



On the Horizon for IFRS

November 3, 2008

IASB issues amendments permitting the reclassification of financial instruments

Introduction

Amendments to IAS 39

Amendments to IFRS 7

Effective date and transition

IASB proposes amendments to financial instruments disclosures

Introduction

Fair value disclosures

Liquidity risk disclosures

Effective date and transition

Comment period

IASB and FASB propose enhancements to the presentation of financial statements

Introduction

Objectives underlying the proposed presentation model

Scope of the project

Proposed format for the presentation of financial statements

Classification guidance

Presenting a cohesive set of financial statements

How the financial statements might change

Comment period

IASB and FASB announce creation of global advisory group to review credit crisis reporting issues

IASB provides update on applying fair value in inactive markets

IASB Expert Advisory Panel issues guidance on fair value of financial instruments in inactive markets

IASB issues amendments permitting the reclassification of financial instruments

Introduction

On October 13, 2008, the IASB issued *Reclassification of Financial Assets*, which amends IAS 39, *Financial Instruments: Recognition and Measurement* and IFRS 7, *Financial Instruments: Disclosures* (the Amendments). The Amendments permit the reclassification of financial instruments in certain situations.

The issuance of the Amendments is the latest in a series of steps the IASB has undertaken to respond to the credit crisis. Against the background of falling asset prices, European Union (EU) leaders and finance ministers had expressed concern that European companies were at a disadvantage compared to their competitors in the U.S. due to the ability of U.S. companies to reclassify financial assets out of fair value through profit or loss in certain circumstances. The Amendments introduce into IFRS the same possibility of reclassifications that is already permitted under U.S. GAAP, so removing this potential disadvantage.

The Amendments permit an entity to:

- Reclassify financial assets (other than derivatives and financial assets designated as at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances
- Transfer from the available for sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if it had not been designated as available for sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future

Additional disclosure requirements have been included in IFRS 7 to provide information to readers of the financial statements where an entity elects to reclassify financial assets under the Amendments to IAS 39.

On October 15, 2008, in view of the urgent and exceptional nature of the Amendments, the European Union [formally endorsed](#) the Amendments to IAS 39 and IFRS 7, without its usual due process.

Amendments to IAS 39

IAS 39 has been amended as follows:

Reclassification of financial assets out of the fair value through profit or loss category

An entity may reclassify some financial assets out of the fair value through profit or loss category if they are no longer held for the purpose of being sold or repurchased in the near term (notwithstanding that the financial asset may have originally been acquired or incurred principally for the purpose of selling or repurchasing it in the near term).

Certain types of financial instruments that were originally included in the fair value through profit or loss category cannot be reclassified under the Amendments. These are:

- All derivatives, either held or issued
- Any financial instrument designated by the entity upon initial recognition as at fair value through profit or loss

Financial assets previously classified in the fair value through profit or loss category which can be reclassified under the Amendments include:

- *Financial assets that would have met the definition of loans and receivables (if they had not been required to be classified as held for trading at initial recognition):*

When a financial asset within this category is no longer held for sale or repurchase in the near term, it may be reclassified out of the fair value through profit or loss category if the entity has the intention and ability to hold it for the foreseeable future or until maturity

- *Other financial assets*: When a financial asset is no longer held for the purpose of selling or repurchasing it in the near term, it may in *rare circumstances* be reclassified out of the fair value through profit or loss category

What are rare circumstances?

The Amendments do not discuss what type of circumstances would constitute *rare circumstances*. However, the Basis for Conclusions notes that "rare circumstances arise from a single event that is unusual and highly unlikely to recur in the near term."

The IASB's press release announcing the issuance of the Amendments states that "the deterioration of the world's financial markets that has occurred during the third quarter of this year is a possible example of rare circumstances cited in these IFRS amendments and therefore justifies its immediate publication."

