



Turun yliopisto
University of Turku

IFRS 9 ‘FINANCIAL INSTRUMENTS’

Anticipated effects of the standard change at Kesko Group

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Author:
Antti Jääskeläinen

Supervisors:
Prof. Hannu Schadewitz
D.Sc. Vesa Partanen

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Turku



Turun kauppakorkeakoulu • Turku School of Economics

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LIST OF ACRONYMS

ED	Exposure Draft ED sets out a particular proposal in the form of a proposed standard or amendment to an existing standard. (Ifrs.org/Development and publication of an Exposure Draft)
EFRAG	European Financial Reporting Advisory Group A private association created in 2001 with the backing of the European Commission to deliver input into the development of IFRS and to provide the Commission with technical expertise and advice on accounting concerns. (Efrag.org/Facts)
ESMA	European Securities and Markets Authority An independent EU authority that commits to securing the stability of the EU's financial system by improving the protection of investors and endorsing stable and orderly financial markets. (Esma.europa.eu/Who we are)
FASB	Financial Accounting Standards Board The U.S. national standard-setter, established in 1973. (Fasb.org/Facts)
FVOCI	Fair Value through Other Comprehensive Income A method of establishing and accounting value of items. Measured at fair value on balance sheet but profit and loss statement will reflect amortized cost accounting, with recycling of realized gains/losses. (KPMG 2012a, 1)
FVTPL	Fair Value through Profit or Loss A method of establishing and accounting value of items. For assets classified at FVTPL, all gains and losses are recognized in profit or loss (P&L). (KPMG 2014b, 5)
G20	The Group of Twenty An international forum for economic co-operation on key issues of global economic and financial agenda. Its members are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the UK, the US and the EU. (European Parliament 2015a, 1)
IAS	International Accounting Standards Standards issued by the IASC, specified IAS are still recognized by the IASB. (Bushman 2010, 266)
IASB	International Accounting Standards Board An independent standard-setting body of the IFRS Foundation established 2001 in London, United Kingdom. (IASB 2015a, 1–2)
IASC	International Accounting Standards Committee The forerunner of the IASB, founded in 1973 by national accounting bodies from nine countries. The standard-setter operated from 1973 to 2000. (Zeff 2012, 807)
IAS 39	IAS 39 Financial Instruments: Recognition and Measurement A standard that describes the requirements for the recognition and measurement of financial instruments. (Iasplus.com/IAS 39, Deloitte)
IFRS	International Financial Reporting Standards Financial accounting standards issued by the IASB. (Zeff 2012, 807)
IFRS 9	IFRS 9 Financial Instruments A standard that replaces IAS 39 and contains requirements for recognition and measurement, derecognition and general hedge accounting of financial instruments. (Iasplus.com/ IFRS 9. Deloitte)
OCI	Other Comprehensive Income Covers items of income and expense that are not recognized in profit or loss as required or allowed by other IFRS. (KPMG 2014a, 11)
SPPI	Solely Payments of Principal and Interest One of the criteria for defining the classification of financial assets in IFRS 9. Relates to examining whether cash flows from financial assets are SPPI. (IASB 2014a,10)
U.S. GAAP	U.S. Generally Accepted Accounting Principles Financial accounting standards set by the FASB. (Accountingfoundation.org/What we do: FASB)

1 INTRODUCTION

1.1 The reform of accounting for financial instruments

The International Accounting Standards Board (IASB) has issued International Financial Reporting Standards (IFRS) reshaping the paradigm of financial accounting since its establishment in 2001 (Barth 2006, 71; Zeff 2012, 807). Especially, the global harmonization of accounting mushroomed, as listed companies in European Union (EU) were obliged to adopt IFRS reporting in 2005 (Baker & Barbu 2007, 273; Christensen et al. 2007, 342; Horton et al. 2013, 390). Among roughly 8,000 EU listed companies, publicly traded Finnish companies were also faced with preparing their consolidated financial statements in accordance with IFRS (Iasplus.com/Finland, Deloitte; Zeff 2007, 290). Correspondingly, the case organization of this thesis, the Kesko Group (Kesko) adopted IFRS, and recorded improved net profit of €58 million and consolidated balance sheet increase of €342 million compared with the Finnish Accounting Standards (Stock exchange release, 6.4.2005, Kesko). Reflecting to the various different types of national accounting standards, the effects of IFRS transition have undeniably been substantial (FIN-FSA 2005, 3). However, currently it is curious that IFRS appears to be under continual refinement that personifies a challenge for companies to adapt the ongoing changes related to their accounting requirements (Haswell 2006, 54).

During the past decade, distinctive for IFRS reporting has certainly been the constant amendments of prevailing standards and the ongoing issuing of new standards (KPMG 2014a, 1). Following the trend, the IASB released an updated standard for financial instruments, International Financial Reporting Standard 9 *Financial Instruments* (IFRS 9) in July 2014 (Lachmann et al. 2015, 21). A standard, which the IASB intends to be mandatory for annual periods beginning on or after 1 January 2018, replacing the International Accounting Standard 39 *Financial Instruments: Recognition and Measurement* (IAS 39). The effective date for EU listed companies still depends on the approval of EU.

The accounting principles for financial instruments have always been considered as a complex (Carvalho et al. 2015, 182). Thus, the reform of accounting for financial instruments is a matter that has been one of the key concerns in the agenda of IASB for years (Onali & Ginesti 2014, 629). IAS 39, which establishes the principles for recognizing and measuring financial instruments, has long been subject to vast criticism, and there has been major pressure to replace the standard. Users of financial statements have voiced that the requirements of IAS 39 are difficult to comprehend, apply and interpret. (Haswell 2006, 54.) Among other things, the standard has been argued to involve complex classification categories, overly demanding hedge

accounting requirements and impairment rules that might have delayed the recognition of loan loss expense (Glaum & Glöcker 2011, 460; IASB 2014a, 6; O'Hanlon 2013, 225). In fact, IAS 39 was amended numerous times for its problems. Eventually, though, the IASB was insisted to develop an entirely new standard for the accounting of financial instruments. (IFRS 9:IN2.)

The global financial crisis put a further spotlight on the criticized IAS 39 and on the debate how to measure the value of financial instruments i.e. fair value accounting (Paananen et al. 2012, 208; Palea 2014, 102). The proponents, including the aspect of IFRS 9, view that fair values reflect the true value of a balance sheet and current market conditions. This should provide users of financial statements timely information and better access to companies' risk profiles. The opponents, particularly from the financial industry, claim that fair value accounting contributes to excessive volatility of profit, does not reflect the value of fundamentals and that fair values based on models are not reliable. (Palea 2014, 103; Bentley & Franklin 2013, 63.) The crisis also initiated discussion about issues of systemic risk and how financial regulation, in specific IAS 39, was connected to creating and intensifying the crisis (Bushman & Landsman 2010, 259). Consequently, the IASB has underlined that the publication of IFRS 9 was the final part of its inclusive answer to the financial crisis (Ifrs.org/Financial Instruments.)

The objective of IFRS 9 is to settle principles for the financial reporting of financial instruments, i.e. financial assets and financial liabilities, to offer useful information to the users of financial statements (IFRS9:1.1). Conforming the three main phases of the IASB's project to replace IAS 39, IFRS 9 encompasses classification and measurement, impairment and hedge accounting requirements for financial instruments (IASB 2014a, 2). For one, the standard is stated to be developed on a logical, single classification and measurement approach for financial assets. The classification approach should reflect the business model in which the assets are managed and the cash flow characteristics of the assets. (IASB 2014a, 2.) What is notable, the term business model incorporated for managing financial assets is a new addition to the vocabulary of financial reporting. The term itself is alleged to be ambiguous and have no established meaning. (Page 2012, 683; Tikkanen et al. 2005, 791.)

For the second, IFRS 9 introduces an entirely new forward-looking impairment model, which should offer further timely information about expected credit losses and result to more timely recognition of loan losses. It is no longer required for a credit event to have occurred beforehand the related credit losses are recognized. Now, companies account for expected credit losses and changes in those losses at all times. (IASB 2014a, 2, 14.) Thirdly, the standard involves new hedge accounting requirements, which should introduce a significant reform of hedge accounting to enhance the link between accounting and risk management (IASB 2014a, 24). The

reform is expected to relax specific requirements and allow for more hedging strategies to qualify for hedge accounting (KPMG 2014b, 106).

Altogether, IFRS 9 is now open to interpretation. Planning the implementation of the standard is expected to be a significant issue for corporate treasurers and accountants in general, though the major impact is appreciated to be on financial institutions (KPMG 2014b, 2). The new classification and measurement requirements are a potential challenge, since the management is required to evaluate the financial assets' classification given the profoundly new business model approach (EY 2015, 3; PwC 2014a, 19.) It is also judged that the adoption of the standard, especially the new impairment rules, is to inevitably cause major implementation costs for companies (EFRAG 2015, 2). Participants in the European Financial Reporting Advisory Group's (EFRAG) 2013 field-test recognized that there would be significant costs related to the buildup and roll-out of systems, tools and processes for assembling data, tracking credit risk and calculating expected credit losses (EFRAG 2015, 86–87). Finally, as the Chairman of the IASB Hans Hoogervorst, emphasized in respect of IFRS 9 on 15th September 2015, "The effective date of the Standard, 1 January 2018, is now less than two and a half years away. That may sound like a long time, but we all know that when it comes to making big accounting changes, it is not." (IASB 2015a, 3.)

What is more, the EFRAG provided an Endorsement Advice on IFRS 9 to the European Commission on 15 September 2015. In the document, the standard was assessed to deliver relevant, reliable, comparable and comprehensible information. It was also assessed that IFRS 9 would be conducive to the European public good, would improve financial reporting and produce a definite enhancement over the existing requirements in IAS 39. (EFRAG 2015, 1.) Likewise, in June 2015 the European Securities and Markets Authority (ESMA) expressed that IFRS 9 should be conducive to the European public good and that the standard is anticipated to have a positive impact on investor protection, and on financial stability in comparison with IAS 39 (ESMA 2015, 1).

With a good reason, it may be argued that the issues related to the reform of accounting for financial instruments are research subjects worth noticing. At least, for the novelty of the phenomenon and for the great sphere of influence the standard will have among thousands of IFRS reporting companies. As, up to 116 jurisdictions currently require the use of IFRS from listed companies (Ifrs.org/Jurisdictions). IFRS 9 is also a product of many years work, which final version has been anticipated by various stakeholders, thus careful consideration of the outcome is in place. This study emphasizes that companies are also obliged to assess the new classification and measurement requirements, and for the first time define by which business model they manage their financial assets.

At Kesko, the necessity for evaluating the possible effects of the IFRS 9 transition is recognized. More particularly, the Group Treasury of Kesko has identified that adopting the new requirements may allow for simplifying the accounting for the company's financial assets. At any rate, managing and accounting for financial assets is not the core business of the trading sector company. Therefore, there is a distinct opportunity under the new rules to simplify these support functions. The opportunity should be evaluated by scrutinizing the relevant requirements and by planning which sort of business model for managing financial assets the company could apply in the future. At the latest, the solution should be ready-made at the end of 2016, as the company is expected to start to conduct reference calculations in 2017, comparing the differences between the accounting results of IAS 39 and IFRS 9.

1.2 Objectives and scope

This thesis introduces accounting for financial instruments and particularly the topical IFRS 9. Since, the standard is fully complete may up to date understanding on the subject be reached for. Studying the topic, emphasis is placed on the new classification and measurement requirements of financial instruments, though the impairment and the hedge accounting parts of IFRS 9 are also examined but with less detail. The choice to focus on these requirements is congruent with the IASB's three-phased project to replace IAS 39. Besides, as the aim is to emphasize the financial assets' classification given the new business model approach, the related classification and measurement rules are stressed. The literature on the recently issued IFRS 9 is scarce, thus the study also seeks to reinforce the body of research related to the subject.

The first objective of the study is to examine what are the major changes IFRS 9 brings to the accounting for financial instruments and what are expected to be the possible effects of these changes. The second objective is to gain insight into what the term business model signifies in IFRS 9, and thus what matters should be considered when defining it. The third and the fourth objective of the study relate to the intention of exemplifying the above-mentioned objectives of the study. Thus, a case study on one organization, Kesko, is conducted. The third objective is to examine what could be the major effects of IFRS 9 at Kesko. Since, the fourth and final objective is to define, in compliance with IFRS 9, a business model for managing financial assets at Kesko. Eventually, on the grounds of the above mentioned research objectives the emerging research questions can be formulated as follows:

- How IFRS 9 particularly changes the accounting for financial instruments and what key effects are the changes anticipated to cause?

- How the term ‘business model’ for managing financial assets can be comprehended and what key issues should be considered when defining it under IFRS 9?
- What are anticipated to be the major effects of IFRS 9 at Kesko?
- What kind of business model for managing financial assets Kesko aims to apply?

The purpose is to answer to the research questions through theoretical examination and by the means of the case organization. Further, the research questions are split in a twofold arrangement. First and second that will be examined with IFRS experts from two Big Four companies, are mostly theoretical issues that apply to IFRS reporting companies in general. Whereas, the latter have a more specific nature that will be evaluated with the relevant experts in the unique context of the case organization Kesko.

1.3 Research methodology and methods

This study will be conducted as an action research, which is an orientation within action-oriented research approach. The action-oriented approach regards reality as bound to subjectivist experiences and emphasizes the role of personal knowledge of individuals. In this arrangement, the reality is understood from the involved individuals’ point of view. (Pihlanto 1994, 378.) The approach focuses analysis on human beings, and in the same way the emphasis of this study is placed on the perceptions of different experts. Typical for the approach is also that the empirical data is gathered from limited origins, using few or even one object or organization as the source, a feature that befits this study. (Neilimo & Näsi 1980, 35.) Further, the action-oriented approach does not try to explain causal relations of the studied subjects as objective truths. Neither, is the purpose of this study to provide a single uniform and acceptable set of rules, particularly when considering the definition of business model for managing financial assets. (Pihlanto 1994, 369–377.)

Representative for the action research itself is that the process in the study is partly experimental. Thus, it is not possible to anticipate a definitive connection to theory, as the research design of a study is formulated. Nevertheless, it is possible to consider that the research aims at theoretical contribution in some degree. The character of action research as theory developing is also more obscure than for example with a theory testing case study. (Lukka 1999, 141–145.) It is still possible to generalize the results of this study to concern other companies to a certain extent. Since, the studied change is forced by law and extrinsic, not especially characteristic for the case organization only.

Furthermore, a common feature for the action research materializes in the empirical phase of a study in which the case study method is typically applied. Subject to the methodological decisions made and the character of the research objectives, this study is similarly organized applying a case study method. (Kasanen et al. 1993, 257.) Central

feature of a case study is that the researcher is directly participating with the actors in the field, applying orthodox ethnographic methods, such as interviewing and observation. These methods are then usually combined and reinforced with study of archives, as empirical data is gathered. (Jönsson & Lukka 2005, 4.) In this context, the action research presupposes a careful awareness of organizational processes for that the intended changes may be achieved. It is presupposed that the researcher adopts a role of a 'change agent' and supports the individuals of the organization in their learning processes. (Kasanen et al. 1993, 257.) Thus, a generic feature of the action research lies also in its practical orientation (Pihlanto 1994, 372).

What is more, the main purpose of action research is not to develop theory, rather to stimulate and contribute to the learning of an organization. However, in this setting the intervention is not as sophisticated as with a constructive research approach. In its framework, the objective is to develop an innovative construction and further implement it, as well as conduct market testing for it. This will not actualize in the study, since neither IFRS 9 nor the business model will be adopted during the study. These are proofs that support the selection of action research over the constructive one. Regardless, the research approaches are ably similar when it comes to collecting the empirical data. Both of them lean on daily communication of an organization, observations, interviews and collection of written materials. (Lukka 1999, 140–141.)

Lukka & Kasanen (1995) argue that a fruitful case study offers new views, observations and in-depth interpretation of limited research objects that add to the understanding of the studied issue. The problem with limited research objects is that generalization of the research results is usually questionable. Yet, it is stated that generalization to a modest extent is achievable, if the case study is conducted appropriately. This requires covering theoretical information and prior empirical results along with interpretation of the subject, besides dealing with the empirical results and analysis of the study in question. (Lukka & Kasanen 1995, 75, 77, 85.) Congruent with the aforesaid, this study introduces, for instance, general consideration of financial instruments and the new requirements under IFRS 9 as a theoretical background. This is extended by scrutinizing the meaning of the business model for managing financial assets in which certain prior empirical results are also brought forward. Eventually, in the empirical phase of the study, the possible effects of the standard transition are examined with the designated experts, and lastly the most important analysis takes place at the case organization.

Once more addressing the features of action research, indeed, peculiar for the approach is that the researcher is involved in the operation of the studied organization. This actualizes in the study, since the researcher works at the Group Treasury of Kesko, participates in different meetings of the organization and frequently communicates with employees of the organization. As a consequence, participant observation emerges to be

one of the data collecting methods of the study. Following the types of participant observation introduced by McKinnon (1988), it may be argued that the participant observation in this study resembles most the so-called observer as participant approach. Under the approach, the researcher takes part in the activities of research setting and is also recognized as a colleague to the research subjects. Compared to participant observation with hidden identity there is no ethical problems, however there is a threat that the researcher might 'go native' i.e. grow into so emotionally and psychologically entangled with the organization that the capability to tell apart and balance the observer and participant roles of the researcher would be gone. (McKinnon 1988, 48.)

As stated, this study is conducted in a twofold manner. The first part consists of theoretical examination, which has been merged with interview results; quotations from the IFRS experts. This part relates to the general consideration of IFRS 9 in which the special method is chosen to be applied, since the literature on the standard is such scant. Hence, this method and the IFRS experts' interviews are strived to strengthen the actual theoretical examination. The second part, the case study part, involves the more distinct ambitions related to the case organization. Consequently, the latter part is especially action research by nature. Indeed, what is peculiar for action research, the researcher was requested by the Treasurer of Kesko to educate i.e. contribute to the learning of the employees of Group Treasury about IFRS 9. The researcher held a presentation before the focus group interview with the intention of especially providing relevant background information about the studied subject. The presentation lasted about an hour, covering general information about the transition to IFRS 9, as well as classification and measurement requirements specific details. Few other interested employees attended this meeting, besides the persons attending the focus group interview.

Another primary method of data collection used in this study is a semi-structured interview. The method involves consistent organized questioning through specified themes, entailing the possibility to interrupt and question more carefully to provoke more detailed responses. Semi-structured interview is a widespread method for its flexibility, accessibility and intelligibility. The method lets the interviewer to adapt style, pace and arrangement of questions. Further, semi-structured interview permits interviewees to present responses to the questions in their own terms. (Qu & Dumay 2011, 246.) The semi-structured interviews of this study will be tailored for the IFRS experts, who will be questioned about the general aspects of IFRS 9. First, Peter Sundvik is a Senior Manager at KPMG Oy Ab. He is specialized, for instance in IFRS, financial reporting, financial auditing, financial accounting, risk management, corporate finance and consolidation. Second, Nina Alaharju is a Director at PwC Oy. She has in-depth knowledge, for example of IFRS, corporate finance, corporate treasury, financial

auditing, financial risk management and financial reporting. To be noted, she has participated in the auditing of Kesko's Group Treasury functions for a number of years.

Empirical data is further collected by conducting a theme-centered interview and a focus group interview, which are customized for designated experts at the case organization Kesko. Theme-centered interview is highly similar to the semi-structured one, though always dependent on its execution. Thus, the method is more structured than an open interview and involves that the interview questions are constructed in compliance with specified fields. That is, by following different themes that the researcher has explored. The interview follows no exact form or order subject to the questions. Typical for the method is also that the field of questions is generally outlined, the number of interviewees is rather small and the collected information is profound by nature. (Hirsijärvi & Hurme 1988, 35–36, 38.) The theme-centered interview is conducted with the Treasury Manager of Kesko. Whereas, the focus group interview takes place in a group setting, called a focus group. Now, a number of people are interviewed together and the purpose is to engage in flexible and exploratory discussion. The method's advantages rest on the convenience and time savings for both the interviewees and the interviewer. (Qu & Dumay 2011, 243.) Further, the method may decrease interviewer bias by making it less probable for the interviewer to influence the respondents at a meeting compared to an individual interview (Shapiro 1952, 453.) The focus group interview is conducted by organizing a meeting for the Treasurer, the Head of Market Operations and the Treasury Manager of Kesko.

Accordingly, the case study part of this thesis involved principally the people interviewed, the written material gathered and the informal discussions held at the Group Treasury of Kesko. The informal discussions with the interviewees related to various different aspects of this study, such as financial reporting, treasury policy, cash reserves and liquidity management of Kesko. The discussions enhanced the researcher's ability to comprehend the interrelations between the different aspects. The written material gathered comprised mainly of data related to the treasury policy and cash reserves of Kesko. Once more addressing the interviews, the theme-centered interview, constituted mostly for the general aspects that relate to the transition of IFRS 9 at Kesko. Additionally, the background of accounting for financial assets at the Group Treasury was examined. Whereas, the focus group interview regarded, above all, the issues that relate to defining the business model for managing financial assets at Kesko.

Eventually, the interviews with the different experts are recorded and transcribed. In order to save time in this process, the researcher has chosen to transcribe the interviewees' statements straight from Finnish to English. This method may in some circumstances cause certain weakness of data. Anyhow, the researcher viewed and was determined that the method is as good as transcribing the interviews first in Finnish and

then translating the chosen quotations to English. After the process, the collected quotations were edited from colloquial to legible with minor amendments.

1.4 The case organization

The case organization of this thesis, the Kesko Group, is a Finnish listed trading sector company. The operations of Kesko include the grocery trade, the home improvement and speciality goods trade, as well as the car and machinery trade. The company acts in close operation with retailer entrepreneurs, hence Kesko and K-retailers form the K-Group. The K-Group employed about 40,000 people and had about 1,500 stores in eight countries in 2015. (Kesko.fi/Kesko in brief.) Kesko's financial performance for the year 2015 was in brief: net sales of €8,679 million (€9,071 million), operating profit excluding non-recurring items of €244.5 million (€233 million) and equity ratio of 54.7% (54.5%) (Stock exchange release, 3.2.2016, Kesko.)

Financial risk management of Kesko is complied with a uniform treasury policy approved by the Company's Board of Directors. The Group Treasury of Kesko (the Treasury) is centrally accountable for acquiring financial resources, for liquidity management, relations with finance providers and the management of financial risks. (Kesko Financial Statements 2015, 112.) The liquidity risk management of Kesko intends to preserve adequate liquid assets and credit facilities for to safeguard the accessibility of adequate funding for the Group's business activities. The aim is to invest liquidity consisting of financial assets in the money market by utilizing competent combinations of return and risk. At fixed intervals, the Group's management accepts the instruments and limits for each investment among those analyzed by the Treasury. The liquid assets have largely been invested in the debt instruments of major Finnish companies, in certificates of deposit and deposits with banks operating in Kesko's market area, in bonds of designated companies, and in corporate bond funds with a weaker credit rating. The return on these investments for 2015 was 0.3% (0.8%) and the duration was 0.7 years (0.6 years). (Kesko Financial Statements 2015, 115, 118, 120.)

In the interest of this study, certain aspects of the accounting for financial instruments at Kesko should be clarified. The liquid financial assets of Kesko are classified into the following categories in compliance with IAS 39:

- Financial assets at fair value through profit or loss (FVTPL)
- Available-for-sale financial assets (AFS)
- Loans and receivables

The present classification at initial recognition is contingent on the purpose for which the financial assets were acquired. (Kesko Financial Statements 2015, 43–44.) The

financial assets are managed by the Treasury in compliance with the treasury policy. The treasury policy includes a portfolio classification, which organizes the financial assets at fair value through profit or loss (FVTPL) and at available for sale (AFS) in three different portfolios. The financial assets are valued at fair value and the changes in the fair values of these assets are recorded, in compliance with a specified category, on the profit and loss statement (P&L) or for the AFS in the own equity. The portfolios and their content on 31 December 2015 are presented in the table below.

