tr>
<tr><td rowspan="2">Business model (continued)</td><td>Role of sales in the business model assessment</td><td>The application guidance in the final standard would include the following clarifications.
• Sales do not drive the business model assessment, and information about sales activity should not be considered in isolation, but as part of an holistic assessment of how the financial assets will be managed.
• Historical sales information would help an entity support and verify its business model assessment. Such information should be considered in the context of:
– the reasons for those sales;
– the conditions that existed at that time;
– the entity's expectations about future sales activities; and
– the reasons for those expected future sales.
• Fluctuations in sales in a particular period do not necessarily mean that the entity's business model has changed if the entity can explain:
– the nature of those sales; and
– why they do not indicate a fundamental change in its overall business strategy.
• If cash flows are realised in a way that is different from the entity's expectations, then this would neither:
– result in the restatement of prior period financial statements; nor
– change the classification of the existing financial assets in the business model;
as long as the entity considered all relevant and objective information that was available at the time that it made its decision.</td><td>Yes</td><td>Yes</td></tr>
<tr><td>Change in business model</td><td>A change in business model would occur only when an entity has either stopped or started doing something on a level that is significant to its operations.
This would generally be the case only when the entity has acquired or disposed of a business line.</td><td>Yes</td><td>Yes</td></tr>
</table>

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	What did the IASB discuss?	What did the IASB tentatively decide?	Is there an identified change to IFRS 9?	Is there an identified change to the C&M ED?
Business model (continued)	**Hold to collect business model**	The current hold to collect 'cash flows (value) realisation' concept would be reinforced by discussing, and providing examples of, the activities that are commonly associated with the hold to collect business model; and by providing guidance on the nature of information an entity should consider in assessing the hold to collect business model. Insignificant and/or infrequent sales may be consistent with the hold to collect business model, regardless of the reasons for those sales. This determination is a matter of judgment and would be based on facts and circumstances. Historical sales information and patterns could provide useful information, but that sales information would not be determinative and should not be considered in isolation. Sales to minimise potential credit risk due to credit deterioration are integral to the hold to collect objective. Sales made in managing concentration of credit risk would be assessed in the same way as any other sales made in the business model.	Yes	Yes
	A third measurement category – FVOCI	The FVTPL measurement category would be retained as the residual category.	No	No
	Clarifying the proposed application guidance for the FVTPL measurement category	The final standard would clarify the following points. • When financial assets are either held for trading or managed and evaluated on a fair value basis, the entity makes decisions – i.e. whether to hold or sell the asset – based on changes in, and with the objective of realising, the assets' fair value. • The activities that the entity undertakes are primarily focused on fair value information, and key management personnel use that information to assess the assets' performance and to make decisions accordingly. • Another indicator is that the users of the financial statements are primarily interested in fair value information on these assets to assess the entity's performance.	Yes	Yes

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	What did the IASB discuss?	What did the IASB tentatively decide?	Is there an identified change to IFRS 9?	Is there an identified change to the C&M ED?
Business model (continued)	**Clarifying the proposed application guidance for the FVOCI measurement category**	The final standard would clarify that managing financial assets both to collect contractual cash flows and for sale would reflect the way in which financial assets are managed to achieve a particular objective, rather than the objective in itself. Assets that are classified at FVOCI would be managed in order to achieve different business model objectives – e.g. liquidity management, interest rate risk management, yield management and duration mismatch management – both by collecting contractual cash flows and by selling. The application guidance should more clearly articulate that FVOCI provides relevant and useful information when both the collection of contractual cash flows and the realisation of cash flows through selling are integral to the performance of the business model. The application guidance should describe activities that are typically associated with a business model where financial assets are managed both to collect the contractual cash flows and for sale. There would be no threshold for the frequency or amounts of sales.	Yes	Yes
Other matters	**Extension of the fair value option to the FVOCI measurement category**	Entities would be permitted to apply the fair value option to a financial asset that would otherwise be mandatorily measured at FVOCI if such a designation eliminates or significantly reduces an accounting mismatch. In accordance with the existing fair value option in IFRS 9, such a designation would be performed at initial recognition and would be irrevocable.	Yes	Yes
Other matters	**Extension of presentation and disclosure requirements**	The disclosure and presentation requirements in IFRS 7 and IAS 1 would extend to reclassifications into and out of the FVOCI category.	Yes	No
Other matters	**Disclosure of significant judgements**	The judgement involved in assessing an asset's contractual cash flow characteristics would 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.	Yes	No
Other matters	**Comparative information and related disclosures for first-time adopters of IFRS**	First-time adopters would be given adequate lead time to prepare for the transition to IFRS 9. They should: • not be required to present comparative information if the beginning of their first IFRS reporting period is earlier than the mandatory effective date of IFRS 9 *plus one year*; • be required to provide additional disclosures if the comparative financial information does not comply with IFRS 9; and • be required to present comparative information that complies with a previous version of IFRS 9 if they choose to early apply that previous version.	Yes	Yes

