IFRS 9

Financial assets – classification & measurement

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We shall discuss ......

- Scoped in financial assets
- Familiar measurement categories
- New classification principles
    - ‘Business Model’ test
    - ‘Contractual Cash Flows’ test
- Conclusion

Scoped in financial assets

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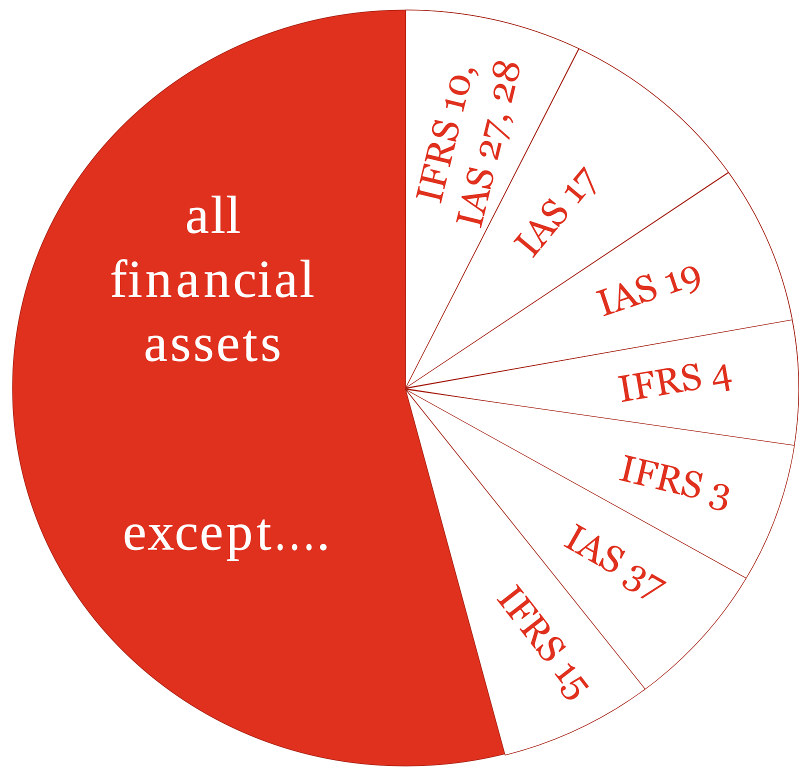
Scoped in financial assets for classification & measurement ......