Table 1 Portfolio classification of Kesko

31.12.2015	Meur	Share	Classification
Cash portfolio	85,429	13,19%	AFS
Money market portfolio	373,887	57,71%	FVTPL
Bond portfolio	188,529	29,10%	AFS
Total	647,845		

What is more, the organization structure for the involved department, the Treasury, is introduced. This is done for the sake of comprehending in what kind of setting the case study takes place. Moreover, for understanding the hierarchy and formal relations between the interviewees (Group Treasurer, Head of Market Operations and Treasury Manager) interviewed, and to perceive the exact position of the researcher in the studied organization. The figure below addresses the organization structure of the Treasury. The interviewees' titles are bolded in the figure below.

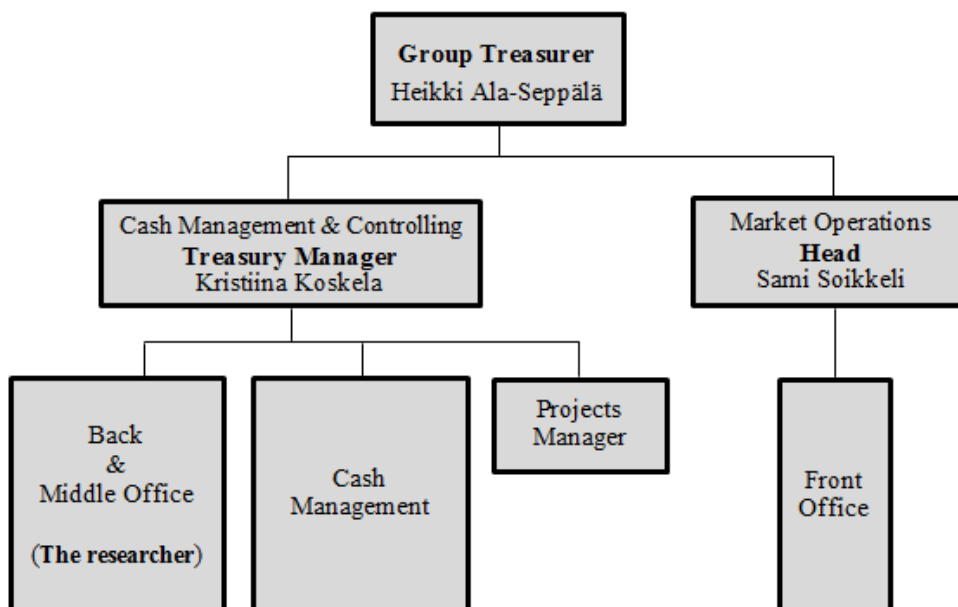


Figure 1 Organization structure for the Group Treasury of Kesko

As the figure implies, the Group Treasurer (Heikki Ala-Seppälä) is the head of the Group Treasury. His superior is the Senior Vice President, CFO, Jukka Erlund. Thus, the Head of Market Operations (Sami Soikkeli) and the Treasury Manager (Kristiina

Koskela) are subordinates to the Group Treasurer. Furthermore, the researcher works as a Treasury Specialist in the Back and Middle Office of the Treasury, and his direct supervisor is the Treasury Manager. In all, the function employs eleven people.

To provide more detail about the interviewees and interviews, Koskela was strongly involved in Kesko's initial transition to IFRS reporting in 2005. At the time, she participated in determining how the 'financial standards' (particularly IAS 39) affect the daily life of the Treasury. Besides, as she holds the most expertise in the actual accounting for financial instruments at the Treasury, she was chosen to be interviewed individually in the theme-centered interview about the background of accounting for financial instruments. In turn, Ala-Seppälä has been the Treasurer of Kesko for more than fifteen years. Hence, among various skills he possesses an extraordinarily in-depth view of the financial markets. Whereas, Soikkeli is responsible for operating the Front Office of Kesko and for the daily market operations, such as liquidity management, the company conducts. The focus group interview was held together with all the aforesaid interviewees, since the definition of the business model was considered to require each one of them. Besides, all the interviewees were expected to have a central voice in defining the business model.

Finally, the illustrated figures of Kesko comprise of data that already has been made public, thus the newest available figures of the related matters are not displayed. Additionally, the treasury policy complied by the Treasury is not entirely disclosed due to its confidential nature.

1.5 Thesis structure

The remainder of the thesis is structured as follows. The second chapter views aspects that relate closely to the modern field of accounting for financial instruments. The chapter begins with introducing the definition of financial instrument. This extends to examining derivatives' significant role in the field of financial instruments and the debatable practice of fair value accounting of financial instruments. Subsequently, characteristics subject to the background of IFRS 9 – joint project of IASB and FASB on financial instruments, criticized IAS 39, and a general introduction of the differences between IAS 39 and IFRS 9 – are examined. What is notable, from the subchapter 2.2.2 onward, quotations from the IFRS expert interviews are incorporated within the actual theoretical text. Further, the last part of the chapter two scrutinizes issues that relate to the transition of IFRS 9.

In the third chapter the study proceeds to focus solely on IFRS 9. The standard is presented in compliance with the IASB's three phased project to replace IAS 39. Thus, the fields covered are the classification and measurement, the impairment, and the

hedge accounting requirements of IFRS 9. In this framework, the classification and measurement requirements, notably the business model for managing financial assets, are emphasized due to the nature of the study. Firstly, the chapter presents the concept of business model, the business model and the contractual cash flow assessments, as well as different business model that all relate to defining the company's business model. Secondly, the chapter examines the most notable changes in the impairment and hedge accounting requirements and summarizes the major accounting changes and anticipated effects of IFRS 9.

Chapter four brings forth a case study on the Kesko Group. First, the more general issues of the standard change, such as the interest of Kesko in IFRS 9, the major expectable effects of the standard change and the preparation for the standard transition are discussed. This will be done by exploiting the material gathered from the individual theme-centered interview. Second, the business model for managing financial assets is in the center of attention. Hence, among other things, matters that relate to the business model and the contractual cash flow assessments are presented, through utilizing the material from the focus group interview. Further, the business model for managing financial assets that Kesko will apply and the forthcoming actions are presented in this context. Eventually, the fifth and the last chapter of the thesis summarizes and concludes the study.

2 ACCOUNTING FOR FINANCIAL INSTRUMENTS

2.1 Financial instruments

2.1.1 *Definition of financial instrument*

In respect of defining what financial instruments are it is rather rational to view the International Accounting Standard 32 *Financial Instruments: Presentation* (IAS 32). The aim of the standard is to create principles for presenting financial instruments in financial statements. Particularly, IAS 32 defines the classification of financial instruments into financial assets, financial liabilities and equity instruments. (IAS 32:2; Iasplus.com/IAS 32, Deloitte.) The principles of the standard supplement the principles for recognizing and measuring financial instruments in IFRS 9. IAS 32 was originally issued in 1995 by the International Accounting Standards Committee (IASC), thus the IASB has inherited the standard. IAS 32 has been amended several times, and it was lastly reissued in December 2003 to apply annual periods beginning on or after January 2005. The revised version of IAS 32 was developed as a part of IASB's plan to enhance it and IAS 39. (IAS 32:IN2, IAS 32:3.)

Ma & Lambert (1998) found the original IAS 32 noteworthy. For one, it was the outcome of a co-operative project over many years between IASC and the Accounting Standards Board of the Canadian Institute of Chartered Accountants. For the second, IAS 32 was timely in the lack of requirements for complex financial instruments. Further, it was presumed that the standard would have been a model for developing countries, and what is more for regions with a long history of standard setting. This related to the fact that, at the time, Australian standard-setters issued a standard, closely modelled on IAS 32. (Ma & Lambert 1998, 145.) Landsman (2007) further states that IAS 32 is one of the key standards related to fair value accounting that the IASC, the forerunner of IASB created (Landsman 2007, 21).

The present requirements of IAS 32 define that a financial instrument is any contract that causes a financial asset to one entity and a financial liability or equity instrument to another entity. (IAS 32:11) As mentioned, financial instruments are classified by the standard into: financial assets, financial liabilities and equity instruments. Below table displays the characteristics and different types of financial assets and financial liabilities following the requirements of IAS 32.

Table 2 Definitions of financial assets and financial liabilities (IAS 32:11)

IAS 32	
Financial assets:	Financial liabilities:
<ul style="list-style-type: none"> • Cash • Equity instruments of another entity • Contractual rights: <ul style="list-style-type: none"> ○ to receive cash or another financial asset from another entity ○ to exchange financial assets or liabilities with another entity under conditions that are potentially favorable to the entity • Contracts that will or may be settled in the entity's own equity instruments and are: <ul style="list-style-type: none"> ○ non-derivative for which the entity is or may be obliged to receive the entity's own equity instruments ○ derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments 	<ul style="list-style-type: none"> • Contractual obligations: <ul style="list-style-type: none"> ○ to deliver cash or another financial asset to another entity ○ to exchange financial assets or liabilities with another entity under conditions that are potentially unfavorable to the entity • Contracts that will or may be settled in the entity's own equity instruments and are: <ul style="list-style-type: none"> ○ non-derivative for which the entity is or may be obliged to deliver the entity's own equity instruments ○ derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments

Examining the definitions in the table, contractual rights to receive cash and correspondingly contractual obligations to deliver cash are for example: trade accounts receivable and payable, notes receivable and payable, loans receivable and payable, and bonds receivable and payable. As financial instruments are defined, the aforesaid will cause a financial asset to one entity and a financial liability to another entity. In addition, financial instruments can be such that the economic benefit obtained or provided is a financial asset other than cash. For instance, a note payable in government bonds allows the holder the contractual obligation to deliver government bonds instead of cash. In this case, the bonds are financial assets as they present obligations of the issuing government to pay cash. Thus, the note is a financial asset for the holder and financial liability to the issuer. (IAS 32:AG4; IAS 32:AG5.)

IAS 32 also introduces a definition of a puttable instrument, which is a financial instrument that allows the holder the right to put the instrument back to the issuer. This may be settled in cash or for another financial asset. It is also possible that the instrument is automatically put back to the issuer in the case of an uncertain future event. Therefore, puttable instrument involves a contractual obligation for the issuer to repurchase or redeem the instrument on exercise of the put, and is a financial liability, except for those instruments that are classified as equity instruments. (IAS 32:16A; IAS 32:18.) Without further introducing the definition of equity instruments in IAS 32, the equity instruments are the third category of financial instruments defined by the standard. They are stated to be any contracts that indicate residual interest in the assets of an entity after deducting all of its liabilities. Therefore, equity instruments cover for

example non-puttable ordinary shares and specified puttable instruments. (IAS 32:11; IAS 32:AG13; Iasplus.com/IAS 32, Deloitte.)

Financial instruments comprise of so-called *primary instruments* that are, for example, the aforesaid receivables, payables and equity instruments. Furthermore, financial instruments include *derivative financial instruments* such as financial options, futures and forwards, interest rate swaps and currency swaps. IAS 32 defines that a derivative financial instrument generates a right and an obligation that has the effect of transferring between the parties to the instrument financial risk that is built-in the underlying primary financial instrument. Thus, on inception of a contract derivative financial instruments or merely derivatives provide one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are possibly favorable. At the same time, derivatives may give a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are possibly unfavorable. Certain derivatives hold both a right and an obligation to make an exchange. Since, the terms of the exchange are defined on the inception of the instrument and prices in financial markets vary, those terms may develop either favorable or unfavorable. Derivatives usually do not effect in a transfer of the underlying primary financial instrument on the inception of the contract, neither the transfer is inevitably made on the maturity of the contract. Moreover, some types of derivatives include a right or an obligation to make a future exchange, these cover for instance interest rate and currency swaps. (IAS 32:AG15; IAS 32 AG16; IAS 32:AG19.)

Altogether, IAS 32 is one of the IASB's three standards that in main address the accounting for financial instruments. Currently, the other two are International Financial Reporting Standard 7 *Financial Instruments: Disclosure*, which deals with disclosing requirements of financial instruments, and IAS 39, which includes the requirements for recognition and measurement of financial instruments. (PwC 2014e, 11.)

2.1.2 Derivatives in the field of financial instruments

The field and application of financial instruments is vast, involving numerous different types of instruments, of which some are highly complex. Especially, the use of derivatives plays a central role in this context. As a financial instrument, a derivative derives its value from the value of other, usually more fundamental, underlying variable. The underlying variable is commonly a financial asset or a rate. (Bezzina & Grima 2012, 414.) Thus, for example the value of options and swaps can be derived from fundamental assets such as stocks, commodities or bonds. This is a one attribute that makes the derivatives extremely complex. (Sandretto 1993, 55.)

Excluding *speculation*, the use of derivatives relates closely to hedging and risk management of companies. *Hedging* is the process of offsetting exposures to different business risks that involves financial and operational hedging. Hedging of financial risks i.e. financial hedging indicates a practice in which companies attempt to reduce the exposure to financial risks by setting up offsetting positions, commonly with the aid of derivatives. Therefore, financial risks can be administered by derivatives, in fact several studies have further endorsed that the hedging of financial risks can increase company value. (Glaum & Klöcker 2011, 462.)

The most significant financial risks confronted by companies are foreign exchange, interest rate and commodity price risks. Since, countless companies face these risks in today's global markets, financial hedging as a part of the financial risk management has become a very general practice. According to Glaum & Klöcker (2011) studies have pointed out that in many companies financial risk management is centralized at company headquarters. The centralized risk management allows to balance out positions that have different terms, and to estimate the net positions affecting all parts of the business group for currencies, interest rates or commodities. Hence, alone the net positions have to be hedged through the derivatives markets and a company should benefit from the lower transaction costs. (Bezzima & Grima 2012, 412; Glaum & Klöcker 2011, 462.) Altogether, numerous companies utilize derivatives as hedging instruments regularly nowadays.

During the last decades, the markets for many financial instruments, including derivatives, have developed significantly larger and considerably more liquid. In fact, many of these markets did not even exist 30 years ago. (Ball 2006, 13.) The financial markets have experienced an expansion of innovation that still continues today. The derivatives markets were relatively small until the 1970s, as developments in pricing of the instruments and economic conditions resulted in unprecedented growth. In the beginning of the growth period, the volatility of exchange rates and interest rates grew abruptly. This made it coercive to find more efficient means than using derivatives to hedge the relative risks. Alongside, the expansion of global trade and capital flows, as well as deregulation, enlarged the demand for financial instruments applied with risk management. (Bezzina & Grima 2012, 415.)

However, during the last few decades, the use of derivatives has tended to attract attention only when the practice has led to significant financial losses. Even though, it has been argued that the most of the disastrous losses have been due to the misuse of the instruments. For instance, Finavia that is a public limited company wholly owned by the Finnish State gained media attention on the subject in 2015. The company admitted that its risk management and reporting had deficiencies, which ultimately resulted to derivative losses estimated value of €34 million. (Finavia.fi/about; Ahtela 2015.) To be noted, on a global scale this loss is still minimal, merely notable in the Finnish financial

markets. Discussing about the worst derivatives-related losses of all-time, the numbers are calculated in billions. Therefore, the growth of the derivatives markets has also had its price. Additionally, complexity of the new financial instruments has raised concerns regarding the possibility for new financial risks to drift into the global financial markets. New risks might be remarkably complex to understand or observe, partly due to a specified lack of transparency in the markets. Consequently, although derivatives have been used to hedge risks that were unwantedly left open and in a ways that were unthinkable before, there are many that have become skeptical about the benefits of the instruments. (Bezzina & Grima 2012, 415–416; Csiszar 2007, 321.)

Regardless of the concerns, the trade of derivatives both on markets and outside the markets has ballooned. To illustrate this, the notional value of *over-the-counter* derivatives contracts outstanding at the end of 2014 was \$630 trillion. This was eight times larger than the global output i.e. global gross domestic product, and six and a half times greater than the outstanding amount of debt securities. (BIS 2015, 219.) On top of, the widespread of derivatives and related new hedging techniques has objectively and considerably extended the toolbox available for the risk management of companies. At the same time, the expansion has presented a challenge for the financial regulation of ever more complex financial instruments. In this framework, the IASB has strived to keep up the pace with developing standards for financial instruments. (Ball 2006, 13.)

2.1.3 Fair value accounting of financial instruments

Fair value accounting or *fair value reporting* signifies a practice in which different items of financial statements are measured applying fair values in financial statements. It has been recognized that a significant feature of IFRS is the extent to which it has been inspired with applying fair values. (Ball, 2006, 12.) Already for years, the IASB and likewise the U.S. national standard-setter, the Financial Accounting Standards Board (FASB) have mandated disclosure or recognition applying fair values for several standards. Similarly, fair value is most frequently applied for financial instruments both under IFRS and U.S. Generally Accepted Accounting Principles (U.S. GAAP). Specifically, it has been argued that among the most noteworthy fair value applying standards are the financial instrument standards. (Palea 2014, 102–103.) Hence, the both standard-setters, the IASB and the FASB, have settled that fair value is the most relevant measurement attribute to be applied with financial instruments (Barth 2006, 98).

Numerous academics have viewed that fair value accounting offers the most relevant information to the users of financial statements. The requirements of fair value accounting drive to integrate more timely information about the economic results on

securities, derivatives and other transactions into the financial statements. Altogether, the use of fair values is expected to have significant benefits. For instance, ensuring enhanced degree of transparency of financial statements, which in turn ought to result to a better value-relevance of accounting information and to an enhanced ability of financial markets to reflect the values of companies. Thus, fair value reporting should increase the amount of relevant information brought to the markets, leading to an increased efficiency of resource allocation and capital formation. (Paea 2014, 12.)

Nevertheless, the benefits arising from the use of fair values and the foundation of the practice are not so unambiguous. Since, along all the rather ideological praises it has also been found that the fair value accounting encompasses noteworthy shortcomings. The IASB's and the FASB's tendency towards the fair value reporting has indeed ignited debate in recent years. The debate has mostly had the following two opposing views. (Paananen et al. 2012, 211.) The devotees of fair value accounting, as partly introduced above, have viewed that the disclosing of fair values reflects the actual and relevant value of the balance sheet of a company and for example allows the users of financial statements to better access the risk profile and the actual value of a company. However, the opponents of fair value reporting argue that it leads to excessive and artificial volatility of financial statements, presenting artificial risks that decrease the value-relevance of the information produced. Accordingly, the value of a company's balance sheet might be driven by short term market fluctuations that do not reflect the values of a company's long term assets and liabilities as well as the value of fundamentals. This viewpoint has especially been expressed by companies in financial industry. (Bentley 2013, 63; Paananen et al. 2012, 211.) Altogether, the evidence of prior studies has suggested that fair value accounting is informative to the users of financial statements, but that the value-relevance of the related information is contingent by the amount of the measurement error and the basis of the estimates (Paananen et al. 2012, 215.)

The debate on the fair value accounting, specifically respect to financial instruments, was on the spotlight after the financial crisis of 2008. Many interested parties believed that the use of fair values for financial instruments had aggravated the crisis. Regulatory debate regarded that the fair value reporting could have had aggregate consequences for the financial system as a whole. Several academics described the dynamics by which fair value reporting could have spread contagion effects and escalated balance sheet changes. These would have, in turn, drove specific pricing patterns in financial assets that would have intensified financial cycles and contributed to the procyclicality. Finally, as the financial crisis unfolded, major pressure was steered towards the IASB and the FASB to relieve some of the supposed negative balance sheets effects that derived from the fair value reporting. As it turned out, both the standard-setters responded to the critic by providing more flexibility in the classification of financial

instruments, most specifically the reliefs considered the requirements of IAS 39. What is more, flexibility was allowed in valuation methodology and in the division of fair value changes between income statement and own equity. (Bushman 2010, 264–265.)

More specifically, the problems related to that the fair value reporting during the financial crisis stemmed from an apparent crash in the trading of financial instruments. This caused companies in the financial industry to suffer permanent losses in the value of their financial assets, and the companies were required to make historically large write-downs. Hence, this was the initial baseline that convinced the standard setters to evaluate their fair value accounting requirements. Irrespective of whether the accounting practice was the origin of the followed liquidity crisis, the standard setters faced strong political pressure to alleviate the systemic effects of the generated procyclicality. (Bushman 2010, 269.)

The fair value issues of the financial crisis draw notably IAS 39 into center of attention. The standard had specific requirements that had been questioned already from its initial introduction. Concerns were linked particularly to the use of fair values as a measurement attribute. Since, IAS 39 determined that various financial instruments, above all derivatives, are to be recognized at fair value with fair value changes recognized in profit or loss. Further, the standard included a fair value option permitting companies to designate irrevocably financial instruments on initial recognition to be measured at fair value with fair value changes recognized in profit or loss. Many European companies had found that the fair value requirements of IAS 39 differed significantly from the rules in their domestic standards. In the matter of fact, several European domestic standards did not initially even contain standards determining the financial reporting of various financial instruments. Thus, IAS 39 had presented significant changes of financial reporting for several companies that were particularly questioned after the crisis. (Armstrong et al. 2010, 35.)

Eventually, the post-crisis pressure prompted to that the EU required the IASB to amend IAS 39. The EU demanded that the standard should permit companies to reclassify financial instruments out of the fair value category and from the available for sale category to the loans and receivables category. Consequently, numerous financial instruments that were initially recognized at fair value were allowed to be reclassified as held to maturity. Furthermore, the IASB was pressured to permit the reclassifications retroactively back to June 2008, before which the prices on loans and debt instruments had plummeted. In hindsight, this may be viewed as a stain in the success of fair value accounting. (Bushman 2010, 269.) At least, the financial crisis brought about a critical assessment of the fair value accounting's part in demoralizing the stability of financial markets. (Magnan et al. 2014, 560.)

2.2 Development of accounting for financial instruments

2.2.1 Joint project of IASB and FASB on financial instruments

The reform of accounting for financial instruments was one of the issues recognized already in the Norwalk Agreement of 2002. The agreement between the IASB and the FASB was set for convergence of IFRS and U.S. GAAP. (Fasb.org/Convergence; IASB 2014a, 4.) In 2005 the IASB and the FASB started actually to deal with the longstanding aim of enhancing the accounting for financial instruments, since many users of financial statements had expressed the requirements in IAS 39 and under its U.S. GAAP counterpart, SFAS 133, as overly complex. The joint effort produced the publication of the Discussion Paper, *Reducing Complexity in Reporting Financial Instruments*, in March 2008. The Discussion Paper centered on the measurement of financial instruments and hedge accounting. The paper recognized many possible approaches for enhancing and simplifying the existing requirements. The publication also received responses that illustrated reinforcement for a substantial change in the existing rules. (IFRS9:IN3.) The ultimate objective of the both standard-setters, in this project, was the convergence and the improvement of accounting for financial instruments (IASB 2008, 8). What is more, in the aftermath of the financial crisis, the Group of Twenty (G20) pursued the standard setters to work for a single set of high-quality global standards for financial instruments (PwC 2014b, 1).

