Transition to IFRS 9: Practical Guidance for the Foreign Reserves of Central Banks

Yunjung S. Ha

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Abstract

This paper provides practical guidance to central banks on accounting practices for their foreign reserves, in connection with the transition from International Accounting Standard 39 Financial Instruments: Recognition and Measurement (IAS 39) to International Financial Reporting Standard 9 Financial Instruments (IFRS 9).

The IFRS 9 preparation process can be summarized in three steps: (1) business model assessment and cash flow characteristic test for classification, (2) impairment, and (3) transition and disclosure preparation. Relative to IAS 39, IFRS 9 is more principles-based, which requires substantive management judgment, such as defining the business model, assessing significance and impracticability in applying exceptions, and determining expected credit loss methodologies. This paper focuses on step 3, transition and disclosure preparation, with an overview of the IFRS 9 transition requirements. A case illustration of a central bank making the transition demonstrates how the process is likely to impact a central bank’s foreign reserve portfolio.

Keywords: Central banks, Foreign reserves, International Financial Reporting Standard 9 Financial Instruments (IFRS9), Business model, Fair value through profit and loss (FVTPL), Amortized cost (AC), Fair value through other comprehensive income (FVOCI), Expected Credit Loss (ECL), Impairment, Transition, Disclosures

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I. Overview of Transition to IFRS 9

IFRS 9 requires a new mindset for the classification of financial assets, a new framework for impairment with a forward-looking expected credit loss (ECL) model and extensive new disclosures. This is very relevant to central banks which hold a large number of financial instruments in their balance sheet. In light of the significant changes introduced by IFRS 9 and the implementation challenges it presents to central banks, the World Bank Reserve Advisory and Management Program (RAMP) accounting team published a paper, “Applying IFRS 9 to Central Banks Foreign Reserves,” to provide guidance on how central banks that have adopted IFRS should classify and measure foreign reserve assets, as well as on the issues that central banks need to consider to effectively implement the ECL impairment model.

Following the publication of the aforementioned paper, which aimed to provide guidance concerning classification, this paper is intended to provide practical guidance for central banks for the transition to IFRS 9 in the context of foreign reserves, either from IAS 39 or from the first adoption of IFRS. The World Bank RAMP accounting team has provided guidance to some central banks with their IFRS 9 conversions, including the preparation of papers supporting classification. Implementing IFRS 9 and understanding its impact on financial statements require close collaboration between foreign reserves management, risk management and accounting teams. This paper is also designed to help those in various areas responsible for preparing or interpreting financial information to be well prepared for the impact of IFRS 9 on the transition-related disclosures.

The IFRS 9 assessment, implementation, and transition process can be summarized in three steps:

- Business model assessment & Contractual cash flow characteristics test for classification
- Expected Credit Loss (ECL) model development for impairment
- Transition & Disclosure preparation

This paper focuses on the final step in the process: transition and disclosure preparation. IFRS 7 Financial Instruments: Disclosures has been updated to incorporate new and extensive disclosure requirements on the basis of IFRS 9; central banks need to work to integrate the additional IFRS 9 disclosures into existing IFRS 7 disclosures. This paper focuses on the foreign reserves of central banks, which normally make up the largest part of their balance sheets: accordingly, only the relevant provisions of the standard are

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2 Reserve Advisory and Management Program (RAMP) is a capacity building service aimed towards central banks and other official sector asset management entities. For more information, please go to: http://treasury.worldbank.org/sip/htm/central_bank.html.


4 There are many published papers that provide detailed guidance and discussions of ECL measurement. Some of them are listed in the references.
discussed. Several paragraphs within IFRS 9 are outside the scope of this paper: these paragraphs include, but are not limited to, discussion of early adoption, financial liabilities, and hedge accounting.

**General Principles**

The application of IFRS 9 is mainly retrospective, being based on IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Under retrospective application, new requirements are applied to transactions, other events and conditions as if those requirements had always been in effect. However, IFRS 9 includes various exemptions and simplifications, which are summarized below.