Familiar measurement categories

Familiar measurement categories ……

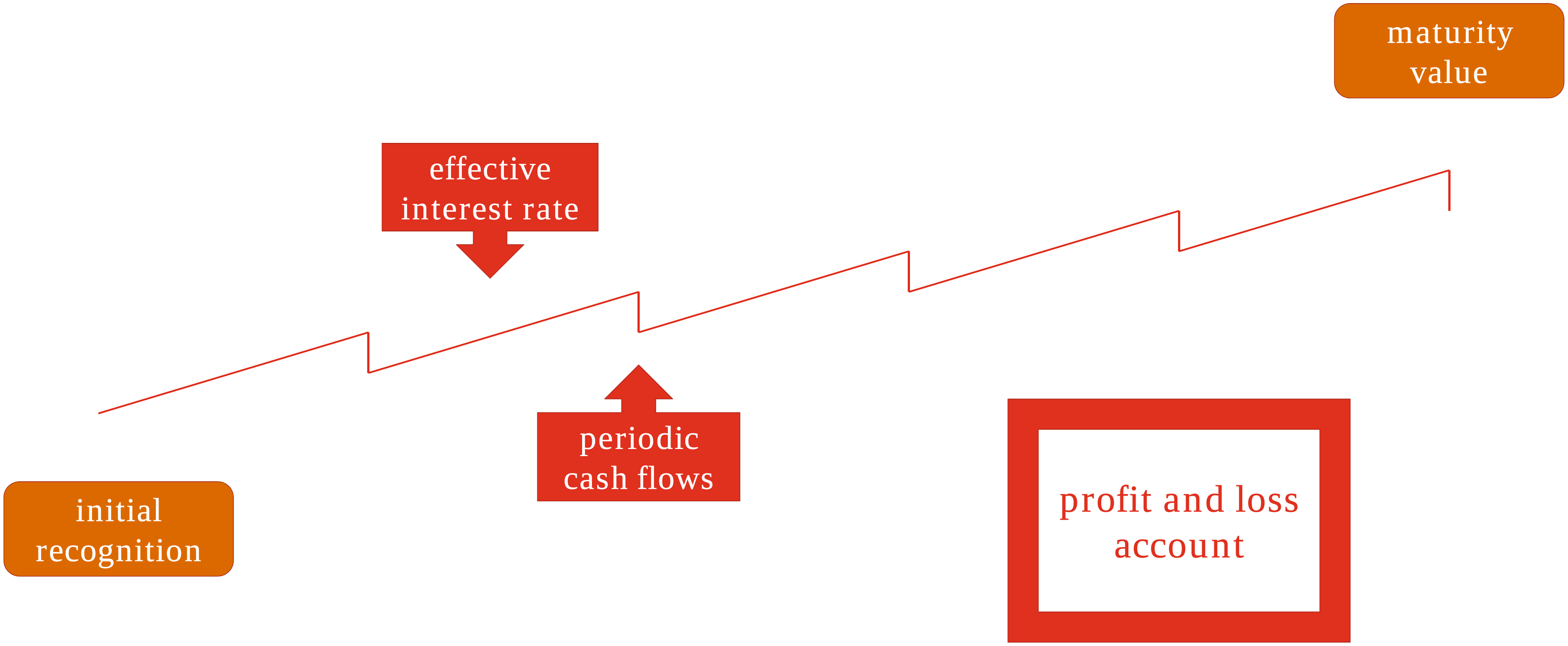
only two available measurements

amortised cost

fair value

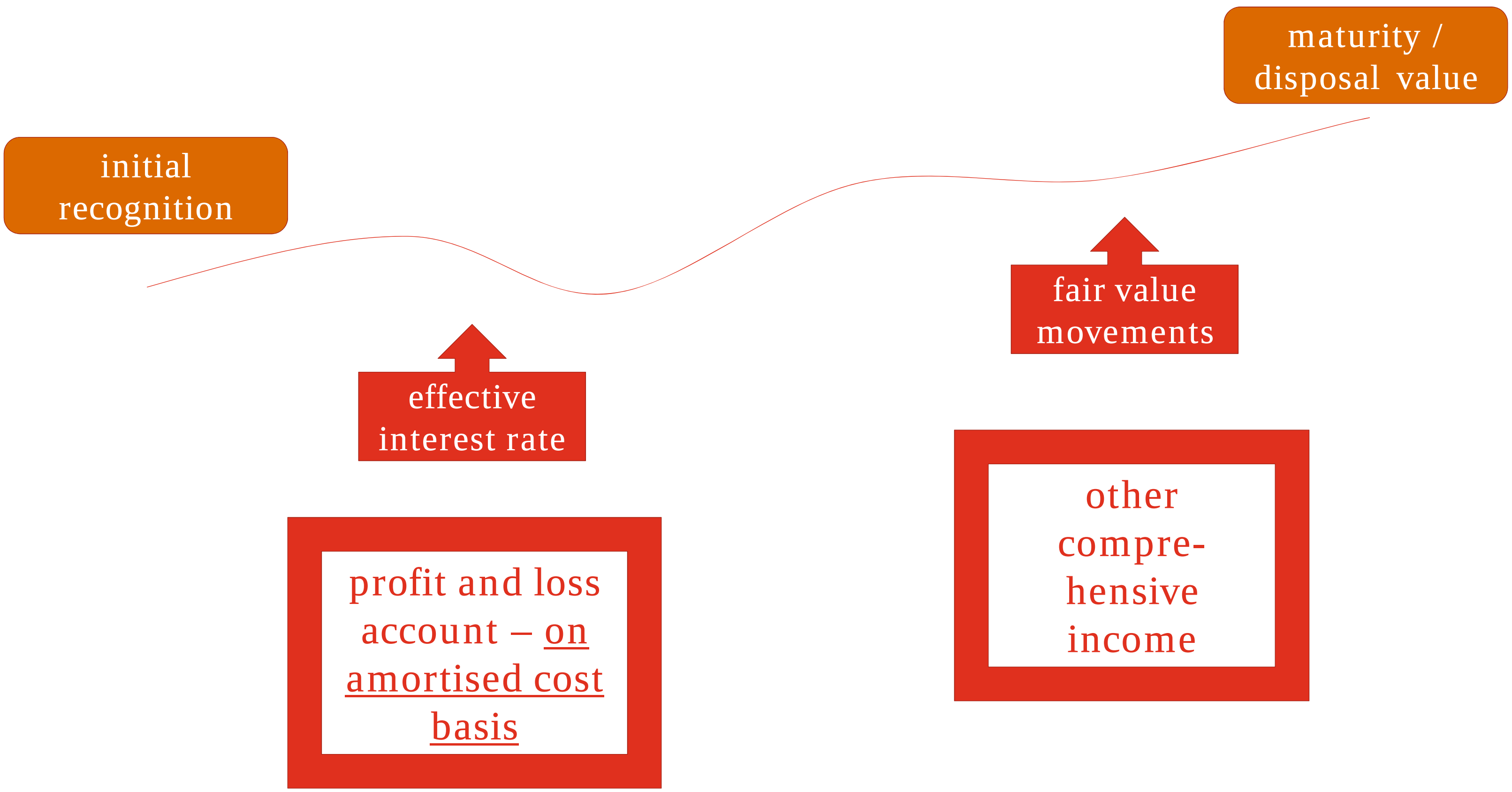
Familiar measurement categories ……

1- amortised cost



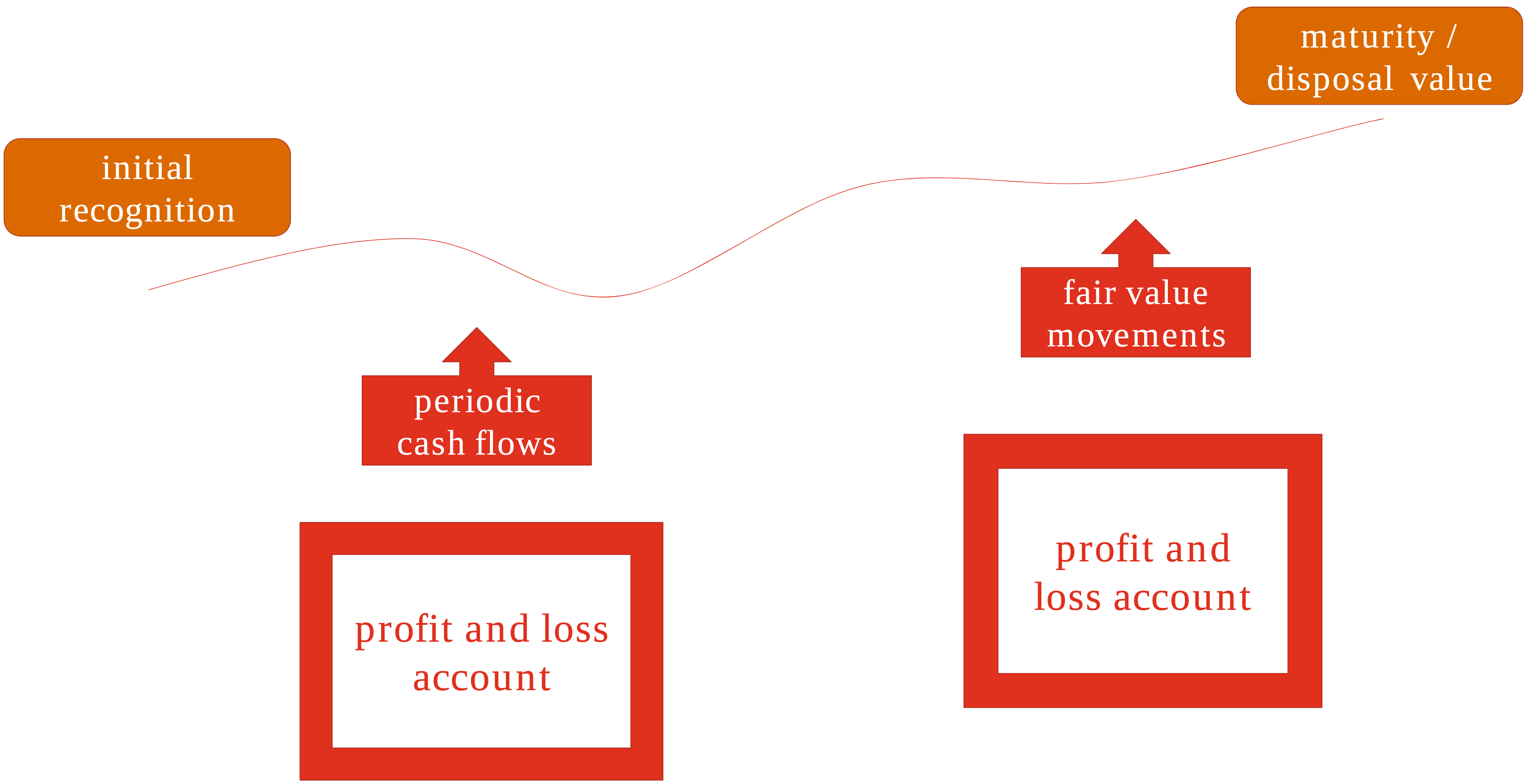
Familiar measurement categories ……

2- fair value through other comprehensive income



Familiar measurement categories ......

3- fair value through profit and loss account



Familiar measurement categories ……

Timing of initial recognition – when an entity becomes party to the contractual provisions of the instrument

- unconditional receivable – when contractual right to receive arises
- firm commitments – when the other party performs obligations
- forward contract – commitment date
- option contract – commitment date
- virtually certain planned transactions ???

Familiar measurement categories ……

initial recognition amount – linked to the fair value* of the asset

measurement basis	incremental transaction cost …	… and later becomes part of
amortised cost	stays with the recognised asset	effective interest rate **
FV T OCI	stays with the recognised asset	effective interest rate ** gains / losses into OCI
FV T PL	charged to PL	…………..

* trade receivables without significant financing element – transaction price (IFRS 15)

** unless it is perpetual instrument

Familiar measurement categories ......

1 - transaction price <> fair value

account for in accordance with economic substance

- an expense or reduction of income
- some other financial asset
- equity contribution
- dividend payment

Familiar measurement categories ……

2 - transaction price <> fair value

day 1 gains / losses

- evidenced by quoted price in [illegible]ive m[illegible]ket
- valuation[illegible]ue that use ONL[illegible]le data
- record in profit or loss

- let it remain with the asset

New classification principles

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New classification principles ……