Therefore, the IASB has worked closely with the FASB during the development of accounting for financial instruments and IFRS 9. At the beginning of the joint project, the standard-setters worked on both the classification and measurement and the impairment aspects of financial instruments. Nevertheless, partly due to lack of backing in the three-stage approach for the recognition of impairment losses in the U.S., the involved parties diverged in their solutions. The IASB continued with the three-stage model, whereas the FASB developed a single measurement model. Moreover, the FASB concluded it would not carry on with a classification and measurement model similar to the IASB. (PwC, 2014b, 2.) The standard-setters also selected different approaches regarding the introduction of the new requirements. The IASB determined to split its project to replace IAS 39 into three parts to handle separately with classification and measurement; impairment and hedge accounting. Whereas, the FASB concluded handle all the three aspects within a single project. (Larson et al. 2011, 101.)

Against this backdrop, the IASB states that during the process of the reform of financial instruments every effort was tried to achieve a converged solution. However, ultimately these efforts have been unsuccessful and IFRS 9 is not a converged standard. (IASB 2014a, 4.) Moreover, the EFRAG made a statement about the convergence in its

Endorsement Advice (ED) on IFRS 9. It was viewed that IAS 39 was significantly converged with U.S. GAAP, but the following changes to U.S. GAAP and the publication of IFRS 9 changed the state of affairs. For instance, since it is not allowed to present fair value changes in other comprehensive income under U.S. GAAP, as in IFRS 9, it is assessed that the lack of convergence, in this case, results to that companies reporting under U.S. GAAP will possibly have considerably higher variations in reported profit or loss. Further, the EFRAG concluded that in relation to the convergence with U.S. GAAP, which was not achieved, IFRS 9 would result to higher quality financial reporting than the equivalent U.S. GAAP standards. (EFRAG 2015, 59, 70.)

2.2.2 The complex IAS 39 and grounds for the reform

The IASC had originally issued IAS 39 *Financial Instruments: Recognition and Measurement* in December 1998. Thus, the IASB inherited the standard, which was set to prescribe the accounting for financial instruments. More specifically, IAS 39 outlined the requirements for the recognition and measurement of financial instruments. (Haswell 2006, 54.) Unfortunately, from its genesis the standard was faced with sharp criticism. Since, accountants, auditors, academics and other users of financial statements find and proclaimed the requirements of IAS 39 as excessively complex, restrictive and oppressive. (Glaum & Klöcker 2011, 459–460; IASB 2014a, 4.)

Well first of all, it (IAS 39) is a standard for all companies but it has to a large extent been created around the financial industry. These companies have large amounts of financial instruments, thus the scale here is something totally different. However, a large amount of the IAS 39 adopters are merely basic companies, with these the use of financial instruments serves some other core function. Thus, these same requirements for all the different actors were a big challenge.

(Alaharju, interview 17.2.2016)

IAS 39 was almost entirely based on U.S. GAAP and implied to merely be an interim solution (Zeff 2012, 818). Over time controversies and problems with the standard induced numerous amendments and reissues to it. These occurred for example in March and October 2000, December 2003, March and December 2004 and June 2005. (Armstrong et al. 2010 34–35; Haswell 2006, 54.) Altogether, it has been generally accepted that IAS 39 is by far the most complex international accounting standard ever published (Haswell 2006, 54). The former chairman of the IASB, Sir David Tweedie has also expressed his thoughts on the standard: “Just look at IAS 39, which we inherited from our predecessor organization. If you think you understand the standard, you have not read it properly” (IASB 2007, 4).

The table below represents some of the major complications embodied by IAS 39. First of all, as the IFRS expert Alaharju stated the standard was originally created around companies in the financial industry. Despite the fact that all IFRS reporting companies are obliged to comply with it. This relates to the oppressiveness of the standard, especially subject to non-financial companies that do not possess such a sophisticated knowledge on the accounting of financial instruments. Other key complications introduced in the table are discussed further in the text below the table.

Table 3 Significant complications with IAS 39

<ul style="list-style-type: none"> • Created around the financial industry, yet applies to all IFRS reporting companies. • Many alternatives in classification that might have resulted to different accounting results. • Several different impairment models. • Allowed for changes in own credit risk to be included with adjustments of fair values of liabilities in net income. ('the own credit issue') • Inability to reclassify from fair value based measures into the cost based measures during the financial crisis. • Incurred-loss method of loan provisioning that might have delayed loan loss recognition. • Rule-based requirements for hedge accounting, which were found as excessively complex, limiting and overly demanding.
<p>➔ <i>Complex standard, which has been difficult to apply in practice.</i></p>

As the table sheds light on the issues of IAS 39, among other things the standard has been stated to involve many different classification categories and related impairment models. The IASB states that many problems with the compliance of IAS 39 associated to the classification and measurement of financial assets. Grounded on the received feedback, the standard-setter concluded that the most adequate way to try to solve them was to replace the existing classification and measurement categories. In this way, the capability of the users of financial statements to understand the information about the amounts, timing and uncertainty of future cash flows could be improved. It has also been noted that the classification and measurement requirements are the foundation of any accounting standard. Thus, the new requirements would form the basis for the subsequent reforms in impairment methodology and hedge accounting. (IASB 2014a, 6; IASB 2009, 3.)

It (main reason for the reform of classification requirements) was probably that there were so many alternatives, as there were four categories for the classification of financial assets. Further, it was possible to quite loosely, well not totally loosely, but quite loosely to change the class within these four categories, which resulted to that the accounting result was totally different. (Sundvik, interview 9.12.2015)

Rules for the sake of rules (classification under IAS 39), and it has really not been thought that why or for what reason that specific instrument or that transaction is there overall. (Alaharju, interview 17.2.2015)

What is more, the original IAS 39 allowed that changes in a company's own credit risk might have been included with adjustments of fair values of the company's liabilities in the company's net income. This resulted in volatility of a company's profit or loss that was produced by the changes in the credit risk of financial liabilities that a company had selected to measure at fair value. To underline, the fair value of a company's liabilities i.e. own debt is influenced by the changes in the company's own credit risk. In practical terms this means rather illogically that when a company's credit risk raises the value of its liabilities declines but if those liabilities are measured at fair value a gain is recognized in profit or loss and contrariwise. Various investors and other parties found this outcome illogical and puzzling. Additionally, research has endorsed that a company's net income contained with these gains and losses from adjustments of fair values can confuse users of financial statements. Therefore, this was also one of the reasons why the IASB developed IFRS 9, which presents new requirements for accounting of changes in the fair value of company's own credit risk when specific liabilities have been preferred to be measured at fair value. (IASB 2014a, 12; Lachmann et al. 2015, 21.)

And this is an exception, this rule can be deployed separately and earlier than the actual IFRS 9, though it also requires approval from the EU for EU listed companies. It is for the reason that the practice is acknowledged to be distinctly as bit of a bizarre. Hence, if the credit rating decreases you won't make profit, which was probably not so logical. (Sundvik 9.12.2015)

Additionally, in the middle of the financial crisis of 2008, pressure increased for a quick fix of certain immediate issues of IAS 39. The key issue was perhaps that companies were not able to reclassify out of the fair value based measures into the cost based measures in a situation where markets to sell instruments were vanishing. This drove companies to hold on to instruments while their fair values were collapsing. The pressure on the IASB led to the IAS 39 Reclassification Amendment that many banks eventually exploited. The amendment was seen as a needed fix of a defective standard. Additionally, as some of the allowed reclassifications were only accessible in so-called rare circumstances, and the G20 had set a deadline for new replacement standard to be available from the end of the following year, the amendment was seen as a temporary solution. (Deloitte 2011, 2.)

After the financial crisis became the first quick fix, when it became clear that it is not necessarily possible to find fair values for all instruments and no one consented to trade between each other, thus there was suddenly a weird situation. Consequently, became this quick amendment, where the reclassification was

possible, and it was possible to reclassify from held for trading category to available for sale or to loans and receivables. Therefore, this quick fix was also in a way connected to the shortcoming of IAS 39. (Sundvik, interview 9.12.2015)

After the global financial crisis, IAS 39 attracted negative attention once again. The *incurred-loss method* of loan provisioning under the standard was one of the emphasized concerns. In specific, the timeliness of banks' recognition of loan loss expense under the related impairment rules was questioned. It has been assumed that the incurred-loss method of IAS 39 might have delayed the accounting recognition of loan losses until the arrival of the financial crisis. Moreover, assuming that the method delayed accounting recognition of anticipated loan losses, it has been alleged that it also contributed to the procyclicality during the crisis, since the method triggered a concentration of loss recognition in a downturn period. Looking back to the crisis, many stakeholders have often referred to the situation with inadequate timely recognition of credit losses and delays in loss recognition. These concerns motivated the IASB and the FASB to seek for replacing the incurred-loss method of IAS 39 with a more forward-looking expected-loss method approach that would allow for earlier recognition of losses. (European Parliament 2015b, 9; O'Hanlon 2013, 225.) The IASB has also stated that after the financial crisis it proved out that the incurred-loss method allowed for earnings management, specifically by postponing losses. In addition, the complexity of IAS 39 subject to the use of multiple impairment models was recognized as a distress by many stakeholders. (IASB 2014a, 14)

IAS 39 has precisely denied that you are not allowed to instantly book any sort of expected loss or credit loss provision, rather you have to wait for something to happen to the credit so that the credit risk increases. Thus, the critic has in a way related to that according to the current model credit losses are booked too late and maybe as too small. (Sundvik, interview 9.12.2015)

Another focus of attention on the criticized IAS 39 has been the requirements the standard posits for hedge accounting. *Hedge accounting* is a set of specific requirements defined to secure that gains and losses on hedged items and hedging instruments of a company will be recognized in the same accounting period. Thus, the idea of hedge accounting is to hinder economically unjustified earnings volatility. However, managers could abuse hedge accounting with its exemptions from general recognition and measurement principles for earnings management purposes. Hence, in order to prevent this IAS 39 outlines requirements under which companies may apply hedge accounting. Unsuccessfully, the users of financial statements have found the requirements as excessively complex, limiting and overly demanding. (Glaum & Glöcker 2011, 460, 484.) Moreover, the requirements of hedge accounting in IAS 39 have been generally considered as rule-based, complex to implement and inconsistent with risk management practices (EFRAG 2015, 16).

Perhaps the appliance of hedge accounting was a problem with IAS 39. Since, IFRS is generally principle-based, where we have the principles. Compared to U.S. GAAP, which is more rule based, where you have these exact rules. Thus, in principle IFRS should be principle-based. Yet, virtually the only standard that has had rules is the IAS 39. Concerning the precise rules for the application of hedge accounting and the precise numerical requirements set for the effectiveness of hedge accounting. Moreover, this has technically been the only place in the whole IFRS where has been these rules. (Sundvik, interview 9.12.2015)

In this setting IAS 39 might have presented a puzzle for companies. Obeying the standard's complex hedge accounting requirements, a company could either carry out the risk management it recognizes as economically optimal by using hedging instruments, abandoning hedge accounting and agreeing to earnings volatility. The other option would be to implement hedge accounting in order to reduce earnings volatility. In this case sub-optimal risk management practices should be accepted, since the practices should be altered to be in line with the hedge accounting rules of IAS 39. Anyhow, in both circumstances the company's value would likely to suffer. Research has indeed suggested that the hedge accounting requirements of IAS 39 have affected companies' hedging practices, likewise some companies have even reported that the requirements have entirely controlled their practices. (Glaum & Glöcker 2011, 460, 484.)

According to the current rules of IAS 39, the application of hedge accounting has perhaps not been rational in practice but maybe too onerous to indicate the hedge relation, whereupon the derivatives have been booked fair value through profit or loss. Consequently, there has become accounting mismatch, concerning to what have been hedged and what is the result. (Sundvik, interview 9.12.2015)

It (hedge accounting under IAS 39) is really oppressive, onerous and requires a lot of documentation. Often unreasonably oppressive compared to the benefits. (Alaharju, interview 17.2.2016)

To summarize, a large group of different stakeholders have agreed that IAS 39 did not live up to its expectations, though it probably presented entirely unexpected difficulties that the most had never been capable to expect. The amount of criticism the standard has faced has nevertheless been so widespread that it is arguably no coincidence. In consequence, replacing IAS 39 with an entirely new standard seems to be least bad solution. The financial crisis played its own part in aggravating the deficiencies of IAS 39, as the standard's principles were again on the spotlight and subject to criticism. (Schwarz et al. 2015, 19.)

The main reason (for the reform) has probably been that the former standard (IAS 39) was so difficult to apply in practice. There were these instances that it did not eventually serve its objective. Hence, there is the need for the reform, for it to be

closer to the concreteness, the practice that is made. In a way, it is a learning process, what have been learned is now being reformed and fixed.

(Alaharju, interview 17.2.2016)

Certain reliefs have been learned, as one's head has been beat against brick wall with the IAS 39. Such as, how the practical life does not work how it is planned in theory. (Alaharju, interview 17.2.2016)

2.2.3 General introduction of differences between IAS 39 and IFRS 9

Before entering to explicitly scrutinize the content of IFRS 9, the major differences between the standard and its forerunner IAS 39 are introduced. The standards are compared through viewing the most significant changes the accounting for financial instruments will undergo. Accordingly, next is presented two tables, which strive to summarize the most relevant aspects that reflect the differences between IAS 39 and IFRS 9. Examination of the differences will proceed from the general to the more detailed aspects. Thus, first is investigated the changes brought by the guidance of IFRS 9 compared to IAS 39 at a general level. The table below highlights the areas where accounting for financial instruments will significantly change.

Table 4 Major changes of IFRS 9 compared to IAS 39 (Deloitte 2014, 6)

<i>Scope</i>
Only minor amendments
<i>Recognition and derecognition</i>
Only minor amendments
<i>Classification and measurement of financial assets</i>
Entirely new approach regarding the classification and measurement based on: <ul style="list-style-type: none"> • The business model of a company • The contractual cash flow characteristics of a financial asset
<i>Classification and measurement of financial liabilities</i>
<ul style="list-style-type: none"> • No amendments regarding classification • New requirements for the accounting of changes in the fair value of a company's own debt where the fair value option has been applied ('own credit issue')
<i>Impairment</i>
Entirely new 'expected loss model' approach
<i>Hedge accounting</i>
Entirely new general hedge accounting model

As the table suggests, IFRS 9 does not practically introduce any changes to the scope of financial instruments. At least, the changes in this context and in the recognition and derecognition requirements are certainly less noteworthy compared to the subsequent aspects. Since, the new standard carries forward the scope of IAS 39 and only introduces an option to include specific contracts that would otherwise be subject to so called 'own use exemption'. Now, specific loan commitments and contract assets in

respect of the impairment requirements are also included to the scope. Whereas, the requirements for recognition and derecognition of financial instruments are sustained from IAS 39 with only minor amendments. (KPMG 2014b, 4.)

The most relevant changes introduced by IFRS 9 associate with classification and measurement, impairment and hedge accounting requirements of financial instruments. The classification and measurement requirements determine how financial instruments are categorized, determining different classes that have implications for the reporting of a company's profits and losses. (Becker 2014, 15.) IFRS 9 introduces entirely new approach for the classification and measurement of financial assets. Most of the requirements, related to the classification and measurement of financial liabilities are sustained unchanged from IAS 39. However, IFRS 9 presents new requirements for the accounting of changes in the fair value of a company's own debt where the fair value option has been exercised. Thus, the standard answers to the criticism of the so called 'own credit issue'.

IFRS 9 also reforms the impairment requirements by presenting completely new 'expected loss model' approach for the impairment of financial instruments, replacing the 'incurred loss model' of IAS 39. Further, the standard introduces wholly new general hedge accounting requirements that reshape the hedge accounting of companies. At the same time, IASB continues with its separate project on accounting for macro hedging. (KPMG 2014b, 4–5.) In the main interest of this study IFRS 9 significantly reconstructs the requirements of classification and measurement of financial assets. The standard presents a thoroughly new approach subject to the requirements. To be more specific, the table below illustrates the most relevant changes carried by IFRS 9 in comparison with IAS 39.

Table 5 Classification and measurement of financial assets, IAS 39 versus IFRS 9

Classification and measurement of financial assets	
IAS 39	IFRS 9
<p>Four categories and the related measurement:</p> <ol style="list-style-type: none"> 1. Fair value through profit or loss (FVTPL) → Fair value 2. Available-for-sale (AFS) → FVOCI 3. Held-to-maturity (HTM) → AC 4. Loans and receivables (LAR) → AC <p>→ Based on the character of an asset and rules of IAS 39</p>	<p>Three categories:</p> <ol style="list-style-type: none"> 1. Amortized cost (AC) 2. Fair value through other comprehensive income (FVOCI) 3. Fair value through profit or loss (FVTPL) <p>→ Based on the business model and nature of the cash flows</p>
<ul style="list-style-type: none"> • Own credit gains and losses recognized in P&L for fair value option liabilities • Complicated reclassification rules • Multiple impairment models 	<ul style="list-style-type: none"> • Own credit gains and losses presented in OCI for fair value option liabilities • Business model-driven reclassification • One impairment model

The table shows that the IASB decided to replace most of the existing classification and measurement categories of IAS 39. Thus, the categories of available-for-sale (AFS),

held-to-maturity (HTM) and loans and receivables (LAR) were replaced, and now IFRS 9 contains only three categories. Of the reformed categories, the late AFS category has been regarded as the most disputed. The category might have covered financial instruments that a company intended to hold for a period of time but could have sold under specific, limited conditions designated by IAS 39. This meant that changes in the values of the AFS instruments should have been recognized instantly unlike with, for instance, bonds that would have been held to maturity. Yet, the fair value changes of AFS instruments did not need to affect the profit or loss of a company. For example, a company might have held specific instruments but could have desired to sell them when their yield turned to any gains in value. Thus, the instruments would have been marked-to-market i.e. accounted for their fair value but their fair value changes would have gone through the equity section on the balance sheet. This equity section is called the other comprehensive income (OCI), in which, the fair value changes of instruments do not cause earnings volatility. Hence, the AFS category has also been regarded as FVOCI kind of category. (Becker 2014, 15.)

What is more, according to IAS 39 the classification was based on the character of an asset and rules of the standard. With the new approach the classification is based on the business model of a company and nature of the cash flows of a financial asset. The reclassification rules of financial assets were regarded complicated under IAS 39, whereas IFRS 9 designates that the reclassification is business model driven. That is, the financial assets are reclassified between different categories only when a company's business model for managing the assets changes. Lastly, the requirements for classification and measurement are stated to be the grounds of the accounting for financial instruments, and the requirements for impairment and hedge accounting are founded on this classification. Hence, as IAS 39 contained more classification categories than IFRS 9, it also involved more associated impairment models. Now, IFRS 9 presents solely a one impairment model that is based on the new classification and measurement requirements. (IASB 2014a, 6–9.)

You would of course hope that it (IFRS 9) would to a larger extent move the trend towards that financial instruments and the meaning of them to that specific actor or to that specific reporting company, which tells this information, would come more transparent. What risks we have, what instruments we have used and why specifically we have these instruments and how those will affect and to what? Since, it is still a bit like that companies copy that information from each other. Thus, that it would become more like firm specific information, telling about the specific risk that the specific company faces, hence providing an enhanced picture. (Alaharju, interview 17.2.2016)

2.3 Forthcoming transition to IFRS 9

2.3.1 Timeline of IFRS 9

The IASB's project for replacing IAS 39 and publishing IFRS 9 has without a doubt been highly diverse, and involved many modifications to the original project plan. For instance, the mandatory effective date of IFRS 9 has been modified on three occasions after the initial plan. (Iasplus.com/Effective date of IFRS 9, Deloitte.) During the course of creating IFRS 9, the IASB consulted extensively with different stakeholders. The standard setting body received over thousand comment letters, published six Exposure Drafts (ED), one Supplementary Document and a Discussion Paper. Furthermore, IASB implemented a widespread program that involved hundreds of meetings with different users of financial statements. (IASB 2014a, 4.) The main events of creating the IFRS 9 and thus the timeline of IFRS 9 are presented in the figure below.

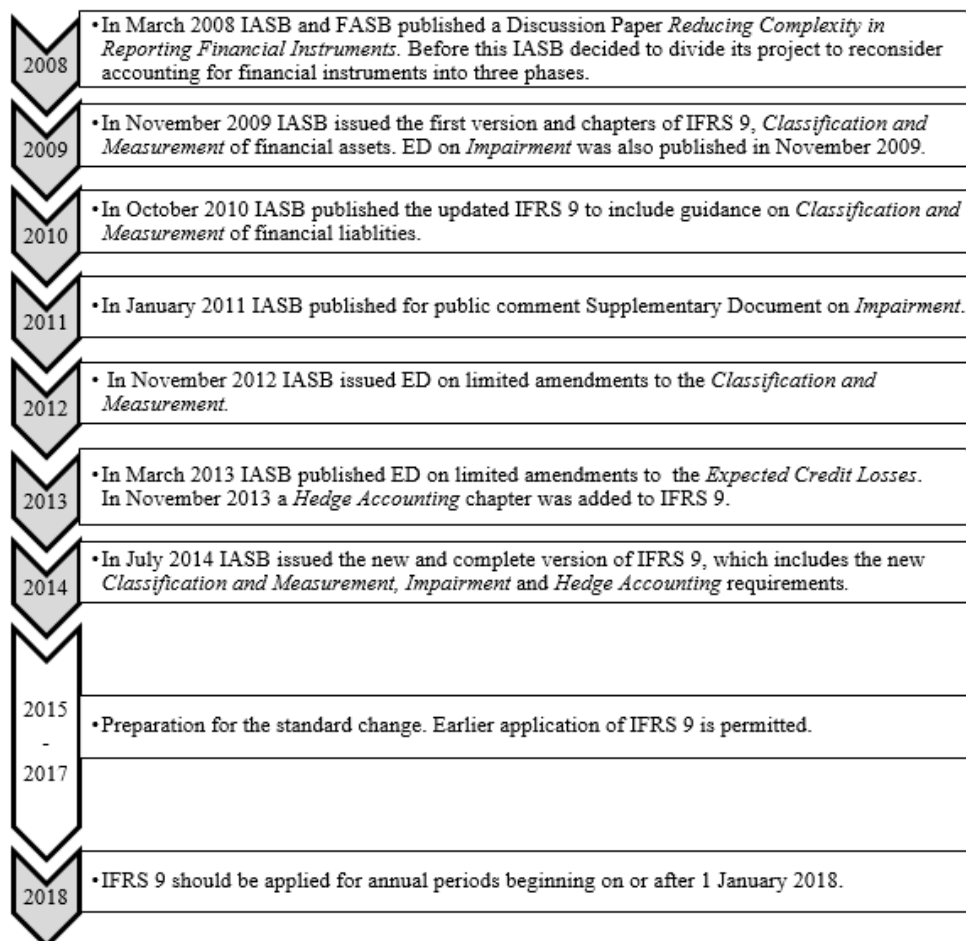


Figure 2 Timeline of IFRS 9

It may be argued that the starting point of the reform of accounting for financial instruments arose in March 2008, as the IASB and the FASB published the aforesaid

Discussion Paper Reducing Complexity in Reporting Financial Instruments. Subsequently, the IASB had elected to divide the project for replacing IAS 39 into three main phases: classification and measurement; impairment and hedge accounting. As the standard setting body finished each phase, it produced chapters to the new standard that supplanted the equivalent requirements in IAS 39. (IFRS 9:IN5.)

At least the project has been long. After the financial crisis it in a way became more distinct that there were too many alternatives in accounting. This caused that the comparability of companies suffered. Thus, in a sense there was an urge to simplify the accounting choices. And this was the first sentiment but along the road it has changed. (Sundvik, interview 9.12.2015)

Next events took place in between of the project's lifecycle. In November 2009 the IASB issued the chapters of IFRS 9 related to the classification and measurement of financial assets. Additionally, an ED on impairment was published during the same month. In October 2010 the IASB included to IFRS 9 the requirements for the classification and measurement of financial liabilities. Most of these rules were derived unchanged from IAS 39. In January 2011 the IASB published and provided for public comment a Supplementary Document on impairment, and in November 2012 the standard-setter issued an ED on limited amendments to the classification and measurement. During March 2013 the IASB published an ED on limited amendments to the expected credit losses to undertake specific application concerns promoted by interest stakeholders, as well as to try to lessen differences with the FASB. In November 2013 the IASB included to IFRS 9 the requirements for general hedge accounting, excluding requirements for macro hedging, as the standard-setter has not yet finished its project on macro hedging. (IFRS 9:IN3, IN6, IN7, IN10; PwC 2014a, 2.)