Where reclassifications are made due to *rare circumstances*, the Amendments to IFRS 7 require disclosure of the facts and circumstances that indicate the situation was rare.

reclassified out of the available-for-sale category to the loans and receivables category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

Effect of reclassification into the loans and receivables category

Where an entity reclassifies a financial asset into the loans and receivables category, it should reclassify the financial asset at its fair value on the date of reclassification.

- When the financial asset was previously classified as held for trading, any gain or loss already recognized in profit or loss should not be reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.
- When the financial asset was previously classified as available-for-sale, the fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable. Any previous gain or loss on the asset that has been recognized in other comprehensive income under IAS 39.55 is to be accounted for in accordance with IAS 39.54.

This means that in the case of a financial asset with a fixed maturity, the gain or loss should be amortized to profit or loss over the remaining life of the held-to-maturity investment using the effective interest method. Any difference between the new amortized cost and maturity amount also should be amortized over the remaining life of the financial asset using the effective interest method. In the case of a financial asset that does not have a fixed maturity, the gain or loss shall be recognized in profit or loss when the financial asset is sold or otherwise disposed of.

Reclassification of financial assets out of the available-for-sale category

A financial asset classified as available for sale that otherwise would have met the definition of a financial asset in the loans and receivables category may be

Impact on effective interest rate

The Amendments include guidance that deals with the impact of a revision of estimates of payments or receipts on use of the effective interest rate (IAS 39.AG8). The revised guidance notes that if a financial asset is reclassified in accordance with the Amendments and the entity subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase should be recognized as an adjustment to the effective interest rate from the date of the change in estimate rather than as an adjustment to the carrying amount of the asset at the date of the change in estimate.

Amendments to IFRS 7

Additional disclosure requirements have been added to IFRS 7 with respect to financial assets that have been reclassified as a result of the Amendments to IAS 39. Among other things, disclosure is required for the following:

- The amounts reclassified into and out of each category as a result of the Amendments and the reason for the reclassifications, particularly when *rare circumstances* are cited as the basis for a reclassification.
- For the reporting period when the financial asset was reclassified, the fair value gain or loss on the financial asset recognized in profit or loss or other comprehensive income in that reporting period and in the previous reporting period.
- For each reporting period until derecognition, the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods.
- For the period of reclassification and each subsequent reporting period until derecognition of the financial asset, the fair value gain or loss that would have been recognized in profit or loss or other comprehensive

income if the financial asset had not been reclassified, and the gain, loss, income, and expense recognized in profit or loss.

- The effective interest rate and estimated amounts of cash flows the entity expects to recover as of the date of reclassification of the financial asset.

Effective date and transition

The effective date and transition of the Amendments is complex and includes the following:

- Due to the exceptional turbulence in the world's financial markets in the third quarter of 2008, the IASB is permitting companies to reclassify financial assets in accordance with the Amendments on a partially retrospective basis from July 1, 2008. This retrospective basis is partial in that the transitional provision does not extend to reclassifying a financial asset as of a date before July 1, 2008.
- The ongoing requirements are effective for periods beginning on or after November 1, 2008. Under those requirements, reclassification will only take effect from the date when the reclassification is made. Any such reclassification is not applied retrospectively.

IASB subsequently clarifies the effective date!

On October 24, 2008, in response to requests for clarification of the effective date of the Amendments, the IASB issued the following clarifying guidance in the [October 2008 IASB Update](#):

- Any reclassification made on or after November 1, 2008 takes effect from the date of reclassification
- Any reclassification made before November 1, 2008 can take effect from July 1, 2008 or a subsequent date

The IASB emphasized that a reclassification cannot be applied retrospectively before July 1, 2008.

The Amendments are a pragmatic response to certain differences between U.S. GAAP and IFRS that have become more significant in the current financial market conditions. Some commentators believed that a perceived greater ability to transfer some financial items out of a fair value category under U.S. GAAP was putting companies (primarily banks) using IFRS at a competitive disadvantage compared to their U.S. competitors.

The Amendments aim to align IFRS more closely with U.S. GAAP, although it is questionable that a truly level playing field has or can be achieved.

We expect that a number of banks will make immediate use of the new rules, but that in normal market conditions such transfers will be extremely rare.