two basic classifications

A

exclusively equity instruments

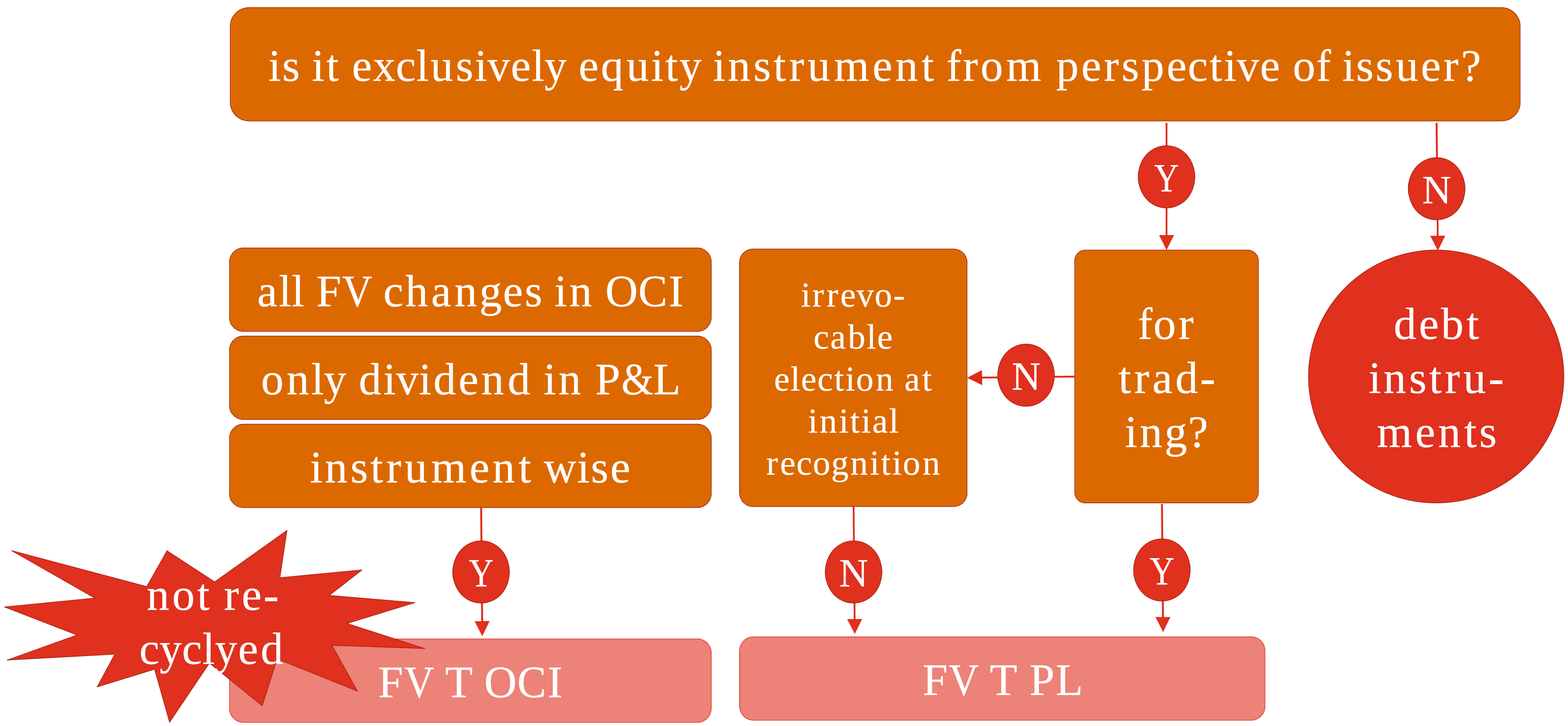
B

every instrument other than ‘A’

debt investment when looked as a whole instrument

New classification principles ……

exclusively equity instruments



New classification principles ……

exclusively equity instruments - unquoted

- removes the ability to measure unquoted equity investments at cost
- in limited circumstances, estimate of fair value = cost
- cost not representative of fair value (indicative negative list)
  - investee's performance deviates form expectations
  - market for the investee's equity or products etc. changes
  - economic environment changes
  - performance of comparable entities
  - frauds, litigations
  - ……………………….