But why this has been so long project? It is probably because the hedge accounting part was a bit challenging. However, the biggest workload has been related to the impairment and credit loss requirements, to get those requirements in place. That is the main reason why IFRS 9 has been delayed. (Sundvik, interview 9.12.2015)

Perhaps, it (the delay of IFRS 9) is because there have also been so many other standards that have been reformed, which have been linked together. Further, the target has been to reform all these standards concurrently.

(Alaharju, interview 17.2.2016)

The complete version of IFRS 9 was eventually published in July 2014. Concurrently, the IASB made limited amendments to the classification and measurement requirements of financial assets that arose from application concerns, as well as presented the fair value through other comprehensive income (FVOCI) measurement category for specified debt instruments. The presentation of the FVOCI category was a response to feedback from interested parties, involving numerous insurance companies. (IFRS 9:IN8.)

In the first version of IFRS 9 there was only two assessment categories, amortized cost and fair value through profit or loss, but then the insurance companies thought that no, we still need an available for sale kind of category in which the fair value changes are shown in the own equity, thus this kind of category was added to IFRS 9. (Sundvik, interview 9.12.2015)

Further, the impairment requirements associated with the accounting for a company's expected credit losses on its financial assets and commitments to extend credit were also included to IFRS 9 in 2014. Finally, the IASB decided the mandatory effective date of IFRS 9, thus it is planned that IFRS reporting companies apply the standard for annual periods beginning on or after 1 January 2018. (IFRS 9:IN8; PwC 2014a, 2.)

I would say it (mandatory effective date) is fairly, fairly certain. It is not in the horizon that it would not be accepted by then. In fact, it is now planned that the EU would approve IFRS 9 in the first half of 2016. (Sundvik, interview 9.12.2015)

I do not see why, I would believe that it (IFRS 9) will come into force by 2018. Moreover, it is already applied out there, outside of the EU, as there are some Australian experiences and so on. (Alaharju, interview 17.2.2016)

2.3.2 Transition issues and requirements

Earlier application than 1 January 2018 of IFRS 9 is permitted. Further, the new 'own credit risk' requirements can be adopted in isolation. The aforesaid are also contingent on the approval of EU for EU listed companies. However, IFRS 9 can be applied in a specific jurisdiction according to the IASB's plan given that it has been accepted there. (Deloitte, 2014, 21.) For instance, one of the first major banks to early adopt IFRS 9 was the National Australia Bank, which adopted the standard on 1 October 2014 (Deloitte, 2015, 33). In the same breath, the EFRAG has noted that currently early adopters of IFRS 9 seem to be exceptional, thus there is a limited amount of data available from financial statements of early adopters (EFRAG 2015, 94).

As soon as, the EU has approved this (IFRS 9) that should occur by the summer of 2016, thus probably after that in autumn, I could imagine that companies start to assess the effects of IFRS 9. Some perhaps even earlier if the standard is critical, for example having hedge accounting issues with electricity.

(Sundvik, interview 9.12.2015)

Companies have not yet worked that much with IFRS 9. This is what I have perceived. (Alaharju, interview 17.2.2016)

In technical means, companies shall generally apply IFRS 9 *retrospectively* with some exceptions and practicability accommodations. The date of the initial application is by definition the date when a company first exercises the requirements of IFRS 9.

The date must be the beginning of a reporting period after the issuing of IFRS 9. (IFRS 9:7.2.1.) *The business model assessment* under the new classification requirements shall be evaluated at the date of the initial application and the resulting classification shall be applied retrospectively regardless of the company's business model in prior periods (IFRS 9:7.2.3). *The SPPI criterion assessment* shall be grounded on the facts and circumstances at the time of initial recognition. The assessments are presented in the subsequent chapters.

Related to impairment requirements, at the date of initial application, companies shall use reasonable and supportable information without excessive cost or effort to determine the credit risk at the date that a financial instrument was originally recognized, and compare this to the credit risk at the date of initial application of IFRS 9. (IFRS 9:7.2.18.) Further, when adopting IFRS 9, a company may choose to carry on applying the hedge accounting requirements of IAS 39. Companies that adopt the hedge accounting requirements of IFRS 9 shall apply the standard prospectively. In order to apply the requirements from the date of initial application, all qualifying criteria have to be fulfilled at that date. (Deloitte, 2014, 22–24; IFRS 9:7.2.21–23.)

In the standard transition the distinct position of insurance companies should also be emphasized. The EFRAG has viewed that the IASB should consider as an option to align the effective date of IFRS 9 with the effective date of a future insurance contracts standard, albeit only for companies in the insurance industry. Among the reasons that if the effective date of IFRS 9 is not integrated with the new insurance contracts standard, users of financial statements of insurance companies may encounter two significant changes within a fairly short period of time. In the matter of fact, in the overall assessment in regard to European public good, the EFRAG concluded that IFRS 9 is conducive, except for the impact on the insurance industry. (EFRAG, 2015, 3, 5.)

Yet, there is one thing that concerns the insurance companies. Thus, it is possible that the approval of EU will concern other companies but not the insurance. It might be that the insurance companies will get some reliefs. This is related to the IFRS 4, which concerns the accounting of insurance contracts that is still a bit unfinished. As, insurance companies have in the assets only financial instruments and in the liabilities there are these insurance technical liabilities. Thus, the insurance companies would adapt the IFRS 9 that concerns only the other side of the balance sheet, and they would have uncertainty about the other side.

(Sundvik, interview 9.12.2015)

On the other hand, the ESMA has expressed that given the uncertainty about the timing of finalization of the future standard for insurance contracts, the application of IFRS 9 for insurance industry should not be delayed. Further, the ESMA has settled with the arguments of the IASB that deferral of the standard for insurance companies might produce a separate set of requirements for a single industry that would be

incoherent with the nature of IFRS. Subsequently, it could lead to incoherent accounting between banking and insurance industries and incur confusion among users of financial statements. The ESMA has also major concerns that the deferral of IFRS 9 might produce scope for earnings management, hence deteriorating the credibility of financial reporting in Europe. Nevertheless, the ESMA views that temporary deferral of IFRS 9 could be considered in specified terms. That is, only if the IASB determines that deferral of any requirements of the standard is essential to indicate identified artificial volatility stemming from different implementation dates of IFRS 9 and the future insurance standard. (ESMA, 2015, 2–3.)

It is a subjective question that how long it requires from a company to prepare to the standard transition. The matter depends, among other things on the generic features of a company, the specific industry, the different types of investments the company has and about the management of the company. Although, it is generally acknowledged that as the standard will impact the most to the banking industry, banking companies would need the most time to prepare and implement the changes of IFRS 9. According to the Deloitte's IFRS Banking Survey released on November 2014, banks would require up to three years of implementation time. (Deloitte, 2014, 3.)

Well, the banks are already in a hurry. By now, large European banks have for a while implemented or analyzed the impacts of IFRS 9. However, I do not think that other companies necessarily are in such a hurry. (Sundvik, interview 9.12.2015)

And I feel that as soon as companies have wrapped up the financial statement of 2015, perhaps then companies might start to think about IFRS 9. Especially, things concerning the hedge accounting and if a company possesses some stock investments. Thus, in these cases early analysis about these might be in place. (Sundvik, interview 9.12.2015)

3 IFRS 9 'FINANCIAL INSTRUMENTS'

3.1 Classification and measurement

3.1.1 The new approach for classification and measurement

IFRS 9 adapts single classification approach for all types of financial assets. Financial assets are classified in their entirety rather than being subject to complex bifurcation requirements as in IAS 39. The new standard involves three principal measurement categories for financial assets: amortized cost (AC), fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). Thus, the existing categories of held-to-maturity, available-for-sale, and loans and receivables are removed. Now, IFRS 9 employs two fundamental criteria for determining how financial assets shall be classified and measured:

- The entity's business model for managing the financial assets.
- The contractual cash flow characteristics of the financial asset. (IASB 2014a, 7; IFRS 9:IN7.)

The figure below illustrates the process for determining the classification and measurement of financial assets according to a summary by the IASB.

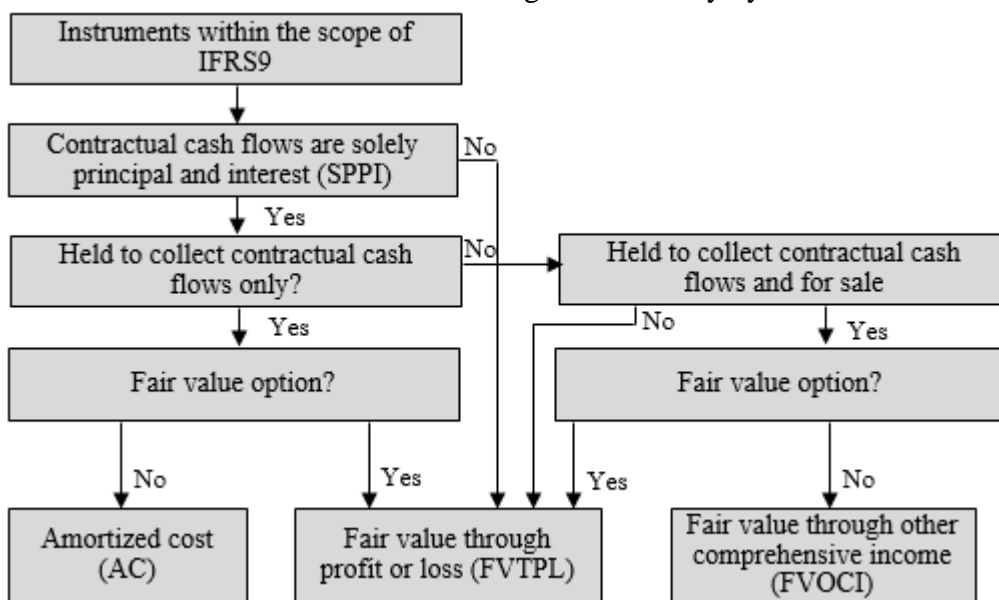


Figure 3 Process for determining the classification and measurement of financial assets (IASB, 2014a, 7)

As the figure implies, the starting point for the classification and measurement is to determine whether or not a financial asset is within the scope of IFRS 9. Subsequently, a financial asset is classified and measured at amortized cost (AC) if the subsequent

criteria are fulfilled: the asset's contractual cash flows represent solely payments of principal and interest (SPPI), the asset is held to collect contractual cash flows only, and the holding company does not apply fair value option to dispose of an accounting mismatch. Financial assets in the amortized cost category are initially recognized at fair value and later measured at amortized cost. (EY 2015, 4–5; IFRS 9:4.1.2; PwC 2014a, 3.)

In turn, a financial asset is classified and measured at fair value through other comprehensive income (FVOCI) if the subsequent criteria are fulfilled: the asset's contractual cash flows represent SPPI, the asset is held to both collect contractual cash flows and to sell the financial assets, and the holding company does not apply fair value option to dispose of an accounting mismatch. Financial assets in the FVOCI category are originally recognized and measured at fair value. Changes in the carrying amount of these assets should be recorded through other comprehensive income (OCI), apart from the recognition of impairment gains or losses, interest revenue and foreign exchange gains and losses that are recognized in P&L. Further, where the financial asset is derecognized, the cumulative gain or loss recognized before in OCI is reclassified from equity to P&L. (EY 2015, 4–5; IFRS 9:4.1.2A; PwC 2014a, 3.)

Discussing about holding or selling an asset refers to the business model a company has chosen to apply, which is subsequently examined in more detail. Moreover, the aforesaid SPPI comprises of a *principal* that is by definition the fair value of a financial asset at initial recognition. Whereas, the *interest* consists, among other things, of reflection for a time value of money. The related SPPI criterion will also be scrutinized more thoroughly below. (IFRS 9:4.1.3.)

The third category, fair value through profit or loss (FVTPL), is a residual category. Thus, financial assets shall be classified and measured at FVTPL if the assets do not fulfill the criteria of AC or FVOCI categories. Financial assets within the FVPTL category are measured at fair value, and all their value changes are recorded through P&L. (EY 2015, 5; PwC 2014a, 3.) Moreover, a company may elect to irrevocably classify a financial asset in FVTPL category if the procedure significantly decreases or eliminates a measurement or recognition inconsistency, which is referred to as an *accounting mismatch*. In other case, these sorts of accounting mismatches would occur from measuring assets or recognizing gains and losses on them, on different bases. (EY 2015, 6.)

Finally, reclassification of financial assets between different categories is permitted, though it is expected to occur only in rare circumstances, when a company's business model for managing financial assets changes (EY 2015, 4–5; KPMG 2014b, 10). This means that the financial assets managed in specific business model will be reclassified according to a different model. Thus, the reclassification of financial assets is business

model driven. The IASB has underlined that the change of a company's business model is a substantial event, which is anticipated to be infrequent. (IASB 2014a, 9.)

Well of course the business model may change if for example some acquisitions or something big like that occurs. But it also may be due to some smaller changes, and of course it may change over time. Just as a policy around financial instruments. Nevertheless, it is good to use the best practices, and at least once a year estimate that is it up-to-date, does it work or should we make some changes or fine-tuning. (Alaharju, interview 17.2.2016)

In normal situation it should not change but if a company, for example closes down some business activity, sells a part of the business, and the investment activity has connected to this, even though you do not relinquish the investments, thus perhaps in a case like this. But this sort of situations should be really rare. (Sundvik, interview 9.12.2015)

3.1.2 The concept of 'business model' for managing financial assets

The IASB incorporates the term 'business model' in IFRS for the first time through IFRS 9. Under the standard it is established that one of the two fundamental criteria for how a company determines the classification of financial assets is the company's business model for managing financial assets. (Page 2012, 683.) The issue is that literature does not recognize settled meaning for the term, nor there are yet extensive examples of using the term in narrative reporting (Page 2012, 683; Tikkanen et al. 2005, 791). Now, companies are faced with a novel term subject to the management of financial assets. In specific industries or businesses the term business model is widely utilized. Nevertheless, it has been regarded that in such a specific relation as with managing financial assets, the term may raise some eyebrows and cause discussion.

It may be that this term (business model) causes discussion for starters. What this means and what is this? Baseline is that everyone will understand it, so that the management of a company understands that what we are talking about. Objective is that the term would be as if a commensurate thing. (Alaharju 17.2.2016)

Consequently, skeptical views have been raised about applying the term (Page 2012, 683). However, the role of business model has also been welcomed in this framework (Singleton-Green 2012, 697). It has also been suggested that establishing financial reporting on a company's business model would be, basically, establishing the reporting on management's intent. This, in turn is not the objective of IASB. (Leisenring et al. 2012, 329.) Altogether, the term business model in IFRS 9 and more extensively in financial reporting has been regarded as ambiguous and called for examination. Since, it

has been suggested to be questioned what the function of the term is, and why in the first place it would be essential. (Page 2012, 684.)

Firstly, Page (2012) states that the term business model is a moderately new addition to the management literature, which would have emerged first time in the 19th century. In the 1970 and 1980s the term was chiefly engaged to illustrate computer-based models of business events and processes. Whereas, extensive use of the term in the strategy and organizational theory materialized, as late as in 1990s, mostly subject to management science and information systems. (Page 2012, 684.) Today, the business model has come to be an intrinsic concept in the managerial vocabulary, as increasing amount of academics from different fields have commenced to apply the term in their work (Tikkanen et. al 2005, 789).

To consider what the equivocal meaning of business model holds, Baden-Fuller & Morgan (2010) propose that it is a generic term, bearing an intermediate degree of detail between the degrees of an individual company and a general approach of economic theories of the firm. Thus, business model represents features of both a streamlined version of reality and an approach, which might be imitated. (Baden-Fuller & Morgan, 168.) Further, numerous academics have viewed that business model is both a static and an evolutionary concept. Since, managers exploit analysis of models for innovation and change but at the same time the static concept encompasses viewing at different parts of the model. Models have also been recognized to be subjective, thus different viewers can easily observe and describe single company's business model in different ways. (Page 2012, 685.) Moreover, Tikkanen et al. (2005) note that despite the obscurity of business model it has gained its place in the managerial vocabulary.

Another question is what is the relationship between a company's business model, objectives and strategy? These concepts have been recognized in management theory for a long time. Alongside, Page (2012) argues that the IASB could have rather possible applied the term 'strategy' instead of 'business model' in IFRS 9. Moreover, he guesses that most of large IFRS reporting companies if asked to describe their business model in terms of how they utilize their market power and avert competition would not result in very informative responses. Altogether, Page (2012) summarizes that the term business model is ambiguous, open to wide-ranging interpretation, and possible to be characterized in numerous ways. Hence, he wonders why the IASB exploits such a vague term. (Page 2012, 685, 689, 693.) To be noted, what comes to the interrelation between a company's business model for managing financial assets and strategy there has been noted specific signs. That is, connecting the business model to the strategy.

With the classification it is visible that this (IFRS 9) has distinctly been thought. Since, when companies have updated and reformed their policies, the new standard has been scrutinized. How the companies will construct it (business model) in relation to their strategies and so on? (Alaharju, interview 17.2.2016)

On the opposite side, Singleton-Greene (2012) views that it is a sensible approach for financial reporting to reflect a company's business model. He argues that this connects to the way financial reporting works, provided that different business models comprise different assets and different transactions. Nevertheless, this would not result in a singular conclusion about how financial reporting should be conducted, since there are different means of reflecting business models in financial reporting. Singleton-Greene (2012) concludes that what functions best, in this setting, should be settled by experience and through empirical results – not based on hypothesis. Not forgetting that the fundamental objective should be to deliver useful information for the users of financial statements. (Singleton-Greene 2012, 705–706.) In the same breath, it has been suggested that the term could provide certain kind of structure for the management of financial assets. In other words, the meaning of the term could serve as a distinct foundation on which the management of the assets is established in companies.

This (business model) will probably bring more that specific structure for consideration. Since, now it is required to structure more concretely those things. I would believe that it has not been made that much until now.

(Alaharju, interview 17.2.2016)

It has also been accepted that the IASB has pursued to exclude accounting policies based on managerial intention. For example, IAS 39 with its criticized classification requirements involved, at least in some instances, managerial intention in the process of classification. However, under IFRS 9 by establishing the process, on a company's business model there is the impression that the classification and measurement is not any more based on managerial intention. Page (2012) states that for the aforesaid to hold true, inter alia, the next issues should be endorsed. A management does not have discretion in designating an asset to a specific business model, it is feasible to recognize a business model by which an asset is managed, business models would be intrinsically stable, and could not be reformed promptly without major costs. Against this background, Page (2012) certainly doubts the introduced assertions. (Page 2012, 686.) Nevertheless, it has been presumed that the business model would at least strive to separate accounting choices from a management's intent. Again, by establishing a more formally defined frame under which financial assets are managed, irrelevant of management's decisions in specific circumstances.

In a way it (business model) perhaps truly pursues to differentiate from that (management intent). In order to, that the business model would be a more formally defined frame, ergo this is how the model is. Not such that what is the intent of the management as such. (Alaharju, interview 17.2.2016)

Furthermore, Leisenring et al. (2012) argue that accounting based both on company's business model and on management's intent involve essentially the same idea. The researchers view that in common parlance, a business models refers to management's

use or disposition of assets and holding, transferring or settling liabilities, with accepting that this activity is commenced with a profit motive. Subject to IFRS 9, the use of the term business model is considered to be in line with the use in common parlance. For instance, it is stated in IFRS 9 that a company shall measure a financial asset at AC only if the aim of the company's business model is to hold the financial asset to collect the contractual cash flows. Attributed to this statement, the concept of a business model would seem to be designed to capture the idea of management's intent. Yet, IFRS 9 designates that the company's business model does not rely on management's intentions for an individual instrument. (IFRS 9:B4.1.2; Leisenring et al. 2012, 330.) Therefore, Leisenring et al. (2012) pay attention to the following consideration. Does the IASB distinguish between management intent and business model by connecting the intent with individual financial instruments and business model with groups of instruments? In any case, the researchers conclude that for aspirations of financial reporting the distinction between a company's business model and management intention would be unnecessary. (Leisenring et al. 2012, 330–331.)

After all, the IASB does not provide a defined term for a company's business model in the standard text of IFRS 9. The standard-setter defines some of the key terms within the standard but not the business model. Rather, it is plainly stated that a company's business model refers to how a company manages its financial assets to generate cash flows. Nevertheless, IFRS 9 guides through considering specific key aspects that relate to the business model and its assessment, as well as presents different business models for managing financial assets. (IFRS 9:Appendix A; IFRS9: B4.1.2A.)

Consequently, it seems that it is not possible to offer an unequivocal answer to what is a company's business model for managing financial assets. On the contrary, the term seems to be such that it takes time to be assimilated and comprehended profoundly. It may be presumed that the actual meaning for the term is captured in different companies by different means. However, it seems most likely that it has to be in some kind of connection and unity with specific drivers of a company such as with its strategy.

It will probably take shape. In order to understand what is the purpose of this (business model) and what we have to define here? Is this just one part or how uniform it has to be with strategy and policy issues? Since, in practice it certainly should be, it is pursued here, hence that it would tell about these things. Yet, as a word it truly might be a bit that what this means to us?

(Alaharju, interview 17.2.2016)

3.1.3 *Business model assessment*

Business model assessment is one of the two phases to classify financial assets under IFRS 9. According to the IASB, a company's business model refers to how the company manages its financial assets to produce cash flows. In other words, a business model should reflect how the company manages its financial assets. (EY 2015, 7.) In this context, it is stated that it would be preferable to start by ensuring that term business model is comprehended within the company. Further, the people defining the model could ask themselves that why specific investments are essentially conducted?

First, you have to understand what the term business model means, what is it all about. Since, a company's treasury cannot understand nor do it by itself, you also have to involve the other management. As, the business model will reflect in the reporting and addressing of financial instruments. (Alaharju, interview 17.2.2016)

Now, with this new business model, company should decide 'why we have done this (investment)' and this is the first question. (Sundvik, interview 9.12.2015)

The business model itself defines whether cash flows from particular financial assets result from collecting contractual cash flows, selling the financial assets or both. The business model assessment should be executed on the basis of scenarios that a company realistically expects to occur. That is, the assessment will disregard so-called 'worst case' or 'stress case scenarios'. Therefore, if a company assumes that it would sell a specific portfolio of financial assets merely under a stress scenario, the scenario would not distress the company's business model assessment for the particular portfolio. (IFRS 9:B4.1.2A.) The infamous past financial crisis serves as an example of a stress scenario.

Hence, that you will truly start to think that what are the functions for those investments? As if what are those portfolios, what are those used for, and for what kind of situations? For example, if the business model is that you will invest short term, you have some investments coming so that it would reflect that.

(Alaharju, interview 17.2.2016)

The determination of business model assessment should be performed at a level that expressess how groups of financial assets are managed together to realize a specific business objective, and the model should not rely on management's intention for an individual instrument. Therefore, the approach to classification and measurement is not an instrument-by-instrument, rather it is established on a higher level of aggregation. Though, a single company may have more than one business model for managing financial assets. Thus, the assessment and classification need not to be performed at the reporting entity level. For instance, a company might have a portfolio of assets for collecting contractual cash flows and another portfolio of assets for trading to realize fair value changes.(IFRS 9:B4.1.2; PwC 2014a, 4.)