- **Comparative information does not need to be restated.** Comparative figures can be presented only if the information is available without giving consideration to facts which arose after an event has actually happened, i.e., without the use of hindsight. If an entity restates the comparative period, a comparative third balance sheet must be presented in accordance with IAS 1 *Presentation of Financial Statements*; and the restated financial statements must reflect all of the requirements in IFRS 9.

- **Retrospective application need not be applied to derecognized items.** Where an entity decides to restate the comparative period, the information for the comparative period would have a mixed basis. The financial assets derecognized prior to the date of initial application (DIA) will be prepared under IAS 39, while the financial assets outstanding as of DIA under IFRS 9.

- **Any differences in the carrying amount between IAS 39 and IFRS 9 at the DIA are recognized in the opening retained earnings (RE) or other comprehensive income (OCI) of the annual reporting period.**

- **Specific requirements based on impracticability related to the assessment at the date of initial recognition.**

The DIA is the first date of the annual reporting period beginning on or after January 1, 2018, the IFRS 9 mandatory effective date. Key assessments must be made at the DIA, including:

- Identifying the assets and liabilities to which IFRS 9 should be applied because the standard is not applicable to instruments derecognized by the DIA;
- Assessing the business model and applying the SPPI test, and noting that the classification is applied retrospectively;
- Designating an equity investment to be classified as FVOCI;
- Designating, or revoking designations of, financial assets or financial liabilities classified as fair value through profit and loss (FVTPL);
- Using reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that a financial instrument was initially recognized.

Hedge accounting policies are generally applied prospectively, but discussion of this process is beyond the scope of this paper.

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5 IFRS 9.7.2.4~9.7.2.5, 9.7.2.11, and 9.7.2.20. See the following sections for details.
6 IFRS 9.7.2.21~7.2.26.
Transition Process

The transition to IFRS 9 is mainly retrospective. Thus, both classification and ECL determined at the DIA are applied retrospectively. This means that computations for the measurement and parameters for ECL should be assessed from the time of the inception of the financial assets. The transition process requires collaboration across a wide range of departments within a central bank. Accounting should work closely with the foreign reserves department to document the assessment of both the business model and the SPPI tests for classifications. Following the initial documentation of the classification and measurement, the risk, macroeconomic, finance, and IT teams will need to be involved in the ECL model development and the implementation of data governance, policies, and methodologies prior to the DIA.

II. Transition Requirements for Classification and Measurement

IFRS 9 applies one classification approach for all types of financial assets based on two criteria: the first is the business model for managing the financial assets and the second is the contractual cash flow characteristics test, which is applied to the financial assets.

Business Model Assessment [IFRS 9.7.2.3]

For transition to IFRS 9, the business model assessment must be based on the facts and circumstances at the DIA. This assessment must be carried out with reference to several factors, including business objectives; risks; sales activities; the use of FV information; compensation; and sources of income to determine whether the generation of interest income is integral or incidental to the management of the subportfolio. These six factors are not to be used as a checklist, but to provide supporting evidence useful for gathering data to support the central bank’s ultimate conclusion, which, if well documented, can facilitate discussions with auditors. The resulting classification at transition is applied retrospectively since the inception of the financial asset, irrespective of the entity’s business model in prior reporting periods. At transition, there may be reclassifications as the IFRS 9 approach to the classification is different from that of IAS 39. IAS 39 classification was more focused on instrument types while IFRS 9 requires asset classification to be linked to its business.

Solely Payments of Principal and Interest (SPPI) Criteria Assessment [IFRS 9.7.2.4 ~ 9.7.2.5]

For the transition to IFRS 9, the SPPI assessment is required at the DIA on the basis of the facts and circumstances that existed at the date of initial recognition for the financial asset. For most instruments used by central banks, the classification is straightforward. However, the SPPI assessment of a foreign exchange reserves portfolio has become increasingly complex in the current market environment, as central banks have been diversifying the types of instruments used in their portfolios in order to seek higher yields and/or protect against inflation. Certain contractual terms need to be assessed to see whether they might modify the timing or the amount of contractual cash flows under IFRS 9. This retrospective transition requirement can be impractical for certain financial assets, for example those with a modified time value of money element or a prepayment feature. For such case, the International Accounting Standards Board (IASB) has provided specific requirements, which are discussed in detail in Appendix 1.
Hybrid Contracts [IFRS 9.7.2.6 ~ 9.7.2.7]