New classification principles ……

debt investments – two basic questions

1?

entity's business model for managing the financial asset

2?

contractual cash flows characteristics of the financial asset

New classification principles ……

1 – entity's business model

1. held to collect contractual cash flows
2. held to collect contractual cash flows and selling

R. residual - everything other than (1) & (2)

New classification principles ……

1 – entity's business model – determinants

- determined by the entity's key management personnel (KMPs)
- observable through the activities that the entity undertakes
- not determined by a single factor or activity
- consider all relevant evidence that is available
  - how the performance is evaluated and reported to KMPs
  - the way risk affecting value or cash flows of the assets are managed
  - how managers are compensated

New classification principles ……

1 – entity's business model – level of aggregation

- not made at the level of individual asset, but performed at higher level
- not a choice – does not depend on management's intentions
- matter of fact that can be observed
- two similar portfolios could belong to different business models
- different portfolios could belong to a single business model

need to apply judgement

New classification principles ……

2 – contractual cash flows characteristics

1. payment of principal
2. payment of interest on principal

X. no other cash flows included

SPPI

New classification principles ……

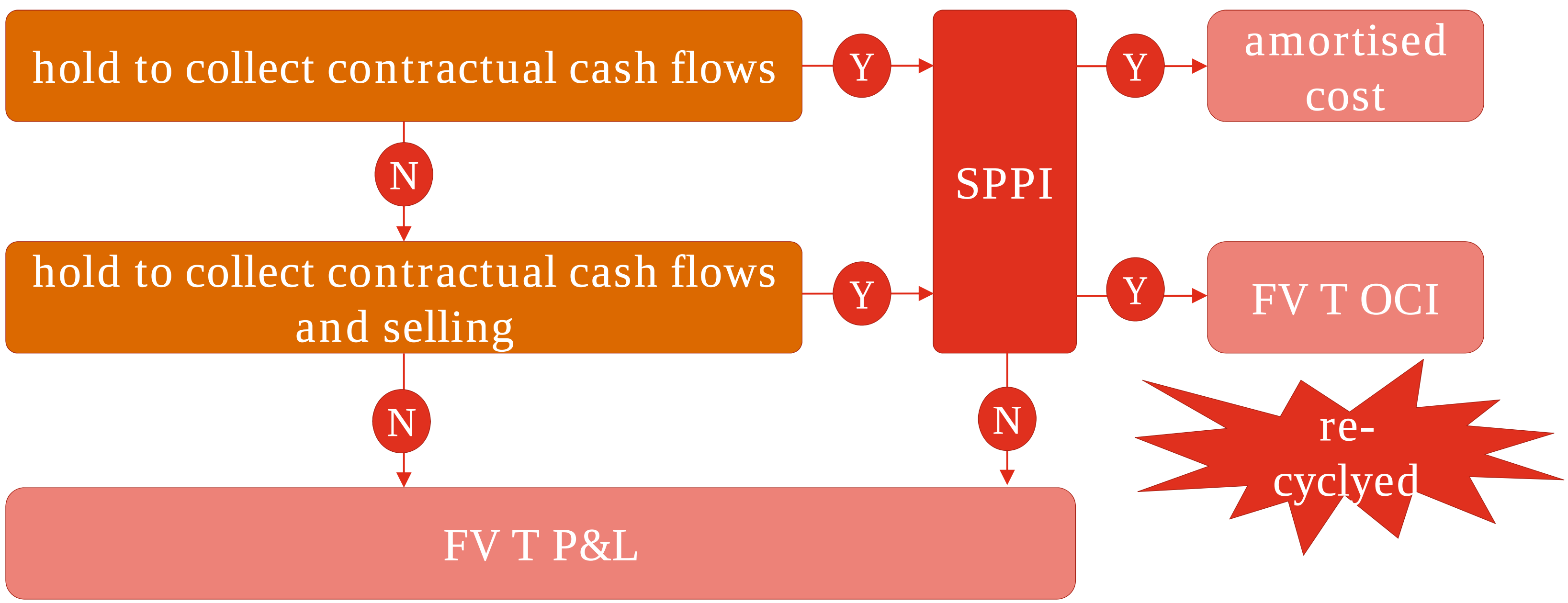
2 – contractual cash flows characteristics – interest