Moreover, the IASB asserts that a company's business model for managing financial assets is a matter of fact and not only a declaration. The business model should usually be identifiable by the activities the company carries out to realize the objective of the business model. More specifically, a company is required to use judgment when assessing its business model and the assessment should not be defined by a single factor or activity. Rather, the company should take into account all relevant evidence accessible at the date of assessment. (IFRS 9: B4.1.2B.) Further, as stated the definition of the business model should be such that the company is not expected to change it in the near future, thus again it is not only a declaration.

The definition of business model is not one time thing, as the standard comes into force. Rather, you are truly obliged to maintain that, even though situations change. (Alaharju, interview 17.2.2016)

Relevant evidence and other aspects that closely relate to the business model assessment are illustrated in the figure below. The researcher developed the figure by combining the addressed aspects with the intention to summarize some of the key evidence. What is more, the figure strives to indicate that the business model assessment is a sum of various aspects that are obliged to be scrutinized when defining the business model.

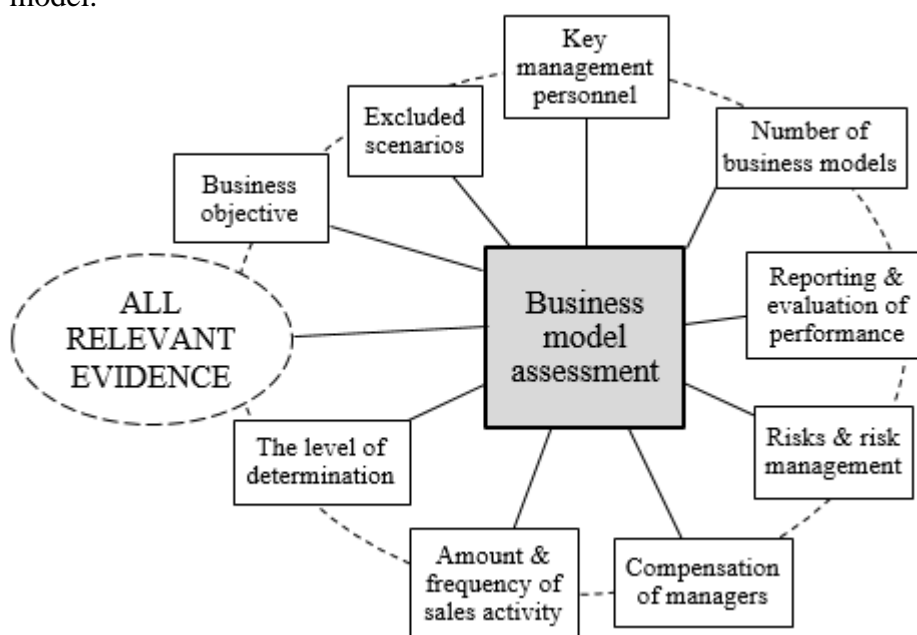


Figure 4 Aspects relating to the business model assessment

Key management personnel of a company affiliates closely to the business model assessment as demonstrated in the figure. The business model is defined by the company's key management personnel in the way the financial assets are managed and their performance is reported to them. (PwC 2014a, 4.)

In some way it has to be documented and described. As if, this is the policy for us, it is based on these things, this is what we have decided, this is the way it has been

chosen, and that it is accepted and addressed by the management.
(Alaharju, interview 17.2.2016)

Further, the figure illustrates that a company must consider how the performance of the business model and the financial assets held in the model are evaluated and reported to the management. The risks affecting the performance of the business model and especially the risk management of these are a central part of the considerable evidence. Moreover, the regarded evidence includes how the managers are compensated. For instance, whether the compensation is formed on the contractual cash flows collected or on the fair value of the financial assets managed. (IFRS 9:B4.1.2B, PwC 2014a, 4–5.) The evidence should comprise of objective information, such as business plans and the amount and frequency of sales activity of the financial assets. Further, the aforesaid business model's level of determination and the excluded scenarios in the assessment needs to be considered. Overall, judgment is required when assessing a business model and the assessment must consider all relevant accessible evidence. (IASB 2014a, 8.)

It (business model) is mainly related to what the management monitors and about the purpose for the investment. In a company where this investment activity is just a part of liquidity management, it is really simple. It is exactly why we have invested, if we have excessive cash and we know we do not need it for like five years and then we invest the cash in some government bond for five years we know that we will hold it, so this sort of would be measured at amortized cost if we do not want that volatility of profit, when we truly have the intent to keep those, in this case the business model is quite obvious. But it is perhaps less often like this.

(Sundvik, interview 9.12.2015)

Furthermore, if cash flows are realized in a manner that differs from the company's assumptions made at the date of the business model assessment (for instance the company sells more or less assets than anticipated when classifying the assets) that does not cause a prior period error in the company's financial statements, neither does it alter the classification of the residual assets in the business model. Provided that, the company regarded all relevant information accessible at the time it conducted the business model assessment. Nonetheless, as a company assesses a business model for recently originated or acquired assets, it is obliged to regard information about how cash flows were realized in the past, together with all other relevant evidence. (IFRS 9:B4.1.2A.)

It is also anticipated that management may divide portfolios into sub-portfolios for to reflect the business model. This is presumed to be eminently judgmental, since it might be problematic to distinguish within a portfolio which assets are held to collect contractual cash flows, to collect and sell, or to trade. In the same vein, it is argued that the business model assessment will be remarkably judgmental. It relies on facts and circumstances and the intentions of a company since it applies to specific assets. Thus, a

company might have the same type of asset, such as government bond, in all three categories (AC, FVOCI and FVTPL) depending on its intention and business model for managing the financial assets. (PwC 2014a, 4–5.)

3.1.4 Different business models for managing financial assets

The IASB has identified specific different types of business models for managing financial assets in IFRS 9. The models characteristics are described, among other things, on the basis of the objectives of the business models. The actual terms for the subsequently presented models are derived from a document produced by PwC. The terms vary among Big Four firms, though they all capture the same idea. It has been regarded that companies are already in the process of forming grounds for different business models, for instance by reforming their policies.

Already now it is identifiable that when companies have reformed their policies, there is a distinct attempt to built-in these different classifications and grounds for business models. Thus, it is thought in several places at the moment.

(Alaharju, interview 17.2.2016)

First, it is recognized that if a company's aim is to hold a financial asset or a portfolio of assets to collect contractual cash flows, the asset should be classified under a *hold to collect business model*, provided that the asset meets the SPPI criterion. Therefore, assets under this model are measured at amortized cost (AC). Second, a company may hold financial assets in a business model, which aim is realized by both collecting contractual cash flows and selling financial assets. Thus, the company business model would be a *hold to collect and sell*, again provided that the assets meet the SPPI criterion. Consequently, the assets would be measured at fair value through other comprehensive income (FVOCI). Lastly, financial assets are measured at fair value through profit or loss (FVTPL) if they are not held within a hold to collect or hold to collect and sell business model. These sorts of business models are referred as *other business models*. (PwC 2014a, 5–7.) It has been noted that companies necessarily do not operate so straightforwardly under the presented business models at present.

Well, now it is probably not totally distinct to see that companies would use models like these, but perhaps in some way there is that some sort of structure. Yet, it is probably not overly easy to categorize these like this at the moment. Let's say that a company would instantly be able to say that this is the way it works with us. Again, it depends so much of the specific company that we are talking about, what kind of portfolio and overall what kind of balance sheet, what kind of items there are.

(Alaharju, interview 17.2.2016)

The table below illustrates some of the presented business models' features, which are subsequently introduced in more detail. The third column in the table indicates the specific measurement category related to the business model in question.

Table 6 Different types of business models (PwC 2014a, 5–7)

Business model	Major elements	Category
Hold to collect	<ul style="list-style-type: none"> • The aim of the business model is to hold assets to collect contractual cash flows. • Sales of the assets are identical to the aim. • Usually lowest sales in frequency and volume. <ul style="list-style-type: none"> ◦ Sales are related to credit risk management. 	AC
Hold to collect and sell	<ul style="list-style-type: none"> • Both collecting contractual cash flows and sales are essential to achieving the aim of the business model. <ul style="list-style-type: none"> ◦ Managing everyday liquidity needs. ◦ Maintaining a specific interest yield profile. ◦ Matching duration of financial instruments. • Typically more sales in frequency and volume than with held-to-collect business model. 	FVOCI
Other business models	<ul style="list-style-type: none"> • Business model is neither identified as hold to collect nor hold to collect and sell. • Collection of contractual cash flows is loosely associated to the aim of the business model. • Such as: <ul style="list-style-type: none"> ◦ Trading (i.e. hold to sell). ◦ Managing assets on fair value basis. ◦ Maximizing cash flows through sales. 	FVTPL

Within the hold to collect business model, despite the aim of the business model, the company will not have to hold all of the assets until maturity. The business model may be hold to collect even if sales of financial assets occur or are anticipated to occur in the future. Thus, it is stated that sales in themselves do not define the business model, and should not be considered in isolation. Rather, data about prior sales and expectations of future sales deliver evidence about how the company's specified business model objective is achieved and, particularly, how the cash flows are generated. Likewise, sales due to an increase in an asset's credit risk will not be inconsistent with the aim of this business model. Credit risk management actions, such as selling an asset for it no longer meets specified credit criteria, for minimizing potential credit losses, may be central to the hold to collect model. What is more, sales or transfers before maturity that arise for other reasons, for instance sales made to manage credit concentration risk (excluding an increase in an asset's credit risk), might be coherent with a hold to collect model. Provided that the sales are infrequent (even if substantial in value) or insignificant in value, either individually or in aggregate (even if frequent). (IFRS 9:B4.1.2C.)

There is no distinct rule for how many sales designate the 'infrequent' or 'insignificant'. A company should always use judgment based on the facts and circumstances. A rise in the frequency or value of sales in a specific period is not

automatically inconsistent with the objective of hold to collect model, if a company is able to clarify the reasons for the sales and prove why those sales do not indicate a change in the business model. Finally, sales may be consistent with the aim of hold to collect model if the sales are realized nearby the maturity of the assets and the revenue from them approximate the collection of the outstanding contractual cash flows. IFRS 9 offers examples of when the aim of the company's business model might be hold to collect. (IFRS 9:B4.1.3; PwC 2014a, 5–6.)

It is really hard to say about those limits for selling, as we have not yet actually faced or interpreted these situations. Thus, it is really hard to say that how it will truly work like in practice. (Alaharju, interview 17.2.2016)

Whereas, the objective of hold to collect and sell business model is realized by both collecting contractual cash flows as well as selling financial assets. Now, a company's key management personnel have decided that both collecting contractual cash flows and selling assets are central to realizing the objective. Various business model objectives may be in line with the hold to collect and sell model. For instance, the aim of the business model might be managing everyday liquidity needs, maintaining a specific interest yield profile or matching the duration of the financial assets to the duration of the liabilities that those assets are funding. To realize these purposes, the company will both collect cash flows and sell assets. In comparison to the hold to collect model, the model is usually connected to higher frequency and value of sales. Though, there is no threshold for the frequency or value of sales that has to take place in the model. Again, IFRS 9 delivers examples of when the aim of the business model might be achieved by hold to collect and sell. (IFRS 9:B4.1.4A; IFRS 9:B4.1.4B; PwC 2014a, 6.)

Companies will probably be fine with one model that is the 'mixed model' (hold to collect and sell). Bond investments will be measured at fair value and fair value changes will be booked in own equity. Since, less often companies invest in instruments that do not fulfil the cash flow criteria in the end.

(Sundvik, interview 9.12.2015)

In the case of that a financial asset or group of financial assets do not belong to the hold to collect or to the hold to collect and sell business model, the assets shall be measured at FVTPL and designated to the so-called other business models. One business model that meets this category is one in which a company manages financial assets with the aim of realizing cash flows by selling the assets. Under this model, a company conducts decisions grounded on the assets' fair values and manages the assets to realize those fair values, which will usually result in active buying and selling. This could, for example be the case for a trading portfolio. Although, the company collects contractual cash flows while holding the assets, the aim of such a business model is not realized by both collecting cash flows and selling financial assets. For the reason that

collection of cash flows is not central to realizing the business model's aim, instead of it is incidental to it. (IFRS 9:B4.1.5; PwC 2014a.)

As always with standards, when the standard is actually adapted, you face those real situations, and may better comprehend that what is the criterion for the adaptation of those different models. Yet, it is of course always open to some level of interpretation and ambiguous to some extent. (Alaharju, interview 17.2.2016)

At the moment, companies do not necessarily have identifiable business models. In my opinion, it has not necessarily been thought like this until now. It is perhaps a new way of thinking. In a certain way, in the bottom are those, as of course it is thought that why we have certain assets and for what purposes.

(Alaharju, interview 17.2.2016)

3.1.5 Contractual cash flow assessment

IFRS 9 sets out that contractual cash flow assessment is the other essential phase for defining the classification of financial assets. Thus, it is required to assess whether cash flows from the financial assets fulfill the so-called SPPI criterion. That is, whether the contractual cash flows are solely payments of principal and interest. Financial assets meeting the criterion are eligible for AC or FVOCI measurement dependent on the business model in which they are held. Financial assets that do not fulfill the SPPI criterion are always measured at FVTPL, except for equity instruments for which a company has decided to apply a specific OCI election. (IASB 2014a, 10; KPMG 2014b, 14.) Management is responsible for evaluating whether a company's financial assets' contractual cash flows fulfill the SPPI criterion (PwC 2014a, 7).

In my opinion the business model is quite straightforward, but the cash flow criterion is perhaps not so unambiguous. How much those can change and what can be the reasons for those to change? It is clear that if you have variable interest, variable interest changes, this is fine. However, if it has some other variables, where is the line, there might be more discretion. (Sundvik, interview 9.12.2015)

As the baseline of the cash flow assessment IFRS 9 presents the definitions of 'principal' and 'interest', which should help management to conduct initial assessment of the SPPI criterion. *Principal* is by definition the fair value of a financial asset at initial recognition. Yet, the principal amount may change over the life of the financial asset, for example if there will be repayments of principal. *Interest* comprises by definition of reflection for the time value of money (i.e. compensation for the time value of money), for the credit risk related to the principal amount outstanding during a specific period of time and for other basic lending risks and costs, in addition to a profit margin. Management will have to assess whether contractual cash flows meet the SPPI

criterion in the currency in which the financial asset is denominated. (IFRS 9:4.1.3; PwC 2014a, 7–8.)

IFRS 9 further defines that contractual cash flows that meet the SPPI criterion are compatible with a *basic lending arrangement*. In a basic lending arrangement, reflection for the time value of money and credit risk are usually the most substantial elements of interest. Nonetheless, within the arrangement, interest may also contain reflection for other basic lending risks (for instance, liquidity risk) and costs (for instance, administrative costs) related to holding the asset for a specific period of time. Moreover, interest may contain a profit margin that is compatible with a basic lending arrangement, and in extreme economic circumstances the interest may also be negative. Nonetheless, a basic lending arrangement does not hold contractual terms that present exposure to risks or volatility in the contractual cash flows, such as exposure to changes in equity prices or commodity prices. Therefore, these contractual terms do not meet the SPPI criterion. Below table further introduces specific contractual features and their relation in meeting the SPPI criterion. (IFRS 9: B4.1.7A; KPMG 2014b, 15–16.)

Table 7 Specific contractual features subject to the SPPI criterion

Specific contractual features		SPPI
<i>Variable interest rate</i>	Consisting of reflection for the time value of money, the credit risk related with the principal amount outstanding during a specific period of time (the reflection for credit risk can be designated at initial recognition only, and so can be fixed) and other basic lending risks and costs, as well as a profit margin.	√
<i>Lending risks & costs</i>	Compensation for basic lending risks, such as: <ul style="list-style-type: none"> • Liquidity risk • Administrative risk 	√
<i>Negative interest</i>	Accepted in extreme economic circumstances, which might be the result of: <ul style="list-style-type: none"> • The holder of asset either implicitly or explicitly pays for the deposit of its money for a specific period of time, and that payment exceeds the compensation the holder receives for the time value of money, credit risk and other lending risks and costs. 	√
<i>Term</i>	A contractual term that allows the issuer (i.e. the debtor) to prepay a debt instrument or allows the holder (i.e. the creditor) to put a debt instrument back to the issuer before maturity and the prepayment amount significantly represents unpaid amounts of principal and interest on the principal amount outstanding, which may contain fair added compensation for the early termination of the contract.	√
<i>Term</i>	A contractual term that allows the issuer or the holder to prolong the contractual term of a debt instrument (i.e. extension option) and the terms of the extension option lead to contractual cash flows during the extension period that are SPPI, which can contain fair added compensation for the extension of the contract.	√
<i>Leverage</i>	Increases the variability of contractual cash flows such that they do not have the economic features of interest, e.g. forward contracts and swap contracts.	×
<i>Exposures</i>	Financial assets containing contractual features that introduce exposure to risks or volatility unrelated to basic lending arrangement, such as exposure to changes in equity prices or commodity prices.	×

In the table are exemplified contractual features that meet or do not meet the SPPI criterion. Meeting the SPPI criterion is illustrated in the third column with pass or reject symbol. Further, IFRS9 provides so-called de minimis effect in subject to the SPPI assessment. To be exact, contractual terms that involve de minimis features should be disregard in the assessment. Thus, a company is not required to take into account any

contractual cash flows characteristics that do not represent SPPI if they would merely have de minimis effect on the contractual cash flows of the financial asset. To determine whether the effect is de minimis, a company has to examine the potential effect of the contractual cash flow characteristics in each reporting period and cumulatively over the life of the financial asset. Furthermore, if a contractual cash flow characteristic might affect the contractual cash flows more than the de minimis, but the specific cash flow characteristic is not genuine, it will not affect the classification of the asset. IFRS 9 issues that a characteristic is not genuine if it impacts asset's contractual cash flows only on the occurrence of an event that is exceptionally uncommon, particularly abnormal and highly unlikely to occur. (IFRS 9:B4.1.11; IFRS 9:B4.1.18; KPMG 2014b, 16.)

IFRS 9 includes also a number a different requirements that relate to the cash flow analysis, such as consideration of modified time value of money, contingent events affecting cash flows and contractually linked instruments, along with a number of examples of how to assess contractual cash flows. (PwC 2014a 8–11.)

The SPPI criterion feels in theory, and as I have not faced that assessment in practice, but in theory it feels quite untroubled. If you think about these tests, as you outline it like this it feels like a quite untroubled idea. But, what kind of situations there might be in real practice, if it goes to some vague area. Anyhow, it feels untroubled. But then again, especially if there are some nuances or special instruments, surely it will not be so clear cut. I am a bit skeptic as to that there will surely be some puzzles. Still, the basic setting sounds logical and distinct. (Alaharju, interview 17.2.2016)

3.2 Impairment and hedge accounting

3.2.1 The reformed impairment model

IFRS 9 introduces completely new impairment requirements for financial instruments, among the reasons, concerns raised on 'too little, too late' provisioning of loan losses (KPMG 2014b, 2). It has been largely acknowledged that the related impairment requirements embody the most significant change of accounting presented by IFRS 9.

I would view that this new impairment model is the most challenging part of these reforms. (Alaharju, interview 17.2.2016)

The new requirements include a reformed impairment model, which differs substantially from the guidance of IAS 39. With the new model the IASB drives to answer to the critic of the impairment rules of IAS 39. The multiple impairment models

in IAS 39 were felt complex. Moreover, its ‘incurred loss’ model was strongly criticized, especially after the financial crisis unfolded. (IASB 2014a, 14.) The new model is conceptually a ‘loss allowance’ model that recognizes a provision for expected credit losses on financial instruments before any of those losses have actually incurred. Credit losses are the value of the difference between the contractual cash flows that are contractually due to a company and the cash flows that the company actually presumes to receive discounted at the original effective interest rate. (EFRAG 2015, 15.)

It (the new impairment model) is totally different than the approach of IAS 39. Since, IAS 39 specifically denies that expected credit losses cannot be taken into account. Expected credit loss means in a way that what is the probability that losses will turn out, and the probability exists already when you grant that credit. If you grant hundred credits, you right away know, on the day of the grant, that some of these may fold or will not pay back. (Sundvik, interview 9.12.2015)

The key aim of the new impairment model is to offer users of financial statements more useful information on companies’ expected credit losses on financial instruments. Under the requirements it is no longer required for a credit event to have occurred before the related credit losses are recognized. The major reform is that now companies account for expected credit losses and changes in those losses at all times. Besides, the amount of expected credit losses is updated at each reporting date to reflect the changes in the credit risk of financial instruments since the initial recognition. (IASB 2014a, 14; IFRS 9:IN9.)

In general, since IAS 39 denies the booking of expected credit losses, and now you have to book all the expected credit losses, thus it (the new impairment model) will increase the amount of credit losses. The estimate is that the current credit loss provisions will increase by 50 percent. Okay, credit loss provisions are at a quite low level at the moment but for some companies it may have effect in own equity or in solvency. (Sundvik, interview 9.12.2015)

IFRS 9 assigns merely a single impairment model that is applied to all financial instruments that are subject to impairment accounting. In the model’s scope are financial assets classified as amortized cost and FVOCI, lease and receivables, commitments to lend money and financial guarantee contracts. Since, there is only one applicable model the reform should remove a major source of current complexity faced with the multiple impairment models of IAS 39. (IASB 2014a, 15.) Moreover, the impairment rules deliver a uniform basis to be adapted for financial instruments in the scope of IFRS 9. This should lead to more comparable accounting information. (EFRAG 2015, 46.)

Now, in IFRS 9 there is only one impairment model. Hence, it should also enhance the comparability of companies, in theory it should be like this, but in practice not necessarily, it remains to be seen. (Sundvik, interview 9.12.2015)

It is definitely for the purpose that the transparency would be enhanced, everything forth without fail for investors that is the target. (Alaharju, interview 17.2.2016)

Since, the new model eliminates the earlier compulsory trigger event in credit risk, companies will require more timely information from expected credit losses. Companies are required to base their measurement of the expected credit losses on reasonable and supportable information. This should include historical, current and forecast information that is available without immoderate cost or effort. The financial instruments should be assessed on an individual or collective basis. (IASB 2014a, 14; IFRS 9:5.5.4.) More particularly, information that should be considered in the assessment of increased credit risks involves: changes in credit ratings, changes in operating results, changes in external market indicators, changes in business, changes in internal price indicators and other qualitative inputs (PwC 2014d, 17). The model involves some operational simplifications for trade and lease receivables and contract assets, as they are often held by companies that do not have highly sophisticated credit risk management systems. Simplifications exclude for example the need to assess when a major increase in credit risk has occurred, allowing or requiring recognition of lifetime expected credit losses at all times. (KPMG 2014b, 5; PwC 2014b, 5.)

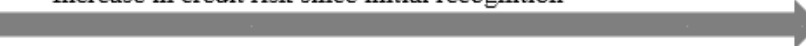
The challenge here is that, well if you have only accounts receivable then you have the simplified model, which means that you do not have to monitor the growth of credit risk. Yet, for instance for banks, and why this has been so challenging, and this is the one that differs from the Basel requirements, is that the most important criterion is the growth of the credit risk, which you have to monitor. Further, you will always monitor the growth compared to the amount of the credit risk at the grant of the credit. This is something that few banks have even monitored in their systems. (Sundvik, interview 9.12.2015)

Now, the new impairment model demands that the actual process will be changed significantly. Whereas, with the business model it is not so that the continuous process in the company needs to be changed. However, this really demands that things will be done and managed a lot differently than before.