A hybrid contract, composed of a host that is a non-derivative financial asset within the scope of IFRS 9 and an embedded derivative, should be classified and measured in its entirety under IFRS 9. This is different from IAS 39, which required bifurcation under certain conditions. Under IFRS 9 a hybrid contract can be classified as AC or FVOCI if it passes the SPPI test. For instance, some embedded derivatives (such as caps and floors) that might have required bifurcation under IAS 39 but might pass the SPPI condition in IFRS 9. For the transition to IFRS 9, if the entity restates prior periods and the fair value of the hybrid contract that is to be classified and measured at the fair value under IFRS 9 had not been measured in comparative reporting periods, the fair value of the hybrid contract in the comparative reporting periods shall be the sum of the fair values of the components (i.e. the non-derivative host and the embedded derivative) at the end of each comparative reporting period; at the DIA, the entity must recognize any difference between the fair value of the entire hybrid contract and the sum of the fair values of the components of the hybrid contract in the opening RE (or OCI, as appropriate) of the reporting period that includes the DIA. If the entity does not restate prior periods, the difference between the carrying amount of components under IAS 39 and FV of the entire hybrid contract under IFRS 9 should be recognized in the opening RE (or OCI, as appropriate) of the reporting period that includes the DIA.

Fair Value (FV) Option Designations [IFRS 9.7.2.8 (a), 9.7.2.9 and paragraph 4.1.5]

For the transition to IFRS 9, financial assets can be irrevocably designated as FVTPL on the facts and circumstances at the DIA, only if this classification eliminates or significantly reduces a measurement or recognition inconsistency, referred to as an “accounting mismatch”. Hence, if financial assets designated as FVTPL under IAS39 do not meet the IFRS 9 FV option requirements, their designations must be revoked. If desired, previous FV designations under IAS 39 may be revoked at the transition to IFRS 9.

Equity Investment Designation as FVOCI [IFRS 9.7.2.8 (b), 9.7.2.12, paragraph. 5.7.5]

At the transition to IFRS 9, an entity may designate particular investments in equity instruments as at FVOCI on the basis of the facts and circumstances that exist at the DIA. To qualify for the designation, the equity should neither be held for trading nor contingent on consideration recognized by an acquirer in a business combination to which IFRS 3 applies. The election is to be applied retrospectively. For unquoted equity investments measured at cost under IAS 39, an entity must determine the fair value of the equity investment at the DIA. The difference between the previous carrying amount and the fair value at the DIA is recognized in the opening RE or OCI, as appropriate. Another noteworthy difference between IAS 39 and IFRS 9 for equity instruments is that, while impairment was assessed under IAS 39 for equity instruments classified as AFS whereas there is no need to assess and measure impairments for such instruments under IFRS 9.

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7 IFRS 9 B5.2.3 acknowledges that cost may be an appropriate estimate of fair value in limited circumstances, such as cases in which insufficient more recent information is available to measure fair value, or the cost falls within the range of possible FV measurements if there is a wide range of possible FV measurements.
Effective Interest Rate (EIR) [IFRS 9.7.2.11]

When the retrospective application is impracticable, the fair value of a financial asset at the DIA is treated as the new gross carrying amount. The retrospective application to the EIR method in the transition to IFRS 9 can be quite complicated when there are reclassifications. For example, in the case of reclassifying at the DIA from Trading under IAS 39 to either FVOCI or AC under IFRS 9, the EIR of the asset is required in order to compute its carrying amount as if the asset had always been held on this basis, even though under IAS 39 the EIR was not required for the asset previously classified as Trading. Another complex case might occur when a financial asset, that was previously reclassified under IAS 39 from a fair value measurement category, such as Trading or AFS, to Held-to-Maturity (HTM) category, is classified as amortized cost or FVOCI at the DIA under IFRS 9. This asset’s carrying amount should be recalculated as if the asset had always been measured at amortized cost or FVOCI, rather than by carrying forward its measurement under IAS 39.