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	What did the IASB discuss?	What did the IASB tentatively decide?	Is there an identified change to IFRS 9?	Is there an identified change to the C&M ED?
Other matters (continued)	**Early application of IFRS 9**	Entities would be able to early apply the completed version of IFRS 9, but not a previous version of IFRS 9, if their date of initial application is six months or more after the completed version of IFRS 9 is issued.	Yes	No
	Transition– Modified economic relationships	If it is impracticable to assess a modified economic relationship on transition, then the contractual cash flow assessment should be made without taking into account the specific requirements for modified economic relationships.	Yes	Yes
	Transition– Prepayment features	If it is impracticable to assess the significance of prepayment features on transition, then the contractual cash flow assessment should be made without taking into account the exception for certain prepayment features.	Yes	Yes
	Transition – Fair value option	On transition, entities would reconsider their fair value option designations only to the extent that either previous accounting mismatches no longer exist or new accounting mismatches are created. Entities would be required to revoke previous fair value option elections if the accounting mismatch that formed the basis for the previous designation no longer exists at initial application of the completed version of IFRS 9 as a result of the amended C&M requirements, but would not be able to revoke previous fair value option elections if the accounting mismatch continues to exist. They may also apply the fair value option for new accounting mismatches that are created by the initial application of the amended C&M requirements, but would not be able to newly apply the fair value option for accounting mismatches that already existed before initial application.	No	No
	Early application of 'own credit' requirements	The early application guidance in IFRS 9 should be amended to permit entities to early apply only the own credit requirements in IFRS 9 when the IASB adds the hedge accounting chapter to IFRS 9.	Yes – included in IFRS 9 (2013)	No
	Deferral of mandatory effective date	The previous mandatory effective date of 1 January 2015 was deferred by IFRS 9 (2013). The new mandatory effective date will be determined once the impairment and classification and measurement requirements are finalised.	Yes	N/A

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APPENDIX B: SUMMARY OF IASB'S REDELIBERATIONS ON THE IMPAIRMENT ED

Note: Decisions made in January 2014 are shaded.

	What did the IASB discuss?	What did the IASB tentatively decide?	Is there an identified change to the impairment ED?
The general principles	**Responsiveness of the impairment model to forward-looking information**	The objective of the model is to recognise lifetime expected credit losses on all financial instruments for which there has been a significant increase in credit risk – whether on an individual or a portfolio basis. All reasonable and supportable information, including forward-looking information that is available without undue cost or effort, would need to be considered. In addition, the final standard would include illustrative examples to reflect the intention of the proposals.	Yes. The final standard would clarify the objective and include application examples
	Recognition of expected credit losses for financial instruments that have not significantly deteriorated	For financial instruments for which there has not been a significant increase in credit risk since initial recognition, an entity would measure the expected credit losses at an amount equal to the 12-month expected credit losses.	No
	Timing of recognition of lifetime expected credit losses	Lifetime expected credit losses would be recognised when there is a significant increase in credit risk since initial recognition. The final standard would clarify (potentially through examples) that: • the assessment of significant increases in credit risk could be implemented more simply by establishing the initial maximum credit risk for a particular portfolio (of financial instruments with similar credit risk on initial recognition) and then comparing the credit risk of financial instruments in that portfolio at the end of the reporting period with that origination credit risk; • the assessment of significant increases in credit risk could be implemented through a counterparty assessment – provided that this assessment achieves the objectives of the proposed model; • the assessment of the timing of recognition of lifetime expected credit losses would consider only changes in the risk of a default occurring, rather than changes in the amount of expected credit losses (or the credit LGD); • an assessment based on the change in the risk of a default occurring in the next 12 months would be permitted unless circumstances indicate that a lifetime assessment is necessary; and • a loss allowance measured at an amount equal to 12-month expected credit losses would be re-established for financial instruments for which the criteria for the recognition of lifetime expected credit losses are no longer met.	Yes. The final standard would include clarifications and potentially examples to articulate how to identify a significant increase in credit risk since initial recognition