(Alaharju, interview 17.2.2016)

IFRS 9 outlines a three-stage model that is also called ‘a general model’ for the impairment. The model is based on changes in a company’s credit quality since the initial recognition of a financial instrument. It includes *12-month expected credit losses* that are the share of lifetime expected credit losses that originate from default events on financial instruments that are potential within twelve months after the reporting date. These are not the expected cash shortfalls within next twelve months, instead these designate the effect of the whole credit loss on an asset weighted by the probability that the loss will occur within the next twelve months. Similarly, *12-month expected credit losses* are not the credit losses on assets that are forecast to actually default within the

next twelve months, these sorts of credit losses, if identified will be recognized in the subsequent lifetime expected credit losses. Indeed, the other type of credit losses that the model introduces is *the lifetime expected credit losses*. These signify an expected present value measure of losses that occur if a borrower defaults on its obligation throughout the life of the financial instrument. Lifetime expected credit losses are the weighted average credit losses with the probability of default as the weight. To be noted, since expected credit losses reflect the amount and timing of payments, a credit loss occurs even if a company anticipates to be paid in full but later than when contractually due. (IASB 2014, 17; PwC 2014b, 2–3.) The below figure further illustrates the different stages of the model with the different expected credit losses.

Increase in credit risk since initial recognition 

Stage 1	Stage 2	Stage 3
<i>12-month expected credit losses</i>	<i>Lifetime expected credit losses</i>	<i>Lifetime expected credit losses</i>
<ul style="list-style-type: none"> • As soon as a financial instrument is purchased, 12-month expected credit losses are recognized in P&L and a loss allowance is established. • Serves as a proxy for the initial expectations of credit losses. • For financial assets, interest revenue is calculated on the gross carrying amount (i.e. without adjustment for expected credit losses). 	<ul style="list-style-type: none"> • If the credit risk grows notably and the resulting credit quality is not viewed to be low credit risk, full lifetime expected credit losses are recognized. • Only recognized if the credit risk grows notably from the event when the company purchases the financial instrument. • Interest revenue on financial assets is calculated as in the Stage 1. 	<ul style="list-style-type: none"> • If the credit risk of financial asset grows to the point that it is viewed credit-impaired, interest revenue is calculated based on the amortized cost (i.e. the gross carrying amount adjusted for the loss allowance). • Financial assets in the Stage 3 are generally individually assessed. • Lifetime expected credit losses are still recognized on these financial assets.
Effective interest on gross carrying amount	Effective interest on gross carrying amount	Effective interest on amortized cost

Figure 5 Three-stage model for impairment (IASB 2014, 17; PwC 2014b, 2)

Stage one involves financial instruments that have not had a major growth in credit risk since initial recognition or ones that have low credit risk at the reporting date. 12-month expected credit losses are recognized for these instruments and interest revenue is calculated on the gross carrying amount of the instrument, which means without deduction of loss allowance. Stage two, on the other hand, involves financial instruments that have had a major increase in credit risk since initial recognition but do not have objective evidence of impairment. Yet, these exclude instruments that have a low credit risk at the reporting date. Lifetime expected credit losses are recognized for the instruments and interest revenue is calculated on the gross carrying amount. Finally, the stage three involves financial instruments that have objective evidence of impairment at the reporting date. Lifetime expected credit loss is still recognized for

these instruments but the interest revenue is calculated on the net carrying amount of the instrument that is net of credit allowance. (IASB 2014, 17; PwC 2014b, 2–3.)

It has been regarded that the eventual effects of the new impairment requirements will vary drastically between companies in different industries. Thus, industry-specific qualities of paying, lending or financing will most likely influence a lot to the overall effect of the new requirements with regard to a single company.

With this (impairment model) it depends a lot on the specific business of a company. In other words, whether you deal with credit card payments or build buildings or ships? Thus, what kind of that business and that cash flow is, and overall what is the meaning of credit losses to your company. This will probably vary significantly. (Alaharju, interview 17.2.2016)

The EFRAG has assessed that the new impairment requirements satisfy the demand of G20 that arose following the financial crisis. The G20 demanded an implementation of a forward-looking impairment model that would lead to more timely recognition of expected credit losses. Under these conditions the EFRAG also views that the impairment rules are expected to contribute to financial stability in EU. Likewise, the users of financial statements should be able to distinguish between instruments for which the credit risk has notably increased from those which it has not. (EFRAG 2015, 2.) Nevertheless, the EFRAG estimates that the new impairment model will lead to higher credit risk provisions, which in turn are especially expected to affect the regulatory capital of banks. Furthermore, it is considered that the level of judgment required by the recognition credit losses is significant as the financial information for the new model is prepared by taking into account high levels of uncertainty. (EFRAG 2015, 44, 78.)

Hence, this is probably the biggest change. Moreover, this will certainly require a lot from the systems. And this is the spot where the largest expenses will appear. In the same EFRAG document (Endorsement Advice on IFRS 9) was an estimate, I do not remember the numbers by heart, but for big banks it was quite an enormous workload. Man-years and expenses, the most part of the implementation expenses of IFRS 9 is related to this. Since, with the other reforms there will not be that much expenses, so that you decide that business model, so you do not have to so much, well okay if you are a bank and you have a lot of different types of investments, you should probably go through the criteria for the cash flows, but it is not that big of a deal compared to this expected credit loss model.

(Sundvik, interview 9.12.2015)

The costs of implementing the new expected credit loss model will differ depending on the development of existing credit risk management systems and the diversity of investment strategies. Participants in the EFRAG's 2013 field-test recognized that there would be significant costs related to for example the development and roll-out of

systems, tools and processes for assembling data, tracking credit risk and calculating expected credit losses. Companies assumed that the new impairment requirements would incur high one-off costs associated with education and training of personnel, definition of roles and responsibilities and new procedures and workflows, and updating of accounting systems that involves disclosures for the annual report. New systems and controls might also be required to integrate information created for credit risk management into financial reporting processes. (EFRAG 2015, 86–87.)

This really requires much, since you are required to consider the processes and the systems. As if, how the data passes there for to abstract this information and be able to manage it. (Alaharju, interview 17.2.2016)

What is more, the EFRAG anticipates that additional costs will incur to the preparers of financial statements because they need to explain to the users of financial statements specific features of applying the new model, in order to support the user's understanding of the presented information (EFRAG 2015, 86–87). Altogether, it is expected that the new impairment requirements will especially have a substantial impact on banks. In regard, how banks account for credit losses, how much larger and volatile provisions on bad debts will be and how banks' systems will adapt to the new requirements. Therefore, a significant issue for banks is also that how the adoption of IFRS 9 will affect their regulatory capital ratios. (KPMG 2014b, 2.)

And you can be pretty sure that no bank will implement this before January, 1 2018. Because it is really difficult, and they will probably run systems concurrently for a while and compare to the current credit loss measurement that how the new model behaves. It requires so much from the systems. Further, as an interface to Basel, the sort of end result of that the credit loss provision is not booked anywhere, so you just use it when you calculate your solvency, but it is not as if transferred to accounting. It is in totally different systems and it is different result than with this. So in a way it requires more reliability so that you can perhaps trust a bit more to those numbers that the systems produced because you really book it in the profit. (Sundvik, interview 9.12.2015)

3.2.2 New general hedge accounting requirements

Numerous companies that conduct hedging to manage, for example foreign exchange risk, interest rate risk or a price of a commodity select to apply hedge accounting to express the effect of managing those risks in the financial statements. According to IFRS 9, the objective of hedge accounting is to show the effect of a company's risk management actions in its financial statements when the company uses financial instruments to hedge risks that could affect P&L or in particular cases OCI. In

comparison, the criticized hedge accounting rules of IAS 39, which are highly similar to U.S. GAAP, do not require that financial statements reflect the effect of a company's risk management actions. Hedge accounting under IAS 39 has been widely considered as oppressive and cried out for a major reform for many years. (EFRAG 2015, 51; IASB 2014a, 24.) Various stakeholders have indeed desired that the IASB would ease up certain requirements of hedge accounting and finally the standard-setter has answered to the appeal.

It has been promised that the hedge accounting will ease up and the IASB has probably even advertised it with a headline like this.

(Alaharju, interview 17.2.2016)

The new hedge accounting model in IFRS 9 does not profoundly reform the types of hedging relationships or requirements to measure and recognize ineffectiveness as specified in IAS 39. Nevertheless, the model significantly relaxes specific requirements and permits more hedging strategies used for risk management to qualify for hedge accounting. (KPMG 2014b, 106.) It has been regarded that the hedge accounting requirements would now become more sensible and easier to be fulfilled. These qualities are the again expected to add to the popularity of applying hedge accounting.

It (hedge accounting) will become more sensible, just that it is based on risk management, and with it all the sort of net positions and the things that new model bring, it will become more flexible. So I believe that thanks to the new requirements more companies will start to apply hedge accounting.

(Sundvik, interview 9.12.2015)

Accordingly, IFRS 9 introduces new general hedge accounting requirements that should reshape the hedge accounting of IFRS reporting companies. In this case the IASB's objective was to bring major improvements to the existing requirements, notably by aligning the requirements more closely with companies' risk management practices. Indeed, the reform pursues to answer to the persistent criticism of IAS 39 that has been received from several stakeholders. (EFRAG 2015, 2; IASB 2014a, 25.) The rules of IAS 39 have caused frustration for both preparers and users of financial statements. The detailed rules have tended to make the achieving of hedge accounting impossible or very costly, even if the hedging has been economically rational risk management for a company. (PwC 2014C, 1.) Hence, the main concerns widely recognized are that the requirements of IAS 39 are excessively rule-based, difficult to implement and inconsistent with risk management practices (EFRAG 2015, 16). In especial, the hedge accounting reform is regarded to be desired by companies that apply hedge accounting for hedging different commodities or electricity derivatives.

I would say these new hedge accounting requirements are pretty desired. Especially, as far as commodities and electricity is concerned the requirements and the application of hedge accounting under IAS 39 have been a bit troublesome.

Further, then again those rule-based issues, it has been a quite oppressive process to apply hedge accounting. (Sundvik, interview 9.12.2015)

IAS 39 has designated strict hedge effectiveness requirements that a company needs to qualify for applying hedge accounting. This involves a highly effective threshold from 80 percent to 125 percent as the qualifying criteria. Now, with IFRS 9 the requirements have changed and they are less rule-based. Rather, the hedged items and hedging instruments are required to have a connection through an economic relationship that derives to offsetting changes in value, provided that those value changes are not dominated by a credit risk. Therefore, the said reform makes the requirements notably more flexible and allows more hedging relationships to qualify for hedge accounting. (EFRAG 2015, 16; PwC 2014c, 2–3.) The effectiveness limits of IAS 39 have, among other things, been regarded as artificial.

These artificial limits depart that have been totally ludicrous. This from 80 to 125 percent limit, how efficient it has to be or suddenly it (hedge accounting) fails entirely. So this will depart, and now if the efficiency is only 50 percent the rest will go to the profit, period. (Alaharju, interview 17.2.2016)

Now, with the new IFRS 9 these rules depart. In a way the application of hedge accounting becomes more principle-based that is based on the risk management of companies. (Sundvik, interview 9.12.2015)

Both prospective and retrospective effectiveness testing of hedge relations under IAS 39 has also been regarded as oppressive in many circumstances. Consequently, once again, IFRS 9 eases the rules and requires only forward-looking testing to be conducted; retrospective testing is not required anymore. Moreover, the new standard permits to illustrate the effectiveness qualitatively or quantitatively, being relative on the characteristics of the hedge relationship. Whereas, IAS 39 required that the effectiveness is demonstrated quantitatively in all circumstances. (PwC 2014c, 7–8.)

According to IAS 39, at every financial statement you are obliged to indicate as if looking backward that the hedge accounting was efficient, and looking forward that it will be efficient. So if you have one on one interest rate swap, it is quite oppressive to conduct such efficiency calculations. Whereas, the starting point in IFRS 9 is that it is much easier, you do not have to test that much if it is just clear that it is efficient. (Sundvik, interview 9.12.2015)

What is more, the hedging of risks has indeed become general business practice. Today, investors want to be capable to comprehend the risks that a company faces, what management does to manage those risks and how effective the risk management strategies are. Yet, many investors have believed that the hedge accounting requirements of IAS 39 have not succeeded to provide this sort of information. As a result, investors have frequently been obliged to use non audited i.e. pro forma information to understand risk management strategies of companies. Against this

backdrop, IFRS 9 strives to that companies may better reflect their risk management practices in their financial statements. This should, in turn assist investors to better comprehend the effects of hedging strategies on the financial statements.

In addition, in compliance with IAS 39 numerous companies have reported different types of profits for stakeholders in order to clarify specific issues caused by the reporting of hedge accounting, notably clarifying the roots of exceptional volatility of profit. (IASB 2014c, 25, 27.) In this regard the reform has been noted to possibly diminish the need of reporting different types of profits and lessen the volatility of the hedge accounting applying companies' profits.

This will probably take a step closer to that more and more transactions will go also in the P&L in the same cycle with that specific risk. And that is the purpose and aim of hedge accounting. (Alaharju, interview 17.2.2016)

I do not think it will affect a lot to the risk management. But with the financial reporting, companies that have not applied hedge accounting and have had the volatility of profit, I think most of these will evaluate that can they make it work, and start to apply hedge accounting, thus the profit should be more correct, hindering the volatility of profit. (Sundvik, interview 9.12.2015)

And some companies have now reported two types of profits; a result according to IFRS and their 'actual operational result' in which among other things the hedge accounting related issues are corrected. Hence, I think that the need for this sort of practice may also diminish in future. (Sundvik, interview 9.12.2015)

Altogether, the new hedge accounting requirements in IFRS 9 introduce a major overhaul of hedge accounting. The IASB has conducted a fundamental review of hedge accounting and reconsidered related aspects, such as the objective of hedge accounting, hedged items, hedging instruments, effectiveness assessment, discontinuation and rebalancing, groups and net positions, presentation and disclosure as well as alternatives to hedge accounting. The IASB states that the failing of IAS 39 in the matter, relates to that the hedge accounting rules of the standard were developed when hedging was relatively new practice and not as extensively comprehended as today. Since, the use and sophistication of hedging has significantly increased, the IASB concluded to profoundly evaluate all aspects related to hedge accounting. (IASB 2014a, 24–25.) Accordingly, the lastly issued IFRS 9 (2014) presents considerable amendments to the hedge accounting requirements that were originally presented in the earlier version of IFRS 9 (2013) (KPMG 2014b, 106.) The below table further demonstrates some of the major changes brought to hedge accounting requirements by IFRS 9.

Table 8 Changes in hedge accounting requirements under IFRS 9

<i>Hedge effectiveness</i>
<ul style="list-style-type: none"> • Hedge designation based on the 'economic hedge' and actual risk management strategy. • No imbalance that could create ineffectiveness to achieve an accounting outcome inconsistent with the purpose of hedge accounting. • Credit risk does not dominate the value changes that result from the economic relationship. ➔ Eases the previous rules (85%-125%) to allow more hedging relationships to qualify for hedge accounting.
<i>Effectiveness test</i>
<ul style="list-style-type: none"> • Only prospective test, required at each reporting period or when circumstances change. • Either qualitative or quantitative depending on complexity of hedge relationship.
<i>Rebalancing</i>
<ul style="list-style-type: none"> • The concept of <i>rebalancing</i> is introduced. • Required if the risk management ratio changes. • Signifies the continuation of hedging relationship without the need to reset a hypothetical derivative (cash flow hedges) or start amortization (fair value hedges). ➔ Permitted by increasing or decreasing the volume of the hedged item or hedging instrument in the relationship.
<i>Eligible hedged items</i>
<ul style="list-style-type: none"> • Components of non-financial items are permitted if the risk component is separately identifiable and reliably measurable. • Permits hedging aggregated exposures, including derivatives. • Groups of dissimilar items, including net exposures allowed. ➔ More flexibility in designation of exposures as hedged risks. ➔ Removes restrictions preventing economically rational hedging strategies from qualifying for hedge accounting.
<i>Hedging instruments</i>
<ul style="list-style-type: none"> • Allows cash instruments classified at FVTPL for hedging all types of risks. • Allows debt instruments classified at AC for hedging foreign exchange risk only. • Significant changes in the accounting for the time value of options and hedges with forward contracts.
<i>Disclosures</i>
<ul style="list-style-type: none"> • Disclosures must be presented for each 'category of risk' on the basis of how a company manages its risks by hedging. • Disclosure requirements in three main sections: <ul style="list-style-type: none"> ○ Risk management strategy. ○ The amount, timing and uncertainty of future cash flows. ○ The effects of hedge accounting on the primary financial statements ➔ Disclosure requirements are extended.

The table above compiles some of the major changes that IFRS 9 brings with its new hedge accounting requirements (PwC 2014c, 4-24). For instance, the capability to hedge risk components of non-financial items may be welcomed by many companies that have not been able to achieve hedge accounting requirements under IAS 39. Since, IAS 39 allows only hedges of components for financial items. Now, IFRS 9 permits companies to designate a risk component of a non-financial item as the hedged risk, provided that it is distinctly identifiable and reliably measurable. This should be easy to demonstrate if it is contractually specified. However, it can prove more challenging outside the contractual specified area. Moreover, the capability to hedge net exposures under IFRS 9 is viewed to be consistent with common risk management practices that should remove the requirement to identify specific gross cash flows. Instead, under IAS 39 it is

required that a specific amount of purchases is matched with the specific net open position. (PwC 2014c, 11–12.)

Perhaps with raw materials and commodities it (new hedge accounting rules) will increase it (hedge accounting), since it will allow to dice those components. Many have not even tried it until now, it (new hedge accounting rules) will bring possibilities for many. (Alaharju, interview 17.2.2016)

What is notable, IFRS 9 also introduces major reforms to the guidance that is related to accounting for the time value of options. Since, IAS 39 permits only the intrinsic value of an option to be designated as the hedging instrument, whereas the time value is marked to market through P&L. The significant reform here is that IFRS 9 equates the time value of an option to an insurance premium, hence the time value is recorded as an asset on day one and then released to P&L based upon the type of item that the option hedges. Consequently, any changes in the fair value of the option related to the time value is recorded in OCI, together with changes in intrinsic value, and then reclassified to P&L. The same treatment applies also to fair value hedges. Such treatment may be welcomed by many companies, and it is evaluated to result in an increased use of purchased options in hedge accounting, since the income statement volatility of the time value is now avoidable. (PwC 2014c, 19.)

Considering the expected benefits of the new hedge accounting requirements, the EFRAG has assessed that the new model should bring relevant information, as the model has been planned to embody in the financial statements the effect of a company's risk management practices, and the model should largely accomplish this objective. Further, the EFRAG anticipates that reflecting the eligibility of hedged risks and the eligibility of hedging instruments, involving the treatment of time value of options, it is generally concluded that the relevance of the consequential information should be improved. Furthermore, it is anticipated that the financial statement information should be enhanced by the extended disclosures of hedge accounting in IFRS 9. Finally, IFRS 9 allows companies to choose between applying hedge accounting requirements under IFRS 9 or continuing to apply the existing hedge accounting rules under IAS 39 for all hedge accounting. (EFRAG 2015, 16, 20.)

So this (new hedge accounting requirements) is precisely for commodity companies, for oil companies, for basic metal or electricity companies types of companies a really big thing. (Sundvik, interview 9.12.2015)

The biggest benefit of IFRS 9 is probably at the commodity side that is where most significant benefits are. For example, if you have not been able to exploit hedge accounting before. (Alaharju, interview 17.2.2016)

3.2.3 The key accounting changes and anticipated effects of IFRS 9

After presenting the selected requirements of IFRS 9, it should be summarized what are eventually the most drastic changes the standard brings to the accounting for financial instruments. The most significant reforms and the related anticipated effects are underlined before entering to the case study part of the thesis. Thus, most of all, it may be stated that the impairment requirements of IFRS 9 are recognized as the most noteworthy change in accounting. The new forward-looking impairment model or the so-called expected credit loss model has been viewed to reform the booking of credit losses entirely. Since, the impairment model requires recognizing credit losses before any of the related losses are realized. The model is stated to differ entirely from the guidance of IAS 39. Alongside theoretical examination, the IFRS experts felt that the new impairment model would be the most significant change presented by IFRS 9. The reformed impairment requirements were also seen as the biggest challenge that companies will face as implementing IFRS 9. The figure below demonstrates the anticipated effects of the new impairment requirements.

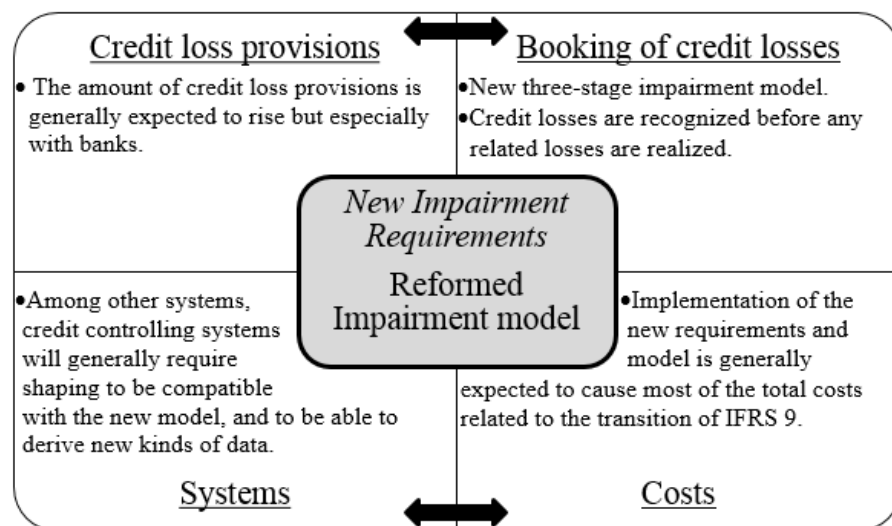


Figure 6 Key anticipated effects of the reformed impairment requirements

As the figure illustrates, the booking of credit losses will alter significantly under the three-stage impairment model of IFRS 9. In short, the model will require companies to recognize credit losses earlier and greater than before. This connects to credit loss provisions as described in the figure. Since, it is assumed that the reform will have effect on credit loss provisions of companies. Thus, it is generally expected that the amount of credit loss provisions will increase, which would in particular concern banks. In the same way the reform is regarded to possibly have effect on companies' KPIs, such as on profit or on solvency.

What is more, it is anticipated that the implementation of the impairment requirements will bring about major costs, as highlighted in the figure. It is expected

that the implementation will cause most of the overall costs related to the transition of IFRS 9. That is, the implementation would cause significant costs related to, among other things, training of personnel and updating of systems. Indeed, here is the costs' connection to systems, as illustrated in the figure. The impairment model is noted to have great effect on different systems of companies. This involves reshaping and updating systems, especially existing credit controlling systems. Again, the various challenges of the reform concern especially companies in the financial industry.

The other major aspect of accounting that IFRS 9 reforms most considerably is the hedge accounting requirements of IFRS reporting companies. Above all, the new requirements and the new general hedge accounting model will significantly relax the present rules of IAS 39. This should allow for more hedging strategies used for risk management to qualify for hedge accounting. It has been regarded that the hedge accounting requirements would now become more sensible and easier to be fulfilled. Again, among theoretical examination the IFRS experts viewed that besides the impairment model the reformed hedge accounting requirements would generally be the most important reform in IFRS 9. The figure below exhibits the above said key changes of hedge accounting requirements and the related anticipated impacts.