III. Transition Requirements for Impairment*

For all financial assets which pass the SPPI test and which are classified and measured as either ‘AC’ or ‘FVOCI’, the ECL should be estimated at DIA under the new impairment requirements of IFRS 9 by comparing the credit risk at DIA with the credit risk at the date that a financial instrument was initially recognized. It is critical to understand the scope of work for ECL model implementation, prior to making the transition to IFRS 9, since the ECL framework is distinctively different from other familiar credit risk frameworks. ECL requires lifetime credit losses, rather than 12-month credit losses, in the case of stage 2 and 3 assets. Normally only 12-month ECL would be required for the foreign reserves portfolios of central banks as they are invested conservatively. However, in developing ECL methodologies and models, central banks will have to consider the forward-looking scenarios and the potential implication of the lifetime ECL in case of significant increase in credit risk.

ECL measures an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. [IFRS 9.B5.5.41-43, BC5.86]. This means that ECL estimates are not conservative or biased towards optimism or pessimism. This is quite different from a prudential depiction of expected losses, such as Value-at-Risk (VaR), a measure of investment risk commonly used by central banks. The implementation of the ECL model is expected to be complex. The paper from the Global Public Policy Committee (GPPC) suggests that governance and controls frameworks should be set up since a lot of additional credit risk information will now be required as inputs to the models. In addition, new ECL methodologies and models, that are commensurate with the complexity, structure, and risk profile of the exposure, need to be developed. This will require significant collaboration among several departments, including finance, risk, accounting, and IT.

For operational simplification, IFRS 9 provides a practical expedient option for assets that are deemed to have low credit risk, such as investment grade rated assets (although an external rating grade is not a prerequisite for a financial instrument to be considered low credit risk). As a practical expedient, the loss

* IFRS 9 ECL, which requires the immediate recognition of expected losses, is challenging for central banks in consideration of their unique role in purchasing credit-impaired assets for financial market stability. Leaving this aside as a domestic policy issues, this paper focuses solely on IFRS 9 ECL requirements [IFRS 9.7.2.17 ~ 9.7.2.20].

9 The implementation of IFRS 9 impairment requirements by systemically important banks was published by GPPC on June 17, 2016.
allowance for assets with low credit risk at the DIA may be recognized equal to 12-month expected credit losses, and interest would be calculated on a gross basis. If, at the DIA, a significant increase in credit risk since initial recognition of the financial asset is determined with supportable information reasonably available without incurring undue cost and effort or if this assessment requires undue cost or effort, the loss allowance or provision is measured as lifetime expected credit losses at each reporting date.

IV. IFRS 9 Transition Disclosure

Case Illustrations Relevant to Foreign Reserves of Central Banks

The case illustrations presented below are aimed at providing clear examples of the disclosures required for transition. For IFRS 9 classification, the business model for foreign exchange reserves of central banks must be defined. For these illustrations, the business models are defined at tranche levels, which are quite common among central banks, as described below:

- **Working Capital (WC)** to finance the central bank’s daily operations including short-term payments and potential foreign exchange interventions;

- **Liquidity (LIQ)** to finance operations as well as foreign debt service up to one year; and

- **Investment (IV)** to finance for obligations longer than one year; this tranche typically has objectives for capital preservation as well as growth.

The tables above are provided for easy reference to the cases. Under IAS 39 financial assets are classified based on instrument types and management intentions without linking those assets to relevant business models in which they are managed. In the transition to IFRS 9, assets are first mapped to each tranche through the business model assessment at the DIA, and are classified based on both the business model and on SPPI criteria. Accordingly the central bank decided to classify the working capital tranche as “hold-to-collect”, the liquidity tranche as “hold-to-collect and sell” while the investment tranche as primarily to sell for profit. It is important to note that this change in approach under IFRS 9 will result in a change in classification even if there is no change to strategic asset allocation and the objectives of managing the portfolios.
**Case 1:** 50 million of commercial paper (CP) is reclassified from Loans and receivable under IAS 39 to FVOCI under IFRS 9. There is a 1 million market value adjustment and implementing forward-looking ECL results in 0.6 million of impairment loss. Under the IAS 39 incurred loss model, it may be assumed that there were no impairments.