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What did the IASB discuss?		What did the IASB tentatively decide?	Is there an identified change to the impairment ED?
The general principles (continued)	**Definition of 'default'**	An entity would apply a definition of 'default' that is consistent with its credit risk management practices. Qualitative indicators of default should be considered when appropriate – e.g. for financial instruments that contain covenants. Also, the final standard would include a rebuttable presumption that default does not occur later than 90 days past due unless an entity has reasonable and supportable information to corroborate a more lagging default criterion.	Yes. The rebuttable presumption was not included in the impairment ED
Operational simplifications	**'More than 30 days past due' rebuttable presumption**	The rebuttable presumption that there is a significant increase in credit risk when contractual payments are more than 30 days past due would be retained in the final standard. Also, it would be clarified that: • the objective of the rebuttable presumption is to serve as a backstop or latest point at which to identify financial instruments that have experienced a significant increase in credit risk; • the presumption is rebuttable; and • the application of the rebuttable presumption is to identify significant increases in credit risk before default or objective evidence of impairment.	Yes. The final standard would provide clarifications to resolve some of the operational concerns
	'Low credit risk' operational simplification	An entity can assume that a financial instrument has not significantly increased in credit risk if it has low credit risk at the end of the reporting period. The meaning and application of the low credit risk notion would be clarified as follows: • the proposed description of low credit risk would be modified to state that: – the instrument has a low risk of default; – the borrower is considered, to have a strong capacity to meet its obligations in the near term; and – the lender expects that adverse changes in economic and business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its obligations; • the low credit risk notion is not a bright-line trigger for the recognition of lifetime expected credit losses; and • financial instruments are not required to be externally rated; however, low credit risk equates to a global credit rating definition of 'investment grade'.	Yes. For low credit risk instruments, it seems that the final standard would allow (rather than require) entities to assume that the credit risk had not significantly increased; also, clarifications on the meaning and application of low credit risk would be provided

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	What did the IASB discuss?	What did the IASB tentatively decide?	Is there an identified change to the impairment ED?
Measurement of expected credit losses	**Discount rate**	The expected credit losses would be discounted at the effective interest rate (EIR) or an approximation thereof.	Yes. The final standard would explicitly require the use of EIR or its approximation
	Use of forward-looking information	The measurement of expected credit losses would incorporate the best information that is reasonably available, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the end of the reporting period.	No
	Use of regulatory models	The regulatory expected credit loss models may form a basis for expected credit loss calculations, but the measurement may need to be adjusted to meet the objectives of the proposed model.	No
	12-month expected credit losses	The final standard would clarify the measurement of 12-month expected credit losses by incorporating paragraph BC63 of the ED as part of the application guidance, namely that 12-month expected credit losses are a portion of the lifetime expected credit losses, and therefore that they are neither: • the lifetime expected credit losses that an entity will incur on financial instruments that it predicts will default in the next 12 months; nor • the cash shortfalls that are predicted over the next 12 months.	Yes. The final standard would clarify that 12-month expected credit losses are a portion of the lifetime expected credit losses by incorporating the discussion in the basis for conclusions into the application guidance
	Financial assets at FVOCI	No relief from recognising 12-month expected credit losses would be introduced for financial assets measured at FVOCI. The final standard would clarify that expected credit losses reflect management's expectations of credit losses. However, when considering the 'best available information' in estimating expected credit losses, management should consider observable market information about credit risk.	Yes. The final standard would clarify that expected credit losses reflect management's expectations of credit losses
Asset modifications	**Scope of application**	The modification requirements in the ED would apply to all modifications or renegotiations of contractual cash flows, regardless of the reason for the modification.	No
	Modification gain or loss	The modification gain or loss would be recognised in profit or loss.	No
	Applicability of the general model to modified financial assets	Modified financial assets would be subject to the same 'symmetrical' treatment – i.e. could revert back to 12-month expected losses – as other financial instruments; however, clarifications would be made in paragraph B24 of the application guidance to emphasise that the credit risk on a financial asset would not automatically improve merely because the contractual cash flows have been modified.	Yes. The final standard would clarify that the application guidance in paragraph B24 applies to all modified financial assets