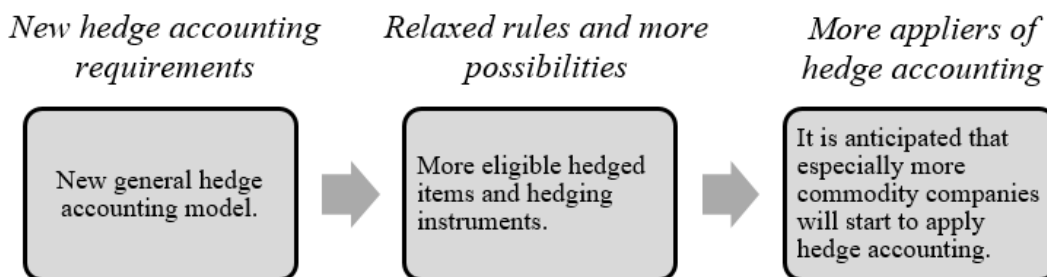


Figure 7 Key anticipated effects of the reformed hedge accounting requirements

As the figure illustrates, the reformed and less rule-based requirements involve a new general hedge accounting model. The model will, for example allow for companies to apply hedge accounting for new kinds of hedged items and hedging instruments. Further, among other things, the measuring of hedge effectiveness will relax. Consequently, in brief, the relaxed requirements are expected to induce to that more companies will start to apply hedge accounting. It is recognized that this is of especial importance for companies doing business with commodities or with raw materials, such as for oil companies. Thus, these companies are particularly anticipated to be better able to exploit hedge accounting and possibly hinder the volatility of their profits in future. In general, many companies have not been able to apply hedge accounting for its oppressive rules under IAS 39. To be noted, it is not all about relaxation of current requirements, since the disclosure requirements of hedge accounting will extend under IFRS 9.

4 CASE: THE KESKO GROUP

4.1 General issues of the standard change at Kesko

4.1.1 *The interest in IFRS 9*

First and foremost, it should be noted that the interest in IFRS 9 emerged at the Group Treasury of Kesko. Hence, it would not be rightly arrayed that Kesko as a company would be exceptionally interested about IFRS 9. The new standard and the related issues are set in the Treasury's area of responsibility and outside the core business of Kesko. The company is a trading sector business, thus managing and accounting financial instruments are not central part of Kesko's operation. Nevertheless, for the operation of the Treasury, IFRS 9 belongs to one of the most interesting and significant forthcoming changes that require careful evaluation already now.

We are a trading sector company, and this finance function is a supporting function, thus our main function is not to have investment actions.

(Koskela, interview 5.2.2016)

Koskela acknowledged that attention is in particular paid to IFRS 9, since it will be a mandatory standard, which Kesko as a listed company will be obliged to apply. In other words, there was no effort to deny the fact that the ultimate reason for being interested in the standard, originates from its compulsion. At the same time, this is perhaps not so surprising, among other things, having heard opinions of the IFRS experts concerning the general preparation of companies for the standard change.

In the first place, it (IFRS 9) will be mandatory when it comes into force. Thus, this is the first point. (Koskela, interview 5.2.2016)

For the other, possibly more interesting roots of the interest, were mentioned the forthcoming relaxation of the hedge accounting requirements and the new classification and measurement requirements in which the amortized cost measurement is conceivable for Kesko's financial assets. Firstly, Kesko applies hedge accounting and the related rules of IAS 39 for electricity derivatives. The new hedge accounting requirements are, among many companies, also desired at Kesko because they may present reliefs and new possibilities related to the hedge accounting the company applies. The possible effects are described subsequently in the relevant chapter. Furthermore, the new classification and measurement requirements and the new measurement principles of

IFRS 9 were subject to interest. Since, it is possible that the new requirements stand for a chance to simplify the accounting for financial assets at Kesko. The related possible effects are also described in the following chapter.

Further, in a way, as I mentioned it will ease the hedge accounting, and most likely, subject to your main focus, the measurement of assets, I envision that better and simpler measurement is achievable. Unless, something unexpected would occur, such as that an auditor would disagree with us in the matter. (Koskela, interview 5.2.2016)

It may be concluded that the compulsion of the standard and the specific simplification possibility through the new classification categories were recognized as the most triggering features of IFRS 9. What is more, the new standard is of importance, as it will have an effect in the work and tasks of several individuals at the Treasury. Likewise, the researcher has observed that the standard would have effect on specific monthly or even daily operations related to the accounting of financial assets.

This is the way I see it (compulsion and simplification), since these are significant matters also related to the doing, as it is really put into effect in practice. Moreover, now for one, we should understand the starting point, where we come from, so what we have to change. (Koskela, interview 5.2.2016)

Once more addressing the issue why IFRS 9 is not overly critical for Kesko as a company, the issue relates to that the forthcoming changes in accounting requirements will probably lead to variations in the company's reported result that will not drastically adjust the reported result of Kesko on the big picture. (Koskela, interview 5.2.2016)

It is viewed from Kesko's point of view, and it is viewed in the sense that those fair value changes would not rise in this size of a Group. If you think that you would book €0.1 million euros from some portfolio as the fair value change, it is rather really small piece of our result and in the possibilities of our result making. We have not had the kind of instruments that would have had fair value changes worth of millions, you know, or something like this. In that case, it would a different thing. Those have been around hundreds of thousands, anyhow. (Koskela, interview 5.2.2016)

4.1.2 Liquid financial assets of Kesko

It may be stated that Kesko has for long been an ably financially sound company. That said, for several years the amount of liquid financial assets that the Treasury manages

has been substantial, at least for a trading sector company. For instance, Kesko had about €887 million worth of liquid assets (bank deposits included) at the end of 2015. In this context this is of importance, since the amount of liquid financial assets relates outright to the management and accounting of the assets.

We have always had sufficiently cash and never has it been that you would have to go to a bank with a hat in a hand. Certainly, with reasonable amounts the Treasurer executes that balancing of balance sheet, as net debt would be ideal, and now our net debt is negative, which is not ideal. We will hopefully achieve it (net debt), but for surprisingly many years we have sit with these excessive cash reserves. (Koskela, interview 5.2.2016)

Koskela stated that the large cash reserves, which have led to the Kesko's significant amount of financial assets, have time to time caused a puzzle at the Treasury. In particular, since the related investment actions are not the core business of the company. What is more, today the managing of those assets, especially the generating of yield for the assets has become most challenging. Since, the markets have experienced interest rates at extremely low levels and for instance the bond investing has entered the so-called low-return world. The figure below illustrates how the amount of liquid financial assets of Kesko developed between December 2014 and December 2015. The financial assets are divided and presented monthly in the different charts following the three different portfolios of treasury policy.

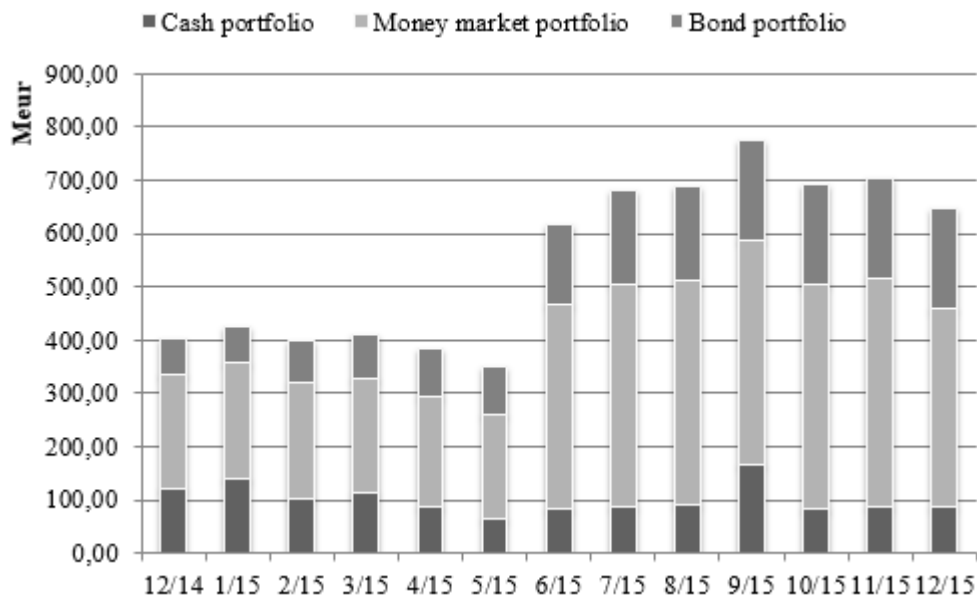


Figure 8 Liquid financial assets of Kesko between 12/2014 and 12/2015

As the figure implies, Kesko had relatively large amount of liquid financial assets i.e. large cash reserves during last year. The figure also illustrates the different portfolios defined in Kesko's treasury policy: the cash portfolio, the money market portfolio and

the bond portfolio. Money market portfolio was clearly the largest component during the examination period, as it has also traditionally been. Koskela noted that the portfolio division was originally made in 1990s, in a way, on the basis of the risks of the different instruments. She also admitted that today generating yield for the assets in the portfolios is ably different than it has traditionally been.

The cash portfolio consists of very liquid items, so the duration is close to a month maximum three months. The treasury policy was made somewhere in the 1990s. Moreover, for finance people it has been important that we have had the option to invest these extra liquid assets, under this large group. Since, we have the centralized Treasury we have all the money in a way in one hand. Hence, we have had the opportunity to also create added value for Kesko with this function at one time. Today, the interests are something totally different, thus the creating of added value is rather difficult. When the interests were just normal, you could have had even 5 percent for some investment, and it was a good yield, if you compare it to today's yields. (Koskela, interview 5.2.2016)

The bond portfolio is the component, which has traditionally generated more yield; longer duration, higher interest and so on. Yet, at the moment the yield has also perished to be quite minuscule. Then we have the money market portfolio, here in between, which duration target is six months, thus it does not include so liquid items. If business would require funds, the first one to be liquidated would be the cash portfolio, as it is so short, those would naturally fall due, or it would be easier to sell the instruments in that portfolio. (Koskela, interview 5.2.2016)

On 8 May 2015, it was announced that Kesko would set up a real estate investment company with AMF Pensionsförsäkring and Ilmarinen. The arrangements lead to €76 million gain for Kesko, which was treated as a non-recurring item in interim report for the second quarter. (Stock exchange release, 11.06.2015, Kesko) This was the most significant gain related to the cash reserves during 2015. Altogether, Kesko has for the most part operated in a relatively stable business, in grocery trade business that generates cash flows rather stably. Though, hardware retailing involves some cycles.

However, now the most intriguing question is that how large cash reserves Kesko will have in future, when the IFRS 9 will be applied? In short term, related issues may already be recognized. For one, Kesko has announced it would invest by acquiring Suomen Lähikauppa for approximately €60 million. (Stock exchange release, 18.11.2015, Kesko) For the second, Kesko has made agreement to acquire Onninen Oy for a transaction price of €369 million. (Stock exchange release, 12.01.2016, 09:00, Kesko) Both of these deals, if actualizing, will significantly decrease the Kesko's cash reserves and funds available to be invested in financial assets. Further, it is after all

recognized that the variation of Group's cash flows and funding needs present certain requirements for the reserve of liquid financial assets.

Furthermore, Kesko has planned to propose the distribution of a €2.5 dividend per share for the financial year of 2015. This is the largest dividend in the history of Kesko. To compare with, last year Kesko's dividend was €1.5 per share. (Stock exchange release, 12.01.2016, 09:01, Kesko) Hence, the distribution of dividend will also affect the cash reserves. Overall, examining the different investment actions and the distribution of dividend, the trend seems to be that Kesko will not have so large cash reserves i.e. amount of liquid assets in future than at the moment. It is also recognized that the development of Suomen Lähikauppa chain will require significant amounts of funds. (Koskela, interview 5.2.2016)

We are able to spend it (cash reserves) quite well, when we buy Onninen if we get the permission, and if we are able to buy Lähikauppa, which will not require that much money, but the development of that chain will require money. Moreover, then we will pay this so-called extra dividend, which is worth of 2.5 euros a share in the spring so that will also cut our cash reserves. (Koskela, interview 5.2.2016)

4.1.3 Accounting under IAS 39

First of all, Koskela allowed that in general IAS 39 has been a standard, which has required specific attention and procedures. This does not take by surprise, as viewing the previous theoretical examination and thoughts of the IFRS experts on the standard. As many others, Koskela referred to IAS 39 as a complex standard. In the initial application of IAS 39, it was also recognized that the transition required a lot from systems and calculating principles. The standard was said to take time to assimilate for its complexity. Moreover, Koskela regarded it as a blessing that Kesko has not principally applied any exotic financial instruments, such as options or hybrid contracts, which would have been treated all the more complexly under IAS 39.

It (IAS 39) was indeed the standard, which required familiarization and it was generally called the most difficult standard ever. You can be thankful that we do not have so exotic instruments at Kesko, thus you did not have to understand all its (IAS 39) nuances. Since, we have rather basic: foreign exchange derivatives, interest derivatives, investment instruments and loans, so we do not have any kind of hybrids. Nor any exotic derivatives in which a specific part, well for instance an option is perhaps the most complex instrument, as it involves the time value and basic value, so you have to understand which part you can for example include in hedge accounting and so on. (Koskela, interview 5.2.2016)

As the most challenging aspect related to the accounting under IAS 39, Koskela distinguishes the calculating or clearing of fair values. Fair values related to specific hedging derivatives and to financial assets managed. Indeed, this is a matter that the researcher has also observed as working at the organization. Every month the clearing of financial assets' fair values consumes a considerable amount of time. Since, the ability and quickness to provide reliable fair values varies a lot among different issuers. Whereas, in practice nothing can be booked at the Treasury before reliable fair values are received. Koskela also stated that the oppressiveness of the documentation requirements of IAS 39 has contributed to that Kesko has not commenced to apply hedge accounting for foreign exchange contracts. The hedge effectiveness limits of IAS 39 (80-125%) were also felt as oppressive to document for electricity derivatives.

It is the calculating of fair values. Thus, all derivatives, all our investments are valued at fair value, then again, where the fair value change is booked, depends on whether hedge accounting is applied or if those investments hold such items that it is possible to book it in the own equity. On the foreign exchange side we haven't started to apply hedge accounting, in particular, because those documentation requirements have been so oppressive. You have to document it so precisely, and then we know that our operation is continuous, we know that we buy from abroad, quite regularly exact amount of products, which we then sell in euros to consumers in Finland. Hence, we conduct that kind of systematic hedging for that, for example hedging the dollar risk, but then in a way the hedge accounting component is left out and the fair value change from those hedging derivatives will always appear in the P&L. This might bring about that volatility of profit, if the sort of underlying product is not in the balance sheet, then you do not have to book that equivalent fair value change. (Koskela, interview 5.2.2016)

Especially, examining the accounting for financial assets under IAS 39, Koskela recognized that as IAS 39 came into force, the existing treasury policy was complied, into which, the requirements of IAS 39 was brought. Thus, the starting point was the treasury policy not the standard itself. Nevertheless, following the rules of IAS 39 under the treasury policy, a lot of effort is currently put into handling the accounting of financial assets portfolio by portfolio. Moreover, again, Koskela underlined that the treating of fair values subject to the financial assets requires much effort. This was specified to relate to the booking of assets' fair value changes. Therefore, the accounting for financial assets was in main recognized as quite oppressive in compliance with IAS 39.

I think it is absolutely that you handle it portfolio by portfolio, in different places of P&L and balance sheet, those fair value changes. And certainly that you in the first

place even get that fair value. Within strict timetables that we have had, as you know, by having done this work here. As, we have had funds and if you do not get the value of that fund, you cannot book it before you certainly know the value. Furthermore, we have built-in TWIN this calculating of fair values. TWIN is our treasury system, which is very basic system, not any kind of Mercedes of treasury systems, but reliable and able to produce that specific outcome we have defined, how we want to disclose that outcome. If we have these kinds of rather basic instruments, like commercial papers or bank's papers etc. so it is purely the measurement to that underlying yield curve to that point where the curve is at the moment when you conduct that measurement so it will affect to that fair value change. All of these, we have had to build by ourselves and understand how these should be build, and this has been the challenge initially, sure the generation of that (measurement) every month is basically routine nowadays. (Koskela, interview 5.2.2016)

Further, Koskela agreed that initially it took a lot of work to construct the TWIN Treasury and Asset Management system, to be compatible for computing the fair values as well as the fair value changes of financial assets. The Treasury applies the TWIN system for a myriad of different reporting purposes. Altogether, the main complexities in accounting under IAS 39 were stated to relate to the applying of fair values in bookkeeping and applying of different measurement basis according to the current portfolio classification. Additionally, providing reports about fair values of liquid assets on monthly basis and under strict timetables has caused challenges. Even though, this does not relate directly to the qualities of IAS 39. (Koskela, interview 5.2.2016)

4.1.4 Accounting under IFRS 9 and its expected key effects

For the high degree of uncertainty related to applying the upcoming rules, it is rather difficult to conclusively describe the future accounting under the standard. At least, most of the nuances related to the actual doing are ought to be left out in this framework. Rather, it is possible to generally anticipate that what reforms IFRS 9 might bring with. The aforesaid challenge was also strongly present with interviewing the IFRS experts. In other words, only after IFRS 9 is actually applied more is naturally known about applying the standard. Koskela also viewed that this study would serve as a learning tool subject to the requirements presented by the standard change.

It is a still a bit that it has not totally unfolded to me, but step by step. My view is that through your study, we would have more to work with, to think about these more carefully. Thus, could we simplify this treasury policy's cash reserve policy,

which is part of that large entirety? Simplify those portfolio structures and through that the bookkeeping specifications, if we could get to the point that we can verify that our aim is to hold in each case the investment instrument to receive those interests and the related principal back, period. Hence, in that case we would measure it to the amortized cost. (Koskela, interview 5.2.2016)

Above all, Koskela viewed that there is a distinct possibility for simplifying the accounting for financial instruments. This would include streamlining the current portfolio structures and measurement of liquid financial assets. Likewise, in the first place, the treasury policy might also undergo some simplifications. Therefore, Koskela desired that the aforementioned hold to collect business model would be the model that Kesko could apply in managing its financial assets in future. She viewed that the qualities of hold to collect model would be suitable for Kesko. Under this business model the financial assets would accordingly be measured at amortized cost. Being capable of applying the hold to collect model would, for instance remove the challenges of dealing and clearing with fair values of financial assets to a large extent.

I strongly want to believe that here is an opportunity (to simplify the accounting of financial instruments). (Koskela, interview 5.2.2016)

Hence, if in the future we have the possibility to measure all our investments at amortized cost, we won't face the 'fair value dilemma', which is totally peculiar today. (Koskela, interview 5.2.2016)

Furthermore, Koskela expressed her opinion about the term business model, which remains a bit ambiguous for her. This underpins the presented theoretical examination about the subject. The specific term choice was felt perhaps a bit artificial and not the most informative, especially when considering the operation of the Treasury.

It (business model) is unfamiliar as a word for me, at least in the beginning as I started to think about it, as to why this sort of word should be stuffed here. As, this is not business, but then you probably have to think about it more broadly that we have a certain amount of assets, which we manage, and then someone has come up with this business model term for that. Still, I do not perfectly assimilate that.

(Koskela, interview 5.2.2016)

Subject to the new hedge accounting requirements, which present certain reliefs, Koskela anticipates that under IFRS 9 it could be possible to choose a specific component under hedge accounting. At the moment, in compliance with IAS 39 it has, for example, been required to include both system and area price of electricity - two different components - under the hedge accounting Kesko applies. Though, only the

system price has been hedged. Hence, it is anticipated that in the future it would be possible to take the system price for the criterion of hedge accounting, when also the effectiveness of hedge accounting would be significantly different. Additionally, new hedge accounting requirements could present potential for applying hedge accounting for foreign exchange derivatives, for which hedge accounting is not at all applied at the moment at Kesko. Oppressive documentation of the process is stated to be one of the reasons for not applying hedge accounting for foreign exchange derivatives. The new requirements will, at least, in theory open up new possibilities to be evaluated. Anyhow, more thorough assessment of the issues calls for another study. (Koskela, interview 5.2.2016)

If this standard (IFRS 9) will allow us more room, not so meticulous documentation, calculations et cetera, then we are able to imagine that also in the foreign exchange side it would be possible to apply hedge accounting.

(Koskela, interview 5.2.2016)

4.1.5 Preparation for the standard change

Implementing IFRS 9, as always with different projects, the preparation is intrinsically critical. Thus, Koskela anticipated that the initial baseline for evaluating the new classification requirements is to scrutinize the existing treasury policy. The subsequent preparation steps Koskela suggested, such as reforming chart of accounts, were strongly based on the assumption that the hold to collect business model would be applied. Despite the applied business model, the initial assessment would probably concern the treasury policy. This is a matter that emerged also with interviewing the IFRS experts. Koskela also thought that the current TWIN Treasury and Asset Management system would without further problems adapt to the reporting in compliance with IFRS 9.

I view that the starting point is the treasury policy, and after that we will form a perception about what is our following, as the standard comes into effect, accounting principles and calculation principles for these investments assets. Further, I believe that our systems will work, there is no significant reform related to the treasury system, we just have to know how we can bring forth that amortized cost from the system, and then it is just also that pure formulation of chart of accounts. Thus, we have to modify the chart of accounts subject to the investment categories, as at the moment there is this fair value change of available-for-sale investments, and there is the fair value through P&L. We will probably simplify the balance sheet lines, simplify the components in the P&L, so there won't be those fair value reserves or something like this. (Koskela, interview 5.2.2016)

The actual timetable for assessing and implementing IFRS 9 was not yet composed at Kesko. However, Koskela had distinct thoughts on how to commence the preparation for the standard change. Thus, even though IFRS 9 is supposed to come into force in 2018 the preparation should be started surprisingly soon. Since, retroactive applying of classification and measurement requirements is mandatory, thus it is required to produce comparison calculations for the financial year of 2017.

In 2005 when the standard (IAS 39) was adapted, thus in 2004 we already calculated how the things would be according to the new standard. Then in 2005 when the financial statement was released, it was needed to produce comparison calculations from the last year for the annual report, even though it was not yet applied then. Thus, we had those calculations, which we compared.

(Koskela, interview 5.2.2016)

Yet, I do not have date marked in the calendar (when the assessment of the standard change starts) but if this will come to effect in 2018, already in 2017 we have to be very aware about what we are doing. In particular if we have to produce comparison calculations but were those mandatory? I do not remember. It has been required with some standards, whereas with some it has not been required. (Checking out that retroactive applying is mandatory) In this case, we have to know this already before the end of 2016. Then we will conduct the comparison calculations for 2017 to be ready. (Koskela, interview 5.2.2016)

In addition, Koskela felt that an essential task that relates to the standard change, at the moment, is the transmitting of information to the management of Kesko. She noted that it is in the responsibility area of the Treasury to inform the management about the most significant issues relating to the anticipated implementation effects of IFRS 9. (Koskela, interview 5.2.2016)

And then the transmitting of this idea to the management, it is our task at the moment, to increase that knowledge for them, because it is not possible for them to get acquainted with everything. So let's provide them some tools through this.

(Koskela, interview 5.2.2016)

4.2 The business model for managing financial assets

4.2.1 Treasury policy under which liquid financial assets are managed

The current treasury policy of Kesko, which was already shortly discussed in Koskela's interview, was regarded for a start in the focus group interview. First, Ala-Seppälä clarified specific guiding factors of the three different portfolios; cash portfolio, money market portfolio and bond portfolio under the present treasury policy. In particular, duration and risk return ratio of investments i.e. financial assets were regarded as the most noteworthy factors. Moreover, he carefully explained about the purpose of the factors, and how the policy had been connected to IFRS in the past. Ala-Seppälä verified the view that as IAS 39 was adapted, the starting point of the standard assessment had been the treasury policy itself, into which the requirements of IAS 39 had been merely adjusted. He also acknowledged that with IFRS requirements it is rather difficult to in a sense tactic. Rather, you are obliged to follow the requirements set by the IASB without questioning. Furthermore, Soikkeli mentioned about specific limits within the treasury policy that partially define the possible market operations he is able to conduct.