**Case 2:** Some of the discounted securities, previously classified as AFS under IAS 39, are reclassified as AC. Out of its market value of 38 million, 1 million of unrealized Mark-to-Market (MTM) gain under IAS 39 is reversed, as no MTM would be calculated for the AC classification.

**Case 3:** GBP securities in the LIQ tranche require the lifetime ECL to be calculated as a result of a downgrade that provided an indication that there has been a significant increase in credit risk since initial recognition. Previously, under IAS 39, MTM unrealized loss of 5 million had been recognized in OCI. However, no impairment was recognized under the IAS 39 incurred loss model. For the transition to IFRS 9, these financial assets are assessed to be in Stage 2. Although their credit risk has increased significantly, they are not yet considered credit impaired (Stage 3). Under IFRS 9 for Stage 2 securities, lifetime ECL is required and carved out of the total MTM gain or loss and recorded in P&L. Assuming that the central bank’s risk model calculated 2 million of lifetime ECL\(^\text{10}\) at the DIA, this 2 million of lifetime ECL would be moved out of OCI to opening RE.

**Case 4:** The USD FRNs in the LIQ tranche would not meet the SPPI test unless it is proved that there is an insignificant difference in cash flows through benchmarking cash flows. At the DIA of January 1, 2018, the central bank applies the exception specified in IFRS9.7.2.4. The FRNs of 100 million market value should be reclassified to FVTPL under IFRS 9. Related MTM gain of 3 million is also reclassified from OCI to the retained earnings.

**Case 5:** Equity investments in Bank for International Settlements (BIS) funds are held for strategic purpose. These assets are classified as AFS and measured at cost of 50 million under IAS 39, and designated as FVOCI at the DIA and measured at market value of 55 million under IFRS 9. Equity investments would not be subject to impairment calculations.

**Case 6:** The EUR securities were initially aligned with the central bank’s EUR denominated liability related to the IMF’s SDR loan and designated as FV asset. At the DIA, however, it was ascertained that the EUR liability was already completely paid off with another source of funding. These assets therefore no longer meet the FV option criteria at the DIA. Hence, the previous designation to FVTPL must be revoked, and these assets, based on both the business model at the DIA and cash flow characteristics tests, are classified as FVOCI. These assets, classified as Trading under IAS 39, did not apply the EIR. Under IFRS 9, at the DIA, the fair value of the securities is treated as its new gross carrying amount by applying the impracticability exception to the retrospective EIR application.

**Case 7:** The strategy for the GBP portfolio involved holding debt securities and futures. In this case, futures will be classified as FVTPL even though they are included in the LIQ tranche, of which the business objective is ‘hold-to-collect and sell’, they do not meet the SPPI criterion as a derivative instrument. All

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\(^{10}\) For a detailed illustration of ECL calculation, see “Impairments of Greek Government Bonds under IAS 39 and IFRS 9” published by the European Parliament Policy Department on October 14, 2015; also, for various simplifications in ECL calculation and considerations for simplifications, see “The implementation of IFRS 9 impairment requirements by banks” by GPPC published in June 2016.
derivatives are measured at fair value under both IFRS 9 and IAS 39, and their gains and losses are recognized in profit or loss, unless hedge accounting is applied.

Disclosure for Each Class of Financial Assets at the DIA [IFRS 7.42I-J]

IFRS 9, together with IFRS 7, requires the transition process to be appropriately reflected in the disclosures for each class of financial assets and liabilities during the period of initial adoption of IFRS 9. Detailed lists of the disclosures required by the standards are presented in Appendix 2. Based on the illustrated cases, each class of original vs. new classifications, and their carrying amounts can be disclosed as presented in the table below. The notes to financial statements should explain how the classification requirements under IFRS 9 are applied, and the reasons for any designation or any de-designations of securities classified as FVTPL.