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What did the IASB discuss?		What did the IASB tentatively decide?	Is there an identified change to the impairment ED?
Financial guarantee contracts and loan commitments other than revolving credit facilities	**Measurement period for expected credit losses**	The maximum period over which expected credit losses should be estimated would be the contractual period over which the entity is committed to provide credit.	No
	Discount rate	Expected credit losses on the undrawn part of the balance would be discounted using the same EIR, or an approximation thereof, as would be used to discount the drawn part, unless the EIR cannot be determined, in which case the discount rate should be determined as proposed in the impairment ED – i.e. it should reflect the current market assessment of the time value of money and the risks that are specific to the cash flows.	Yes. The final standard would require, with some exceptions, that the same EIR is used for the drawn and undrawn components
	Presentation of expected credit losses	The provision for the expected credit losses on the undrawn balance would be presented together with the loss allowance on the drawn amount if an entity cannot separately identify the expected credit losses associated with the undrawn balance.	Yes. The final standard would provide an operational simplification in certain circumstances
Revolving credit facilities	**Measurement period for expected credit losses**	Expected credit losses – including expected credit losses on the undrawn facility – would be estimated for the period over which an entity is exposed to credit risk and over which future draw-downs cannot be avoided – i.e. considering the behavioural life.	Yes. The final standard would change the measurement period
	Discount rate	Expected credit losses on the undrawn part of the revolving credit facility would be discounted using the same EIR, or an approximation thereof, as would be used to discount the drawn part.	Yes. The final standard would require that the same EIR is used for the drawn and undrawn components
	Presentation of expected credit losses	The provision for the expected credit losses on the undrawn component of the facility would be presented together with the loss allowance for expected credit losses on the drawn facility if an entity cannot separately identify the expected credit losses associated with the undrawn facility.	Yes. The final standard would provide an operational simplification in certain circumstances
Purchased or originated credit-impaired assets	**Credit loss allowance**	In respect of POCI assets: • at initial recognition, these assets would not carry a loss allowance; instead, lifetime expected credit losses would be incorporated into the EIR calculation (resulting in a credit-adjusted EIR); and • the cumulative changes in lifetime expected credit losses since initial recognition would be recognised as an impairment gain or loss.	No
	Interest revenue	Interest revenue would be calculated by applying the credit-adjusted EIR to the amortised cost (net carrying amount) of the POCI asset.	No