- time value of money
- associated credit risk
- basic lending risks and costs
- lender's profit margin

features of a basic lending arrangement

New classification principles ……

debt investments – measurement



New classification principles ……

entity's business model – hold to collect – premature sale

- no issues even where sales occurs or is expected to occur in the future
- look for
  - historical frequency, timing and value of sales
  - reasons for sale
  - expectations about future sales activity

New classification principles ……

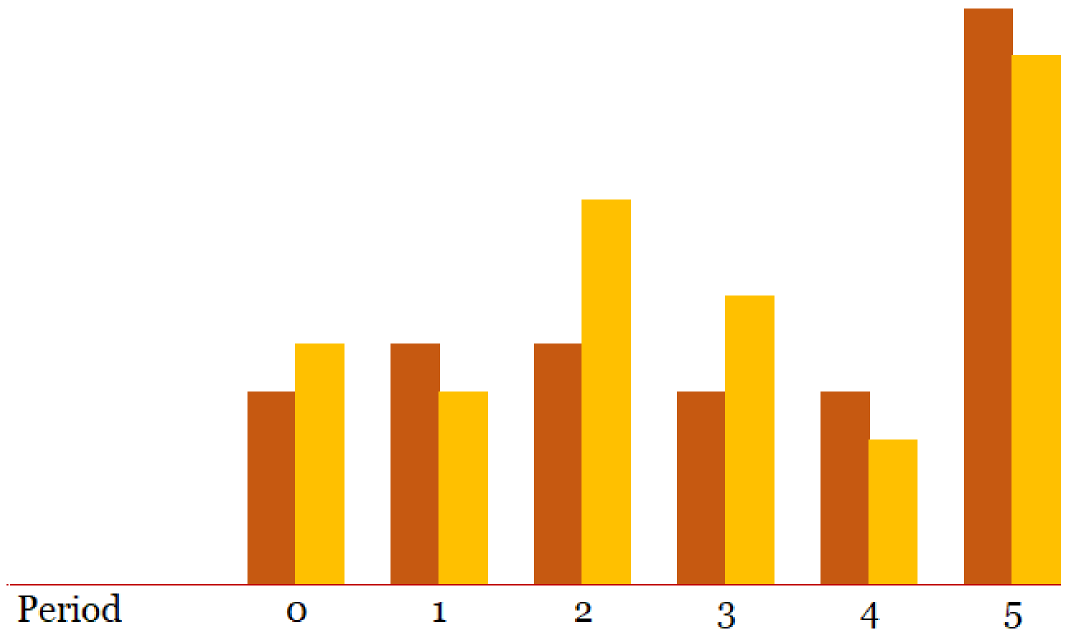
SPPI considerations – modified SPPI

- annual rate over quarterly payments….???
- average rates used as benchmark….???
- regulated interest rates….

qualitative assessment

not conclusive

quantitative assessment



New classification principles ……

SPPI considerations – terms that change timing or amount of flows

- assess whether life cash flows after change represent SPPI
- contingent events that change cash flows
- prepayments essentially match unpaid cash flows
- extensions compensate for additional interests due to delays

New classification principles ......

some of the SPPI examples of instruments

- where payments are linked to an un-leveraged inflation index
- borrower can choose the market interest rate on an ongoing basis
- that pays a variable market interest rate that is subject to a cap or floor
- full recourse loan that is secured by collateral