IASB proposes amendments to financial instruments disclosures

Introduction

On October 15, 2008, the IASB [announced](#) the issuance of an [Exposure Draft](#), *Improving Disclosures about Financial Instruments*, which proposes amendments to IFRS 7, *Financial Instruments: Disclosures*, as part of the IASB's response to the credit crisis. The proposed amendments would improve the information available to investors and others about fair value measurements and the liquidity risk of financial instruments. The proposals result from recommendations of the Financial Stability Forum, which had the support of the Group of Seven (G-7) Finance Ministers and discussions by the IASB's Expert Advisory Panel on measuring and disclosing the fair values of financial instruments when markets are no longer active.

Fair value disclosures

Users of financial statements and others have recommended that the IASB consider disclosures similar to those included in FASB Statement 157, *Fair Value Measurements*. The disclosures in Statement 157 are based on a three-level hierarchy based on the inputs to the valuation techniques that are used to measure fair value. The Exposure Draft proposes amendments to the disclosure requirements of financial instruments that would be based on a three-level fair value hierarchy similar to that used in Statement 157 but using the terminology in IAS 39, *Financial Instruments: Recognition and Measurement* and IFRS 7 (until the IASB's fair value measurement project has been completed.)

For each class of financial instruments (except as noted in IFRS 7.29), the proposed amendments would require

- *Disclosures of fair value measurements for financial instruments categorized into a proposed hierarchy (see shaded box below):* This requirement would be applied for fair values included in the statement of financial position and for other fair values that are disclosed but not included in that statement. Such a hierarchy would improve comparability between entities about the effects of fair value measurements as well as increase the convergence of IFRS and U.S.GAAP.
- *Additional disclosures about the Level 3 fair value measurements:* The disclosures would include a reconciliation from the beginning balances to the ending balances.
- *Disclosures about the movements between different levels of the fair value hierarchy, and the reasons for those movements*
- *Any changes in valuation technique along with the reason for the change*

An entity would also disclose the fair values by level of the proposed hierarchy of financial instruments or classes of financial instruments that are not measured at fair value in the statement of financial position.

Proposed fair value hierarchy

An entity would classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements and would have the following levels:

- *Level 1:* quoted prices in active markets for the same instrument (i.e. without modification or repackaging)
- *Level 2:* quoted prices in active markets for similar assets or liabilities or other valuation techniques for which all significant inputs are based on observable market data
- *Level 3:* valuation techniques for which any significant input is not based on observable market data

A *significant input* is defined as “an input that is significant to the fair value measurement in its entirety.” Judgment would be required in assessing the significance of a particular input.

Liquidity risk disclosures

After IFRS 7 was applied during 2007, the IASB was informed that some of the disclosure requirements about the nature and extent of liquidity risk were unclear and difficult to apply and did not always result in useful information for users of financial statements. The Exposure Draft proposes amendments to IFRS 7 that would:

- *Clarify that liquidity risk disclosures are required only for financial liabilities that will result in the outflow of cash or another financial asset:* Appendix A of the Exposure Draft amends the definition of liquidity risk to clarify that the

disclosure requirements would not apply to financial liabilities that will be settled in the entity's own equity instruments and to liabilities in the scope of IFRS 7 that are settled with non-financial assets.

- *Replace a requirement to present a maturity analysis based on contractual maturities for derivatives with a maturity analysis based on how the entity manages liquidity risk:* The IASB was informed that most entities do not manage liquidity risk associated with derivative financial liabilities on the basis of remaining contractual maturities. Accordingly, the existing requirement to disclose derivative financial liabilities on the basis of remaining contractual maturities was difficult to apply and did not result in useful information for users on how many entities manage liquidity risk for such instruments.
- *Require entities to disclose the remaining expected maturities of non-derivative financial liabilities (in addition to the remaining contractual maturities) if the entity manages liquidity risk on the basis of expected maturities:* The IASB decided that such information for non-derivative financial liabilities is useful information for users of financial statements.