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What did the IASB discuss?		What did the IASB tentatively decide?	Is there an identified change to the impairment ED?
Trade and lease receivables	**Simplified approach**	A simplified approach would be available for trade and lease receivables. • Trade receivables that do not constitute a financing transaction would always carry a loss allowance equal to lifetime expected credit losses. • For trade receivables with a significant financing component and lease receivables, an accounting policy election could be made to either: – apply the general approach; or – recognise lifetime expected credit losses at all times.	No
	Disclosures for receivables assessed using the simplified approach	Reduced disclosure requirements in the impairment ED for trade receivables and lease receivables that are accounted for using the simplified approach would be retained.	No
Interest revenue	**Calculation basis**	Interest revenue would generally be calculated by applying the EIR to the gross carrying amount unless there is objective evidence of impairment, in which case interest would be calculated by applying the EIR to the net carrying amount (amortised cost) of an asset.	No
	Criteria for the change in calculation basis	The calculation of interest revenue would change to a net basis for financial assets that have objective evidence of impairment at the reporting date.	No
	Symmetry in calculation	The calculation of interest revenue would be symmetrical – i.e. it would revert to the gross basis if there is no longer objective evidence of impairment.	No
Presentation	**Presentation requirements**	• Interest revenue and impairment losses (including reversals) would be presented as separate line items in the statement of profit or loss and OCI. • No accumulated impairment amount would be presented in the statement of financial position for assets that are mandatorily measured at FVOCI. However, the loss allowance amount would be disclosed.	No
Disclosure objectives	**Disclosure objectives**	Disclosure objectives would be expanded to emphasise that the information provided should enable a user of the financial statements to understand: • how an entity manages credit risk; • the methods, assumptions and information used to estimate expected credit losses; • an entity's credit risk profile – i.e. the credit risk inherent in the financial instruments – including significant credit concentrations; and • changes, and the reasons for the changes, in the estimate of expected credit losses during the period.	Yes. Disclosure objectives would be expanded

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What did the IASB discuss?		What did the IASB tentatively decide?	Is there an identified change to the impairment ED?
Qualitative disclosures	**Qualitative disclosures**	• Additional disclosure requirements would be added to explain: – the entity's policy on the modification of financial instruments; and – how macroeconomic information has been incorporated in the estimates. • The requirement to disclose information about the discount rate selected would be removed.	Yes. Changes would be introduced to qualitative disclosure requirements
Quantitative disclosures	**Reconciliations**	Disclosures would be amended such that the reconciliation of the gross carrying amounts for all financial assets would focus on the key drivers for changes in the loss allowance.	Yes. Quantitative disclosure requirements for gross carrying amounts would be simplified
	Modifications	• The disclosure of the gross carrying amount of modified financial assets for which the measurement for the credit loss allowance has changed from lifetime expected credit losses to 12-month expected credit losses should be required only in the period of change. • The disclosure requirement would be clarified by referring to the deterioration rate – i.e. the percentage – of financial assets, for which credit risk has subsequently increased significantly, resulting in the measurement of the loss allowance reverting to lifetime expected credit losses.	Yes. The final standard would clarify when the disclosure of the gross carrying amount for modified assets would be required and by referring to the deterioration rate
	Collateral and credit risk mitigation	The following will be clarified: • qualitative information should be disclosed about how collateral and other credit enhancements have been incorporated into the measurement of expected credit losses on all financial instruments; • quantitative information about the extent to which collateral or other credit enhancements affect the expected credit loss allowance (or provision) does not require information about the fair value of collateral; and • entities would be required to disclose the gross carrying amount of financial assets that have an expected credit loss of zero because of collateral only in certain circumstances.	Yes. The final standard would clarify the extent of disclosures in respect of collateral and other credit enhancements
Other disclosures	**Write-offs**	The final standard would clarify the term 'nominal amount' and that: • only financial assets written off during the period would be subject to the requirement to disclose the nominal amount of assets subject to enforcement activity; and • financial assets written off in prior periods but still subject to enforcement activity would be subject to the requirement to disclose narrative information.	Yes. The term 'nominal amount' would be clarified and the disclosure of it would be required only for write-offs during the period