<table>
<thead>
<tr>
<th>In millions</th>
<th>Note</th>
<th>Previous classification under IAS 39</th>
<th>New classification under IFRS 9</th>
<th>Previous carrying amount under IAS</th>
<th>New carrying amount under IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash equivalent</td>
<td>Loans and receivables</td>
<td>Amortized cost</td>
<td>200</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Cash equivalent</td>
<td>Case 1</td>
<td>Loans and receivables</td>
<td>FVOCI</td>
<td>50</td>
<td>49</td>
</tr>
<tr>
<td>Investment securities - debt</td>
<td>Case 2</td>
<td>AFS</td>
<td>Amortized cost</td>
<td>38</td>
<td>37</td>
</tr>
<tr>
<td>Investment securities - debt</td>
<td>AFS</td>
<td>FVOCI</td>
<td>209 (Note)</td>
<td>209</td>
<td></td>
</tr>
<tr>
<td>Investment securities - debt</td>
<td>Case 4</td>
<td>AFS</td>
<td>FVTPL</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Investment securities - debt</td>
<td>Case 6</td>
<td>Trading (designated)</td>
<td>FVOCI</td>
<td>120</td>
<td>120</td>
</tr>
<tr>
<td>Investment securities - debt</td>
<td>Trading</td>
<td>FVTPL</td>
<td>150</td>
<td>150</td>
<td></td>
</tr>
<tr>
<td>Investment securities - equity</td>
<td>Case 5</td>
<td>AFS</td>
<td>FVOCI</td>
<td>50</td>
<td>55</td>
</tr>
<tr>
<td>Derivative assets held for risk management</td>
<td>Trading</td>
<td>FVTPL</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td><strong>Total Foreign exchange reserves assets</strong></td>
<td></td>
<td></td>
<td><strong>920</strong></td>
<td><strong>923</strong></td>
<td></td>
</tr>
</tbody>
</table>

*Note: Investment securities - debt of 209, classified as AFS under IAS 39 and as FVOCI under IFRS 9, are composed of 59 EUR discounted security, 70 GBP debt security and 80 USD debt security.*

Additional Disclosures on Transition from IAS 39 [IFRS 7.42K-S]

Based on IFRS 9 Implementation Guidance for meeting the quantitative disclosure requirements in IFRS 7 paragraphs 42K-42O, the reconciliation of changes due to the classifications and measurements is illustrated in the table. Any differences in the carrying amounts from IAS 39 to IFRS 9 are presented as “remeasurements” in the reconciliation which is disclosed in the notes to the financial statements. IFRS 7 requires additional disclosures for the assets reclassified to AC, such as the fair value at the end of the reporting period and fair value gain or loss that would have been recognized in profit or loss or OCI during the reporting period.

Also, when impracticability exceptions are applied, additional disclosures are required. For example, in the case of reclassifying out of Trading with an EIR exception (Case 6), EIR determined on the DIA and interest income or expense recognized should be disclosed. If exceptions are applied related to the SPPI criteria assessment (Case 4), the carrying amounts of the relevant assets should be disclosed until they are derecognized.
Los Allowance Balances [IFRS 7.42P]

New credit risk disclosures are required in order to communicate the effect of credit risk on the amount, timing, and uncertainty of future cash flows. IFRS 9 introduces additional management judgment as a result of incorporating macroeconomic variables and forward-looking information into the ECL model. To make financial statements useful and to supplement subjective estimates, qualitative and quantitative inputs are required. Disclosures include the methods, assumptions, and information used in arriving at ECL. For the transition disclosure, it is required to reconcile the ending impairment allowance under IAS 39, or the provisions under IAS 37 Provisions, Contingent Liabilities and Contingent Assets to the opening loss allowance or provision under IFRS 9. This disclosure would be provided by the related measurement categories in accordance with IAS 39 and IFRS 9 for financial assets. The effect of changes in the measurement category on the loss allowance at that date would be shown separately.

Assuming that under IAS 39 the central bank carried no allowance in both HTM and AFS, the reconciliation of opening to closing amounts of the respective loan loss allowances can be presented, based on the aforementioned cases, as follows:

<table>
<thead>
<tr>
<th>(in millions)</th>
<th>IAS 39/ IAS 37 carrying amount 12/31/2017</th>
<th>Reclassifications</th>
<th>Remeasurements</th>
<th>IFRS 9 carrying amount 1/1/2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>AFS debt securities under IAS 39 &amp; at FVOCI under IFRS 9</td>
<td>-</td>
<td>-</td>
<td>(Case3)</td>
<td>2</td>
</tr>
<tr>
<td>HTM debt securities under IAS 39 reclassified to FVOCI under IFRS 9</td>
<td>-</td>
<td>-</td>
<td>(Case1)</td>
<td>0.4</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td>2.4</td>
</tr>
</tbody>
</table>