Effective date and transition

The Amendments would be applied for annual periods beginning on or after July 1, 2009 with earlier application permitted. The IASB noted that, although the effective date of IFRS and amendments to IFRS is usually 6-18 months after issue, there is an urgent need for earlier enhanced disclosures about financial instruments.

Comment period

The comment period ends December 15, 2008.

IASB and FASB propose enhancements to the presentation of financial statements

Introduction

On October 16, 2008, the IASB and the FASB (the Boards) [jointly announced](#) the issuance of their Discussion Papers on the presentation of financial statements. The [IASB's Discussion Paper, Preliminary Views on Financial Statement Presentation](#), is an analysis of current issues in financial statement presentation and proposed responses to those issues by the Boards. The objective of the Discussion Paper is to invite comments on a new format for financial statements designed to communicate information to users following two new principles: *cohesiveness* and *disaggregation*. The staffs of the IASB and FASB also issued [Snapshot: Preliminary Views on Financial Statement Presentation](#), a summary of the major ideas presented in the Discussion Papers.

IFRS and U.S. GAAP provide only limited financial statement presentation guidance. In addition, presentation guidelines in U.S. GAAP are dispersed across the standards. Moreover, users of financial statements have often expressed dissatisfaction that information is not linked across the different statements and that dissimilar items are in some cases aggregated in one number. The Boards have developed a principle-based format to achieve these main objectives.

Main objectives of the presentation model

Cohesiveness: a reader would be able to follow the flow of information through the different financial statements of an entity

Disaggregation: items that respond differently to economic events would be shown separately

Objectives underlying the proposed presentation model

The Boards developed the following objectives for financial statement presentation based on the objectives of financial reporting and the input the Boards received from users of financial statements and from members of their advisory groups.

- *Portray a cohesive financial picture of an entity's activities:* A cohesive financial picture means that the relationship between items across financial statements is clear and that an entity's financial statements complement each other as much as possible.
- *Disaggregate information so that it is useful in predicting an entity's future cash flows:* Financial statement analysis aimed at objectives such as assessing the amount, timing, and uncertainty of future cash flows requires financial information that is disaggregated into reasonably homogeneous groups of items.
- *Help users assess an entity's liquidity and financial flexibility:* Information about an entity's liquidity helps users to assess an entity's ability to meet its financial commitments as they become due. Information about financial flexibility helps users to assess an entity's ability to invest in business opportunities and respond to unexpected needs.

Scope of the project

The proposals in the Discussion Paper would apply to all entities except not-for-profit entities, entities within the scope of the IASB's forthcoming *IFRS for Private Entities*, and non-public entities (U.S. GAAP). In determining the scope of this project, the Boards considered various aspects of financial statement presentation and concluded that this phase of the project should focus on financial information included in the primary financial statements—how assets, liabilities, equity, revenues, expenses, gains, losses, and cash flows should be grouped into line items and categories and which subtotals and totals should be presented.

Proposed format for the presentation of financial statements

The proposed presentation model would require an entity to present cohesive information in the statement of financial position, the statement of comprehensive income, and the statement of cash flows about

- The way it creates value (its *business activities*) separately from information about the way it funds or finances those business activities (its *financing activities*).
- Operating activities separately from information about its investing activities
- Financing activities with non-owner sources of finance (and related changes) presented separately from owner sources of finance (and related changes)
- Discontinued operations separately from business activities and financing activities
- Income taxes separately from all other information in the statements of financial position and cash flows. In the statement of comprehensive

income, an entity should separately present information about its income tax expense (benefit) related to income from continuing operations, discontinued operations, and other comprehensive income items.

The table below illustrates the proposed classification scheme for the financial statements and indicates the section names in bold italic type and the required categories within sections by bullet points.