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	What did the IASB discuss?	What did the IASB tentatively decide?	Is there an identified change to the impairment ED?
Other disclosures (continued)	**Credit risk disaggregation**	Credit risk disaggregation requirements would be modified to permit the use of an ageing analysis for financial assets for which delinquency information is the only borrower-specific information available to assess significant increases in credit risk. The requirement for the minimum number of three credit risk grades would be removed, but instead credit risk disaggregation would be required to be aligned with the way credit risk is managed internally.	Yes. Credit risk disaggregation requirements would be aligned closer to risk management
	Significant effect on the loss allowance	The disclosure of information about significant effects on the loss allowance that are caused by a particular portfolio or geographical area would be incorporated into the qualitative disclosures. (The impairment ED proposed in addition that quantitative disclosures would be required.)	Yes. The impairment ED contained a separate requirement to disclose quantitative and qualitative analysis of significant effects on the loss allowance caused by a particular portfolio or geographical area
	The amount of financial assets assessed on an individual basis	The following quantitative disclosure requirements would be removed: • the gross carrying amount of financial assets; and • the amount recognised as a provision for loan commitments and financial guarantee contracts that are evaluated on an individual basis and meet the criterion for the recognition of lifetime expected credit losses.	Yes. Quantitative disclosure requirements on the amount of assets assessed on an individual basis would be removed
Transition	**Retrospective application**	The final requirements would be applied retrospectively in accordance with IAS 8.	No
	Low credit risk exception	When applying the proposals retrospectively, entities may use the low credit risk exception to identify financial instruments for which the credit risk has not significantly increased.	No
	Approximation of credit risk	An entity could approximate the credit risk on initial recognition by using the best information that is available without undue cost or effort.	Yes. The final standard would allow an approximation of the credit risk at initial recognition to be used
	Assets for which credit risk on initial recognition cannot be determined or approximated	If an entity is unable to approximate the credit risk at initial recognition without undue cost or effort, the loss allowance would be measured based on the credit quality at each reporting date until the financial instrument is derecognised.	Yes. If an entity is unable to approximate the credit risk at initial recognition, the loss allowance would be measured based on the credit quality at each reporting date until the financial instrument is derecognised

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	What did the IASB discuss?	What did the IASB tentatively decide?	Is there an identified change to the impairment ED?
Transition (continued)	**Application guidance or examples**	To provide, in the final standard, application guidance or examples to describe how an entity would assess whether there has been a significant increase in credit risk where it uses: • the more than 30 days past due rebuttable presumption if the entity identifies increases in credit risk according to days past due; and • a comparison of the credit risk at the date of transition to the initial maximum credit risk (by product type and/or region).	Yes. The final standard would include application guidance or examples
	First-time adoption	Transitional requirements in the final standard would apply to first-time adopters of IFRS.	Yes. The impairment ED did not include similar transition requirements for first-time adopters
Other matters	**Deferral of mandatory effective date**	The previous mandatory effective date of 1 January 2015 was deferred by IFRS 9 (2013). The new mandatory effective date will be determined once the impairment and classification and measurement requirements are finalised.	N/A

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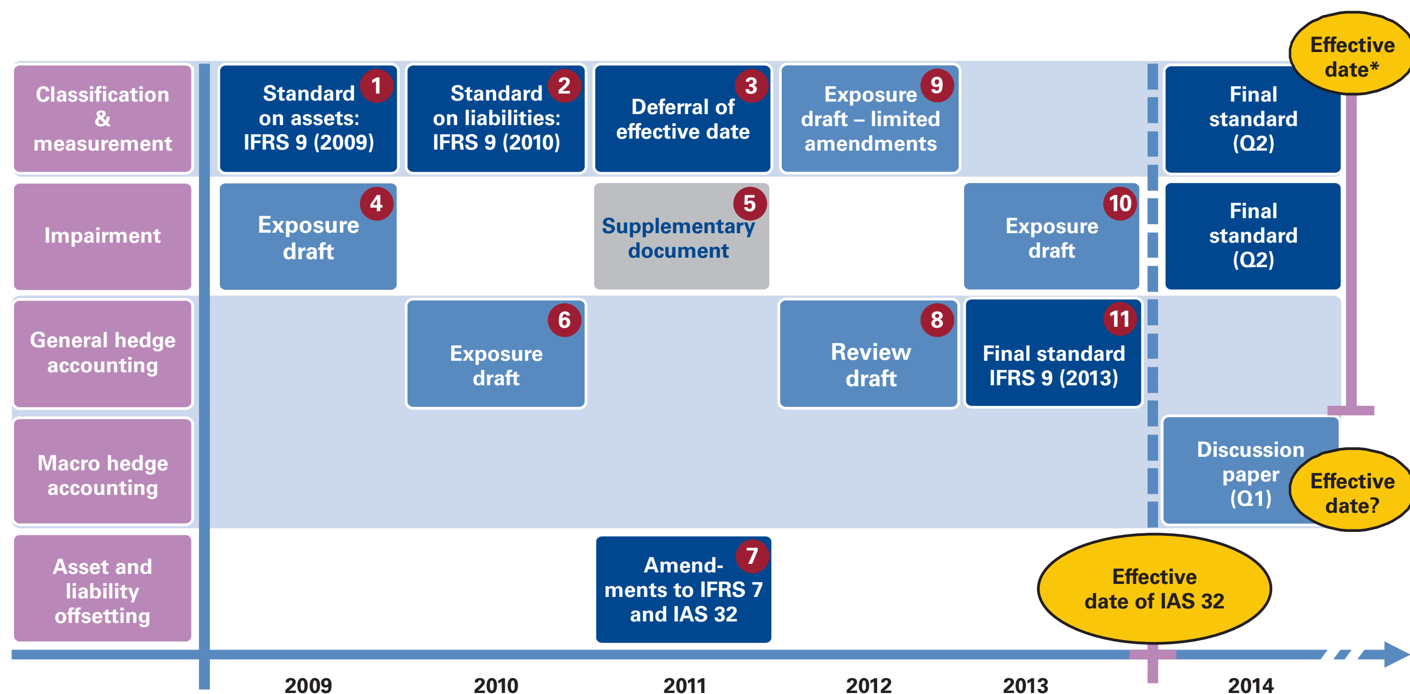
PROJECT MILESTONES AND TIMELINE