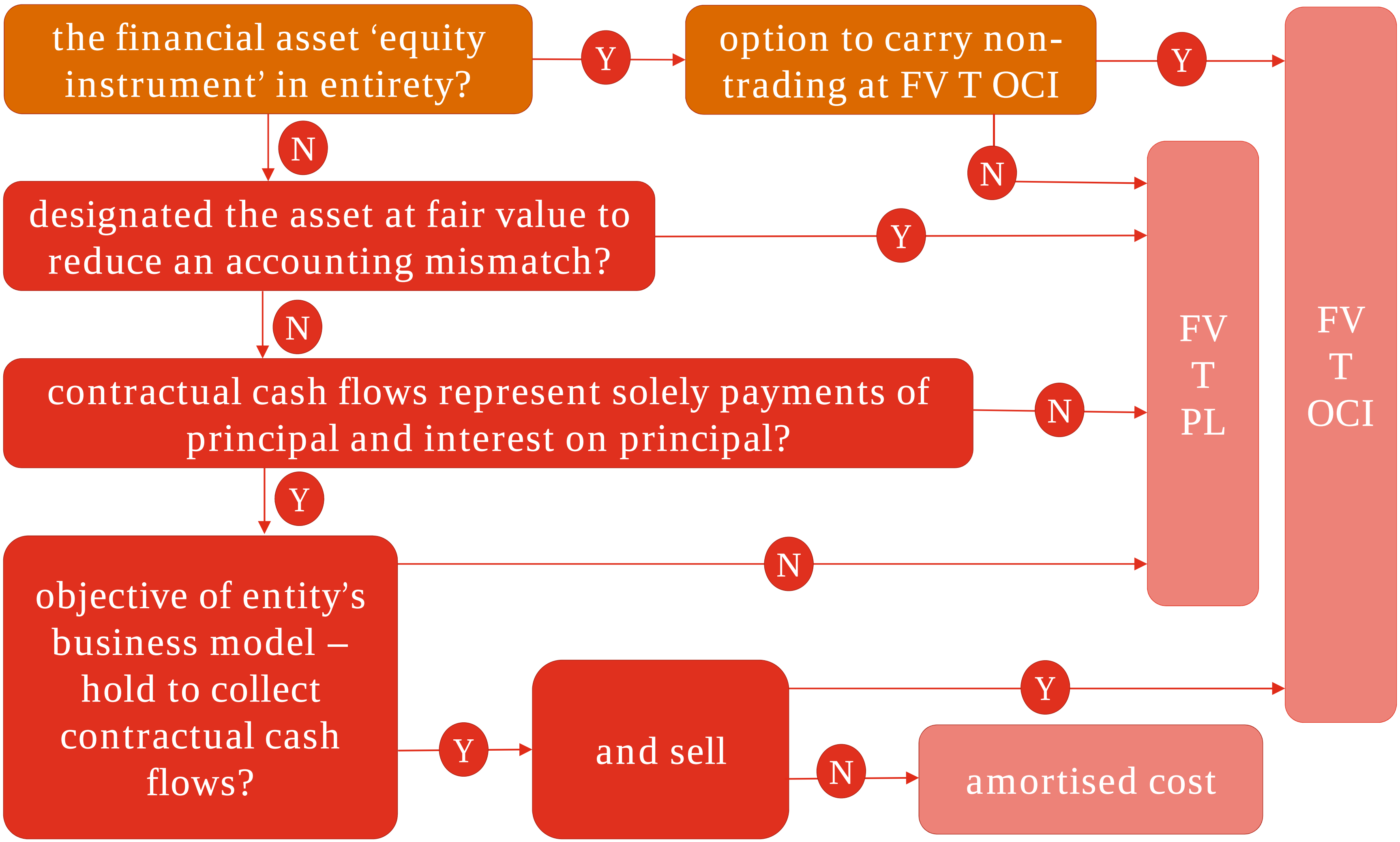
- collateralised non-recourse loans
- payments linked to equity index or borrower's net income
- convertible into a fixed number of equity instruments of the issuer
- inverse floaters
- deferrals of interest payments without additional compensating interest

New classification principles ……

Overriding FV T PL choice to reduce an ‘accounting mismatch’

- on initial recognition only
- irrevocable
- available asset be asset

New classification principles ……



Conclusion

Conclusion ……

key messages

- no arbitrary bright line tests, accommodations, options and abuse prevention measures
- simpler model that has fewer exceptions
- classification follows the entity's business model
- embedded derivatives over financial assets cannot be separated from the host contracts
- expectation of more fair value measurements, especially through PL
- price of simpler model is more volatility expected in periodic profit or loss