Illustration of the proposed clarification scheme for the financial statements

Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
<p>Business</p> <ul style="list-style-type: none"> ▪ Operating assets and liabilities ▪ Investing assets and liabilities 	<p>Business</p> <ul style="list-style-type: none"> ▪ Operating income and expenses ▪ Investing income and expenses 	<p>Business</p> <ul style="list-style-type: none"> ▪ Operating cash flows ▪ Investing cash flows
<p>Financing</p> <ul style="list-style-type: none"> ▪ Financing assets ▪ Financing liabilities 	<p>Financing</p> <ul style="list-style-type: none"> ▪ Financing asset income ▪ Financing liability expenses 	<p>Financing</p> <ul style="list-style-type: none"> ▪ Financing asset cash flows ▪ Financing liability cash flows
<p>Income taxes</p>	<p>Income taxes, on continuing operations (business and financing)</p>	<p>Income taxes</p>

Discontinued operations	Discontinued operations , net of tax	Discontinued operations
	Other comprehensive income , net of tax	
Equity		Equity

The sections and categories within a section may be presented in a different order as long as the order is the same in each statement. Each section and category within a section would have a subtotal. The proposed statement of comprehensive income would include a subtotal for profit or loss or net income and a total for comprehensive income in the statement of comprehensive income. Note that the statement of changes in equity is not included in the table. The cohesiveness principle does not apply to the statement of changes in equity.

Classification guidance

To prepare financial statements using the classification scheme, an entity would first classify its assets and liabilities into the sections and categories in the statement of financial position and use that classification to determine the classification in the statements of comprehensive income and cash flows. Management would make the classification decisions and its classification rationale would be presented in the notes to the financial statements as part of the accounting policy discussion. Classification would be consistent with how the asset or liability is used within an entity and the

way an entity views its activities. An entity with more than one reportable segment would classify items according to how they are used in its reportable segments.

Presenting a cohesive set of financial statements

In order to present a cohesive set of financial statements, an entity would align the line items, their descriptions, and the order of presentation of information in the statements of financial position, comprehensive income, and cash flows. To the extent practical, an entity would disaggregate, label, and total individual items similarly in each statement.

How the financial statements might change

Statement of financial position

The proposed revisions to the statement of financial position are as follows:

- Group assets, liabilities, and equity by major activities (operating, investing, and financing)
- Disaggregate assets and liabilities into short-term and long-term subcategories within each category
- Present totals for assets and liabilities and subtotals for short-term and long-term assets and liabilities in the statement of financial position or in the notes to the financial statements

Statement of comprehensive income

The proposed revisions to the statement of comprehensive income are as follows:

- *Present a single statement of comprehensive income, with items of other comprehensive income presented in a separate section.* The proposed presentation model would eliminate the choice that an entity currently has of presenting components

of income and expense in an income statement and a statement of comprehensive income (two-statement approach) or, alternatively, of presenting information about other comprehensive income in its statement of changes in equity (U.S. GAAP only).

- *Include a subtotal for profit or loss or net income and a total for comprehensive income for the period*
- *Disaggregate line items when such presentation will enhance the usefulness of the information in predicting future cash flows:* In addition to classifying its income and expense items into the operating, investing, and financing categories, an entity would disaggregate those items on the basis of their function (such as cost of sales or administration) within those categories and their nature (such as materials, labor, and depreciation) within those functions.

Statement of cash flows

The proposed presentation model indicates that in the statement of cash flows, an entity would use the direct method and present separately the main categories of its cash receipts and payments for operating activities, such as cash collected from customers and cash paid to suppliers to acquire inventory, rather than reconciling profit or loss or net income to net operating cash flows (the indirect method).

New reconciliation schedule

The proposed presentation model includes a new schedule in the notes to the financial statements that would reconcile cash flows to comprehensive income. The reconciliation schedule disaggregates income into its cash, accrual other than remeasurements, and remeasurement components (e.g., fair value changes).

Comment period

The comment period ends on April 14, 2009. The Boards expect to publish an Exposure Draft in 2010.