Source: IASB work plan – projected targets as at 27 January 2014

* IFRS 9 (2013) removed the previous 1 January 2015 mandatory effective date of IFRS 9. At the IASB's November 2013 meeting, the Board tentatively decided that the mandatory effective date of IFRS 9 would not be before 1 January 2017, but that the final effective date will be determined when the classification and measurement and impairment chapters of IFRS 9 are finalised.

Our suite of publications considers the different aspects of the work plan, and provides a comparison to IAS 39 where relevant.

	KPMG publications
1	First Impressions: IFRS 9 Financial Instruments (December 2009) • For KPMG's most recent and comprehensive views on IFRS 9, refer to *Insights into IFRS: Chapter 7A – Financial instruments: IFRS 9*.
2	First Impressions: Additions to IFRS 9 Financial Instruments (December 2010) • For KPMG's most recent and comprehensive views on IFRS 9, refer to *Insights into IFRS: Chapter 7A – Financial instruments: IFRS 9*.
3	In the Headlines: Amendments to IFRS 9 – Mandatory effective date of IFRS 9 deferred to 1 January 2015 (December 2011)
4	New on the Horizon: ED/2009/12 Financial Instruments: Amortised Cost and Impairment (November 2009)
5	New on the Horizon: Impairment of financial assets measured in an open portfolio (February 2011)
6	New on the Horizon: Hedge Accounting (January 2011)
7	First Impressions: Offsetting financial assets and financial liabilities (February 2012)
8	New on the Horizon: Hedge Accounting (September 2012)
9	New on the Horizon: Classification and Measurement – Proposed limited amendments to IFRS 9 (December 2012)
10	New on the Horizon: Financial Instruments – Expected credit losses (March 2013)
11	First Impressions: IFRS 9 (2013) – Hedge accounting and transition (December 2013)

For more information on the project, see our website.

The IASB's website and the FASB's website contain summaries of the Boards' meetings, meeting materials, project summaries and status updates.

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FIND OUT MORE

For more information on the financial instruments (IAS 39 replacement) project, please speak to your usual KPMG contact or visit the IFRS – financial instruments hot topics page, which includes line of business insights.

You can also go to the Financial Instruments page on the IASB website.

Visit KPMG's Global IFRS Institute at kpmg.com/ifrs to access KPMG's most recent publications on the IASB's major projects and other activities.

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Our IFRS – revenue hot topics page brings together our materials on the revenue project, including our *IFRS Newsletter: Revenue*.

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Our IFRS – insurance hot topics page brings together our materials on the insurance project, including our *IFRS Newsletter: Insurance*.

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IFRS Newsletter: Financial Instruments **is KPMG's update on the IASB's financial instruments project.**

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