Note: Total changes due to reclassification sum up to zero because additions in one category would be offset by subtractions in another category.
Reconciliation of Retained Earnings (RE) and Other Comprehensive Income (OCI)

IFRS 9 requires recognition of any difference between the previous carrying amount under IAS 39 and the carrying amount at the DIA under IFRS 9 in opening RE or OCI, as appropriate. As illustrated in Case 4, scenarios impacting the opening RE at the transition include reclassification from HTM or AFS to FVTPL. In this case the MTM amount will be recognized in RE. This would also be the case when computing ECL for assets measured at amortized cost as was illustrated under Case 1.

There may also be situations where neither the carrying amount nor the classification has changed in the transition to IFRS 9. However, there could still be transfers between the opening RE and OCI. Case 3 is one of those scenarios. In this instance, the carrying value is already measured using fair market value as the securities were already classified as AFS under IAS 39. IFRS 9 introduces a change, in that impairments are carved out of the total fair market value, and are posted to the RE. Reclassification between Trading/FVTPL and AFS/FVOCI will also require a transfer of the unrealized gain or loss between the opening RE and OCI.

The following table presents the impact of transition to IFRS 9 on RE and OCI.

<table>
<thead>
<tr>
<th>(in millions)</th>
<th>RE</th>
<th>OCI</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/2017 under IAS 39</td>
<td>X</td>
<td>Y</td>
</tr>
<tr>
<td>Reclassification</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt securities from Amortized Cost to FVOCI (Case 1)</td>
<td>(0.4)</td>
<td></td>
</tr>
<tr>
<td>Debt securities from AFS to Amortized Cost (Case 2)</td>
<td>(1)</td>
<td></td>
</tr>
<tr>
<td>Debt securities from AFS to FVTPL (Case 4)</td>
<td>3</td>
<td>(3)</td>
</tr>
<tr>
<td>Equity Investments (Case 5)</td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>ECL under IFRS 9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 month ECL (Case 1)</td>
<td>(0.6)</td>
<td></td>
</tr>
<tr>
<td>Lifetime ECL (Case 3)</td>
<td>(2)</td>
<td></td>
</tr>
<tr>
<td>1/1/2018 under IFRS 9</td>
<td>X+0.4</td>
<td>Y+2.6</td>
</tr>
</tbody>
</table>

V. First-time adoption of IFRS

For first-time adopters of IFRS, the transition requirements are generally quite similar to those detailed for the transition from IAS 39 to IFRS 9. One exception is that references to the DIA are generally replaced with reference to the date of transition to IFRS. In applying IFRS 9, the date of transition is the beginning of the first IFRS reporting period (IFRS 1.E1). Another difference is with regard to the SPPI criteria assessment of the provisions under IFRS 1. IFRS 1 requires that the assessment take place at the date of transition, instead of at the inception of the instrument. If an entity adopts IFRS for the first time, for annual reporting periods beginning before January 1, 2019, it does not have to restate comparative information in its financial statement disclosures.

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11 This section is focused only on the application of IFRS 9. For more general information on the first-time adoption of IFRS, see IFRS 1.
Appendix 1: Benchmarking Cashflows for SPPI Test

IFRS 9 clearly states that TIPS qualify for the SPPI criterion, as the inflation index is not leveraged and the principal is protected. [IFRS 9.B4.1.13] However, U.S. FRNs and some Japanese government securities called ‘10 year constant maturity bonds’ may not meet the SPPI criterion, depending on materiality thresholds, due to the modified time value of money element with weekly resets to the 13 week Treasury Bill rate and a semi-annual interest reset to a 10-year rate, respectively. The SPPI assessment of these financial assets with the modified time value of money element should determine how different the contractual (undiscounted) cash flows could be from the (undiscounted) cash flows that would arise if the time value of money element was not modified.