IASB and FASB announce creation of global advisory group to review credit crisis reporting issues

On October 16, 2008, the IASB and FASB (the Boards) issued a [joint press release](#) announcing that the Boards will create a global advisory group to review reporting issues related to the credit crisis. The global advisory group will be comprised of regulators, preparers, auditors, investors, and other users of financial statements. The advisory group will help to ensure that reporting issues arising from the global economic crisis are considered in an internationally coordinated manner.

At their joint meeting on October 20 and 21, 2008, the Boards continued to discuss the global advisory group and indicated that the advisory group will be comprised of senior leaders with a broad level of international experience with financial markets. The advisory group will consider how improvements in financial reporting could help enhance investor confidence in financial markets. In addition, the advisory group will be charged with identifying the accounting issues requiring urgent and immediate attention of the Boards as well as issues for longer term consideration. The advisory group will draw upon work already under way in a number of jurisdictions on accounting and the credit crisis.

The Boards plan to identify external chairpersons and members of the advisory group to enable the advisory group to begin its work. The Boards will report on the first advisory group's meeting and will consider its discussions immediately thereafter. Appropriate due process will be followed by the Boards in developing their approaches on issues resulting from the advisory group's

discussions. The meetings of the global advisory group will be open to the public and will be webcast.

See the October 2008 [IASB Update](#) for additional information on the credit crisis issues that were discussed at the joint Board meeting.

IASB provides update on applying fair value in inactive markets

On October 14, 2008, the IASB [provided an update](#) on its work to consider the application of fair value when markets become inactive. In May 2008, at the request of the Financial Stability Forum, the IASB established an Expert Advisory Panel to consider the application of fair value when markets become inactive.

The Expert Advisory Panel met on October 10, 2008 and

- Agreed to emphasize that the objective of a fair value measurement is the price at which an orderly transaction would take place between market participants on the measurement date, not the price that would be achieved in a forced liquidation or sale
- Reaffirmed that forced liquidations or distressed sales should not be considered a fair value measurement and also noted that even in times of market dislocation, not all activity arises from forced liquidations or distressed sales
- Agreed to emphasize existing guidance within IFRS that permits use of the entity's own assumptions about future cash flows and appropriately risk-adjusted discount rates when relevant observable inputs are not available

- Reviewed comments received on the [Draft Document](#), *Measuring and disclosing the fair value of financial instruments in markets that are no longer active*. The final guidance will include the FASB guidance included in FSP FAS 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active.” (**Note:** On October 31, 2008, the IASB Expert Advisory Panel issued its Final Report – see the summary below.)

Next steps

The IASB has reaffirmed its belief that guidance on fair value measurement in accordance with IFRS and U.S. GAAP is already consistent; however the IASB will continue to cooperate with the FASB in order to ensure that applying fair value in inactive markets is dealt with consistently and to issue common guidance resulting from the U.S. Emergency Economic Stabilization Act of 2008.

See the [IASB project summary](#) for more information on this project.

IASB Expert Advisory Panel issues guidance on fair value of financial instruments in inactive markets

On October 31, 2008, the IASB [announced](#) the issuance of the [IASB Expert Advisory Panel's Final Guidance Report](#), *Measuring and disclosing the fair value of*

financial instruments in markets that are no longer active (Guidance Report), which provides useful information and educational guidance with respect to the fair value measurement and disclosure of financial instruments in markets that are no longer active for entities applying IFRS. The Guidance Report summarizes the discussions of an Expert Advisory Panel that was formed in response to recommendations of the Financial Stability Forum in its report entitled *Enhancing Market and Institutional Resilience*.

The Guidance Report is accompanied by an [IASB Staff Summary](#), *Using judgement to measure the fair value of financial instruments when markets are no longer active* (Summary Document), which sets out the context of the Guidance Report and highlights important issues associated with measuring the fair value of financial instruments when markets become inactive.

The Guidance Report is considered to be consistent with the documents recently issued by the FASB on October 10, 2008 and by the SEC Office of the Chief Accountant and FASB staff on September 30, 2008 that looked at fair value measurements in illiquid markets.

Note: A more detailed description of the Guidance Report and the Summary Document will be included in a future *On the Horizon for IFRS*.