Unless that determination can be made clearly with a qualitative assessment, it may be necessary to perform a quantitative test by benchmarking cash flows based on a comparable financial asset that does not contain such a modification. [IFRS 9 B4.1.9B ~ D] The appropriate comparable financial asset is a contract of the same credit quality, and with all of the same contractual terms, with the exception of the contractual term under evaluation. If the modification could result in cash flows that are more than significantly different from the benchmark cash flows, it can be concluded that the financial asset does not meet SPPI requirements.

The objective of such a quantitative assessment is to establish how different the contractual (undiscounted) cash flows could be from the benchmark (undiscounted) cash flows that would arise if the time value component of the interest rate were commensurate with the period for which the rate is set. For instance, U.S. FRNs are issued for a term of two years with the index set to the most recent 13-week Treasury bill rate; their coupon rate and payment frequency are quarterly whereas the coupon rate is reset every week. For the quantitative assessment of these securities, forward projections of quarterly interest rate would be required as an entity must consider factors that could affect future contractual cash flows.

Acknowledging that a quantitative assessment of the time value of money component of an interest rate is operationally complex, the IASB has added an exception on the basis of impracticability. This involves applying the assessment of the asset’s contractual cash flows characteristics without the notion of a modified economic relationship as set out in the requirements issued in IFRS 9 (2009). Hence, if the entity applies this exception or cannot prove an insignificant difference via benchmarking cash flows without using hindsight from the date of initial recognition of the financial asset, the asset would not qualify at transition for the SPPI criterion, which means it should be classified as FVTPL.

12 IFRS 9.7.2.4~ 9.7.2.5 and Basis for Conclusions (BC)7.54~56.
Appendix 2: Checklist for IFRS 9 Transition Disclosures

The checklist below would be a useful starting point for financial statement users to assess the breadth and depth of disclosures required.

<table>
<thead>
<tr>
<th>1) Disclosure relevant to all cases (IFRS 7.42I-J)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• The original measurement category and carrying amount under IAS 39 or an earlier version of IFRS 9;</td>
</tr>
<tr>
<td>• The new measurement category and carrying amount determined under IFRS 9 for each class of financial assets and financial liabilities;</td>
</tr>
<tr>
<td>• Explanations to support how the classification requirements under IFRS 9 are applied;</td>
</tr>
<tr>
<td>• The reasons for any designation or any re-designations of securities classified as FVTPL;</td>
</tr>
<tr>
<td>• The amount of securities previously designated as FVTPL, distinguishing between mandatory and elective re-designations, should be disclosed.</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>2) Changes in the classifications of financial assets and financial liabilities as at the DIA:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Changes in the carrying amounts on the basis of classification categories under IAS 39 (IFRS 7.42L(a));</td>
</tr>
<tr>
<td>• Changes in the carrying amounts arising from a change in measurement attributed to the transition to IFRS 9 (IFRS 7.42L(b)).</td>
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<tr>
<th>3) The impact of the reclassifications, when reclassifying to Amortized Cost (IFRS 7.42M):</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Fair value at the end of reporting period;</td>
</tr>
<tr>
<td>• Fair value gains or losses that would have been recognized in either profit or loss or OCI during the reporting period, if the financial assets and financial liabilities had not been reclassified.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>4) Interest in case of reclassifying out of FVTPL (IFRS 7.42N):</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Effective Interest Rate (EIR) determined on the DIA;</td>
</tr>
<tr>
<td>• Interest income or expense recognized.</td>
</tr>
</tbody>
</table>

IFRS 9.7.2.11 states that if it is impracticable to apply the EIR retrospectively, then the fair value of a financial instrument at the DIA is treated as its new gross carrying amount. The disclosures in IFRS 7.42N must be made for each reporting period until derecognition.

| 5) If exceptions related to the SPPI criteria assessment are applied, the carrying amounts of the relevant assets should be disclosed until they are derecognized (IFRS 7.42R-S). |

| 6) Impairments require a reconciliation of the ending loss allowance balances recorded under IAS 39 and IAS 37, to the opening balances of the new loss allowance computed under IFRS 9. This disclosure must be provided by the related financial asset measurement categories in accordance with both IAS 39 and IFRS 9. Separate disclosure should reflect the effect of changes in the measurement categories on the loss allowance at the DIA. (IFRS 7.42P) |
References