My view is that with this (portfolio division) the guiding factor has been the duration, and in a way with this you have to control, besides the risk return ratio, that duration. Moreover, as Kesko is a listed company that releases results at regular intervals, thus it is not desired that the valuation of these would shake the interest income of Kesko to be negative with regard to some quarter. Therefore, these factors have been there, and with IFRS interpretations you cannot tactic, rather then we have just gone according to the standard (IAS 39). The treasury policy itself today and originally has been established on considering what the interest rate risk is. (Ala-Seppälä, interview 23.2.2016)

The treasury policy has defined those limits within you have to operate, as it probably should be, defining what you can do and what is prohibited. (Soikkeli, interview 23.2.2016)

Ala-Seppälä also expressed his view concerning the future development of Kesko's treasury policy under which the financial assets are managed. He noted that the grounds for the policy would unlikely change, though admitting that the year 2016 is expected to be exceptional for Kesko. That is, the company is expected to possess a higher amount of liquid assets than ordinarily for certain funding needs. Further, a minimum level of €50 million worth of liquid assets within the portfolios and a mental target to be capable

to liquidate all the assets within a month, were recognized to be a part of the treasury policy's guiding lines.

We do not desire to possess an enormous quantity of financial assets permanently. The current treasury policy defines that the minimum amount we have to have is €50 million. Further, as this year (2016) we have announced these acquisitions agreements that are in regulatory process, we will hold it higher due to that there are lots of opportunities for surprises in the cash flows because those investments are so large. Nevertheless, I do not believe that in future we would especially desire to collect more financial assets, rather we have this that we have collected those assets as a pot, and when a right business investment faces us then we have that money already. Moreover, we have kept this mental aim that there would not be anything that we could not liquidity within a month when needed for the business. (Ala-Seppälä, interview 23.2.2016)

Discussing more particularly about the future of the treasury policy, particular differing views of the interviewees emerged. Since, Koskela reinforced her position for simplifying and modifying the treasury policy, in order to further simplify the specific accounting practices concerning the underlying financial assets. Whereas, Soikkeli's and Ala-Seppälä's stand on the issue was that no changes regarding the policy would likely to occur. The differing opinions might have partly originated from the interviewees' dissimilar knowledge about the standard change's effects. As, the policy is likely to undergo some modifications to support the requirements of IFRS 9, irrespective of whether any drastic classification and measurement changes will occur. All the same, the gentlemen viewed that the treasury policy itself would probably not undergo any significant reconstruction.

I hope for that simplifying, as to be able to decrease those accounting practices. Since, the standard gives an opportunity for that in the future, and as anyway we are not a financial institution, our aim is not similar to a bank or any corresponding to this. (Koskela, interview 23.2.2016)

There is probably no reason to expect that the treasury policy would significantly change in future. Perhaps, those bookings and that, but how the treasury policy is done in practice, the risk limits and those, I do not believe it will change very drastically. (Soikkeli, interview 23.2.2016)

Neither, do I believe that the treasury policy will change. There is even a possibility, I do not predict that it would remain entirely but it is not completely impossible. Then we would just interpret it according to the current situation, what

kind of classification we would have. Further, we would use the required terms for it to fulfill the requirements of the upcoming standard.

(Ala-Seppälä, interview 23.2.2016)

Dancing around the issue came up relevant questions that associate to the relation between a company's business model for managing financial assets and a company's treasury policy. What is the relation between the business model and the treasury policy? In particular, which one of these should be addressed primarily when performing the business model assessment under the requirements of IFRS 9? The standard does not provide unequivocal answer for this, as it does not particularly cover any guidance about companies' treasury policies or about analogous policies. However, interpreting the requirements of IFRS 9, as well as hearing the opinions of the IFRS experts, the below statement of Ala-Seppälä might have just elegantly captured the idea of the elements' interconnection. (Focus group interview, 23.2.2016)

Those (business model and treasury policy) are in interaction. Yet, if you say which the egg is and which the chicken is, first surely comes the treasury policy. I underline that there is a feedback, because we have to understand surely that we have novel classification and novel measurement so it affects to that treasury policy itself from this way. Thus, it is possible that certain approaches that have before been allowed to operate are not so compelling and others may in a way be allowed again. Further, I feel that in general this seems to be an improvement compared to the IAS 39. (Ala-Seppälä, interview 23.2.2016)

Those (business model and treasury policy) goes hand in hand, right? (Soikkeli, interview 23.2.2016)

Taken together, the treasury policy will most certainly be in a central role, as the business model for managing financial assets is defined at Kesko. Having examined the subject, the treasury policy will arguably be at least part of the most relevant evidence, on which the business model is based. This came forth with IFRS expert Alaharju's interview, as she stated that some companies have already reformed their policies, and this has included a distinct effort to built-in grounds for the business models. With Kesko it seems that the guiding factors of the current treasury policy will not change but atleast the narrative reporting about the policy will be altered to be in line with the chosen business model.

Furthermore, the idea Ala-Seppälä suggested concerning business model and treasury policy; which is the egg and which is the chicken, as if which one is primary, is anyhow intriguing in this context. Specifically, if a company analyzes that from what basis it should start its business model assessment. Since, basing the business model

thoroughly on an existing treasury policy will perhaps not induce any drastic changes or emerging developments. Whereas, if the treasury policy itself is regarded to some extent inferior to the business model in the assessment, significant changes are possibly expected to occur, as the policy is reshaped. This would naturally induce more workload, yet unexpected benefits might follow from the thorough overhaul.

4.2.2 *Stance on the term business model for managing financial assets*

Considering the term business model for managing financial assets, the interviewees expressed opinions that were mostly critical and corresponding to the previous perceptions of this study. In other words, as the theoretical examination has indicated the business model remained ambiguous also amongst the interviewees. Soikkeli, for instance, felt that the concept is a perhaps a bit unclear and does not feel very natural with respect to business of Kesko. Meanwhile, Ala-Seppälä agreed to Soikkeli's statement, noting that the term has been applied in other businesses of Kesko, such as with real estate business operations, yet not in the least with managing financial assets. Further, Koskela expressed even a stronger opinion about the term, viewing that it does not settle with finance world, allowing that Group Treasury is merely obligated to cope with it.

It (business model) does not feel somehow overly natural as an idea for a company like this whose business is not actually holding financial assets but to do something totally different business in which are those business models. In that sense, it feels perhaps a bit unclear as a concept in this context. (Soikkeli, interview 23.2.2016)

Frankly speaking, the term business model does not settle with this finance world. But we have to live with it and that is the only way. (Koskela, interview 23.2.2016)

However, Ala-Seppälä regarded that the term assumedly settles with the financial industry, along with financial companies for which the business model for managing financial assets is of completely different importance than for Kesko. At the same time, he still considered that understanding and applying the term, even if forced to do so, might be professionally developing for the people working around the term.

If we think about those experts, I have understood that IFRS 9 is most significant for companies operating in the financial industry, as for banks. In that field this (term business model) is important, since it is their core business.

(Ala-Seppälä, interview 23.2.2016)

But as such it is professionally developing for us to be forced to take side on this (business model). It may surely develop for instance our policies.

(Ala-Seppälä, interview 23.2.2016)

Altogether, the term business model was not welcomed without prejudice. The consensus amongst interviewees was that for a company like Kesko the term comes across as an artificial word choice. Like Alaharju had suggested that in general companies may need time to understand the term, similar seems to be case at Kesko. As such, the results are no surprise, since the term is so unfamiliar to the interviewees in this context. (Focus group interview, 23.2.2016)

4.2.3 Business model assessment related issues

IFRS 9 delivers extensive guidance on the relevant matters that should be considered when a company conducts a business model assessment. In this context, the purpose of the focus group interview was not to rigorously go through the issues but to look answers for the most prominent matters for the grounds of the actual business model assessment at Kesko. Thus, the issues that were discussed involved, for example business model examples, compensation of managers and specific risks within a business model as well as other relevant evidence. Many of the investigated matters were illustrated in the figure (Aspects relating to the business model assessment) on the page 47.

The standard provides examples subject to when the aim of a company's business model could be hold to collect, hold to collect and sell or other business models. The list of examples, which was provided to interviewees, is not exhaustive nor are the examples expected to discuss all the factors that may be significant to the business model assessment. The idea of displaying the examples was to provoke a discussion about the possible qualities of Kesko's situation that might have been in line with the examples. Particular examples were instantly allowed to be disregarded, since for instance describing an entity as a financial institution. Under these conditions no perfect match was found by the interviewees, as the business model examples were scrutinized. In other words, none of the examples exhaustively fulfilled the features of Kesko's operation, though specific similarities were found. Most resemblances were found from the examples that imitate the hold to collect and hold to collect and sell business models.

Yes, there were many good pieces but Kesko was not any of those (business model examples) directly. (Ala-Seppälä, interview 23.2.2016)

When I was reading through these examples, I found from many places these at least parts that are in a way in use with us. But, in a sense there was not a single example that would have met all the things we do. I have underlined here that I have found at least from the examples one, four, five and six some aspects that describe our situation. (Soikkeli, interview 23.2.2016)

Accordingly, Koskela made the natural conclusion that for relevant evidence the Treasury needs to develop a unique description of how the aim of its business model is fulfilled, in a way Kesko's own business model example. Conducting this, specific aspects of the standard's presented examples might however be exploited. This might include description of monitored values, compensation of managers and relevance of stress scenarios under the chosen business model.

For behalf of Kesko we need to do the conclusion that a single example from the standard will not work, rather we will do our own, and in the end we will get it approved by the management and by the auditors. (Koskela, interview 23.2.2016)

Furthermore, already inspecting the examples Ala-Seppälä made it clear that it is farfetched to view that Kesko would operate under the so called other business models, which include for instance trading activities. He emphasized that the managing of financial assets at Kesko has traditionally excluded characteristics of short term speculation, which would most certainly be the case also in the future. Thus, it was also underscored that the selling of assets has not focused on the rises of their values. On the contrary, the focus has been on the decreases of the assets' values, which have been monitored and analyzed. Additionally, actions have been conducted on this basis to preferably bear losses immediately, and in a sense this way the liquidity of the assets has been ensured.

After all, we have a quite small band here doing this, hence that we per se would think that we buy some financial assets and then soon sell them, if there would be some positive swing. Thus, it is not, we have not operated like this during my fifteen years. It is hard to believe that we would operate like this. Instead, we have always operated like that if there is something negative about the market or about the issuer, we have to be able to very rapidly analyze, and if it would seem like this investment is not like it was when initially analyzed, in this case you have to be ready to realize it. Rather, take the loss immediately because these are the liquid assets and we do not want that the risk of loss is increasing. (Ala-Seppälä, interview 23.2.2016)

Another discussed subject that relates to defining the appropriate business model was the compensation of managers managing the business model. At this point, resemblance

to the compensation of Group Treasury, in general, was found from the hold to collect and sell model's presented remuneration. Ala-Seppälä admitted that overall return generated by the portfolio is a component of the compensation at Group Treasury. Unfortunately, the discussion did not move into detailedly concern the compensation of managers. Nevertheless, it may be assumed and the researcher has, in fact observed that the managers managing the business model have not bonus schemes that would lead to excessive risk appetite or short term speculation.

It (the overall return generated by the portfolio) is a component, not with a significant emphasis but for years it has been a component in defining the whole department's bonus. (Ala-Seppälä, interview 23.2.2016)

Meanwhile, Koskela noted that the compensation scheme might undergo some inspection in future if the underlying assets' related measurement principles would change. Since, also the compensation is now based on the fair value of financial assets. This might have related to her aspiration for simplifying the accounting principles.

At the moment it is based on fair value, as our accounting practices are based on the fair value. But, I would say that in future there is a place for a totally different consideration. (Koskela, interview 23.2.2016)

Anyhow, Ala-Seppälä declared that the remuneration based on fair values would be the right way to operate also in future. He likewise noted that performance bonuses have not played a central role being part of the total salaries at Kesko. Moreover, Ala-Seppälä recognized specific challenges that are related to the monitoring fair values of liquid financial assets.

It has to be assessed, as the models change but surely that fair value is, in my opinion, the right way. Further, we will not, it is not part of Kesko's culture that this kind of performance bonus would have a significant role as a part of the total salary. (Ala-Seppälä, interview 23.2.2016)

At its best, the added value that the return of the fair value should be examined in the long term. But, now we have these financial assets that are by nature short term, liquid assets. Thus, there is a challenge that what would be the right incentive scheme. (Ala-Seppälä, interview 23.2.2016)

The most significant risks that might affect the performance of the anticipated business model were regarded to be the credit and the counterparty risk of liquid financial assets. These risks are also monitored when Group Treasury analyzes the qualities of financial assets at present. Ala-Seppälä further described the process of

monitoring the risks of financial assets and how it is expected to withdraw from risks in general.

Thus, credit risk and counterparty risk are the ones. (Soikkeli, interview 23.2.2016)

Yet, definitely it is like this that we very strongly pursue to monitor all those lines that our treasury system shows us, and from what those liquid assets consists of. Further, we know that it makes sense to withdraw quickly from those risks and we pursue to do that. (Ala-Seppälä, interview 23.2.2016)

What is more, the level of determination is one of the designated issues, as a company performs a business model assessment. That is, the level at which the business model is determined. Soikkeli and Ala-Seppälä felt that this is a part of the standard's requirements in which the IASB could have succeeded to present the idea more articulate. The description about the level of determination under IFRS 9 is admittedly somewhat confusing. Nevertheless, Koskela might have grasped the idea behind the IASB's jargon. In this context, it may be premised that the level of determination concerns most importantly organizations that manage various different business models for managing financial assets, such as financial institutions.

They (IASB) have succeeded to make it sound exceptionally ambiguous.
(Soikkeli, interview 23.2.2016)

As a person of practice, I understand it like that we can combine commercial papers, investment certificates and possibly some deposits and so on. Thus, I would not see that it (the level of determination) is too difficult. (Koskela, interview 23.2.2016)

As suggested that could Kesko have more than one business model for managing financial assets, Soikkeli and Ala-Seppälä regarded that it could certainly be possible. Though, Soikkeli admitted that he is not aware that what it would bring about in practice. Ala-Seppälä also thought that it would nonetheless be better if only one business model would be applied. Concurrently, Koskela remained silent, possibly leaning on her view that Kesko could apply only the held to collect model. Eventually, it was agreed that Kesko would be better off having just one business model.

I do not know what it causes in practice but purely on the basis of the classification, at this point, and on the basis of these examples, I view that it seems pretty probable. (Soikkeli, interview 23.2.2016)

As to that there would be two business models, so without doubt it is possible. Of course, it would be certainly distinct that if we could squeeze it to that one model.
(Ala-Seppälä, interview 23.2.2016)

Stress scenarios and their role with regard to the business model assessment were viewed as moderately distinct. Koskela also noted that the stress scenarios could function as a desirable relief under the standard's requirements. In other words, through the stress scenarios it might be possible to apply the hold to collect business model, if actions under specific scenarios would not distress the selection of hold to collect model in the first place. Further, Ala-Seppälä paid attention to specific qualities of the recent stress scenarios in financial markets, underlining that future might as well bring these sorts of scenarios.

In my opinion, it (stress scenarios) is a good relief for this standard.
(Koskela, interview 23.2.2016)

Thus, this way (through stress scenarios) it could fit to that hold to collect model?
(Soikkeli, interview 23.2.2016)

Now, we have seen and in a way we have lived through these stress scenarios in the world's financial markets. Further, nothing predicts that we would have seen all the horror. Rather, world's markets have changed into that rapid changes occur, tremendous currency movements, interest movements and the combination of these. Moreover, the sudden emergence of counterparty risks, thus these may cause these (stress scenarios). Consequently, even though our aim regard to those assets, liquid assets, or that business plan would not be changed, we may have to take rapid actions. (Ala-Seppälä, interview 23.2.2016)

Discussing about relevant evidence that could be provided for endorsing the chosen business model, Kesko's long history data of managing financial assets was recognized to have a central role. With this in mind, no specific system challenges were expected to emerge as the data is derived from the TWIN Treasury and Asset Management system. Simultaneously, the same data, from more than fifteen years of asset management was regarded as valuable. Therefore, the history data from could be exploited as an evidence of the amount and frequency of financial assets' sales activity.

I would say that our history about conducting these investments, portfolio selections, instruments selections. Thus, with this information we may well justify that what we have used in the past so why would we begin to do something totally different. (Koskela, interview 23.2.2016)

Per se, we have quite good tools, as we have the treasury system, rightly specific IT-system and for that this automatic support for market values. Moreover, we have that history of more than fifteen years, since the year 1997. We have a sound data basis to conduct analyses, and looking back to those is very encouraging.

(Ala-Seppälä, interview 23.2.2016)

Consequently, exploiting and reshaping the figure (Aspects relating to the business model assessment) on page 47, below is illustrated a figure that addresses specific issues of the business model assessment at Kesko.

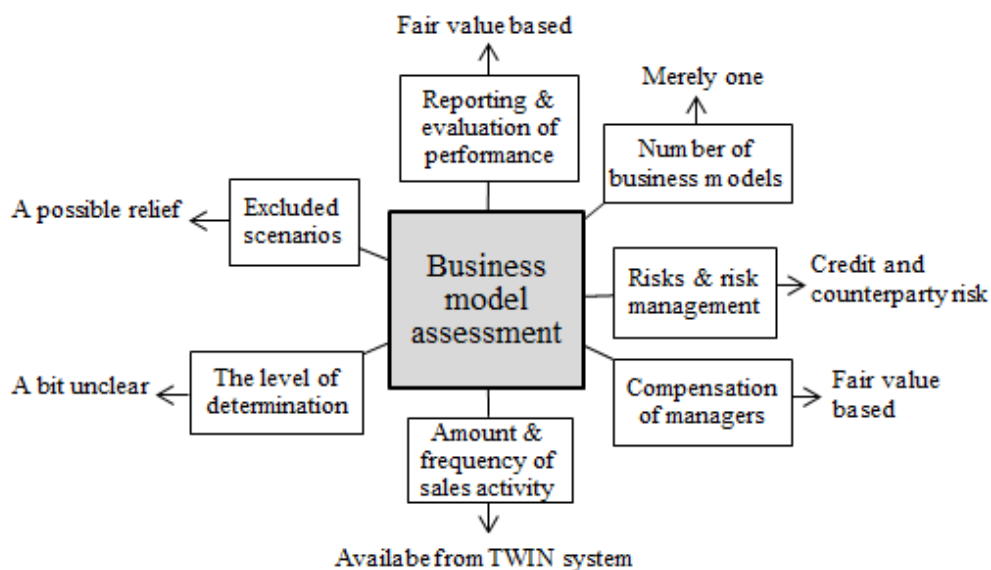


Figure 8 Answers for different aspects of business model assessment at Kesko

As the figure demonstrates and as was discussed above, Kesko would have merely one business model for managing financial assets. The most prominent risk of the business model would be the credit and the counterparty risk of the financial assets. The compensation of managers and the reporting of assets' performance would be fair value based. Further, the history data of sales activity is expected to be fairly easily derivable from the TWIN system. Whereas, the level of determination was felt a bit unclear and the excluded scenarios could have served as a relief in determining the business model. The excluded scenarios in the business model assessment were also viewed as a possible relief, through which the hold to collect model could have been thinkable for Kesko.

Ultimately, an issue that labeled the examining of business model assessment was that a numerous aspects related to this are under a high level of uncertainty at the moment. As a result, the gathered perceptions are above all anticipatory by nature, and changes in the fundamentals of the business model or perhaps in the treasury policy would most likely modify certain insights. (Focus group interview, 23.2.2016)

4.2.4 Challenges and uncertain issues with defining the business model

The issues that remained ambiguous after examining the business model assessment were in relatively plentiful. One of the main uncertain matters concerned the limits, or the absence of those, for selling financial assets within different business models. In other words, when the selling is such frequent in quantity or significant in value that, for example the hold to collect model could not be applied? Already, in the theoretical examination it became clear that IFRS 9 does not provide precise guidance for these questions. The IFRS expert Alaharju had also noted that it is genuinely difficult to comment about the limits for selling assets before the standard is actually applied and real life examples are faced. To some extent the guidance of IFRS 9 may be considered as confusing in this context, as Soikkeli demonstrates below. For Kesko this matter is of particular importance, since if the hold to collect model would allow for certain level of selling assets, the model could possibly be applied within the company. Soikkeli as well as Ala-Seppälä had already previously stressed the importance of being capable for selling financial assets for liquidity needs.

Where is the limit (of selling assets) if those have not been determined that accurately? You may sell, but you cannot sell? (Soikkeli, interview 23.2.2016)

In a way, every time that we have made a new investment there is a quite significant weight on the ability to sell that investment. Since, those are short term financial assets, and it is a must to be able to sell those if required. (Soikkeli, interview 23.2.2016)

Moreover, Koskela had in general remarked that fair value, as a measurement attribute, would perhaps not always reflect the actual return of the examined asset. This may be connected to the broader discussion about applying fair values in accounting and in financial reporting. In this debate, Koskela could, in a sense, have been considered as an opponent of fair values. Whereas, particularly Ala-Seppälä had viewed that fair value is exactly the right measurement attribute for measuring financial assets. Thus, he could have been regarded as a devotee of fair value reporting. The broader discussion about fair values is presented above in the theoretical examination of the study in the chapter 2.1.3. Altogether, Koskela had doubts about applying fair values, and suggested that the practice should be questioned.

I would say that fair value does not necessarily always, in that specific moment when the fair value is examined, reflect the actual return from that instrument. Thus, in that sense it distorts our current net income from financial assets. (Koskela, interview 23.2.2016)

Similarly, linking the requirements of IFRS 9 to a broader discussion, specifically regarding the rules on managing of financial assets, provoked interesting thoughts from Ala-Seppälä. He strongly criticized the ruling qualities of the standard in respect of precluding the ability of the Treasury to adapt its operations for needed actions. Further, he went to underscore the adaptive nature of the Treasury, which is naturally associated with that the department is a support function for the core business of Kesko. Therefore, in all circumstances the Treasury is expected to be capable to provide its expertise, such as arrange liquidity for funding investments, as management or Board has decided to be executed. It becomes clear that peculiar in this setting is that the management and the Board operate on the basis of entirely different business models than the requirements of IFRS 9 describe for managing financial assets. Namely, how the business model requirements within the standard may determine the thinkable actions for the Treasury if the actions are derived from completely different basis?

Treasury is by nature that part of business that adapts, thus perhaps because of that it feels strange that we would start to determine that this is the business model and with this we live and die, since it is just not like that. We have to upkeep the alert to adapt to every direction, depending on what the management and the Board decides. This is connected to the future investments, holding the accumulated profit in the company or distribution of the profit and so on.

(Ala-Seppälä, interview 23.2.2016)

In this regard, it is possible to consider that there is a distinct difference between companies like Kesko and financial companies, which possess an enormous amount of financial assets or whose core business managing financial assets is. In the first place, it may be assumed that in a financial company a management or a Board may address the management of financial assets directly as it may be a part of the company's strategic competencies. Thus, reflecting this to the situation of Kesko it is distinguishable that in practice the requirements of IFRS 9 are relatively farfetched for the company. The issue is that the requirements are equivalent for all IFRS reporting companies but it seems that the requirements are developed in main by the terms of financial companies. This is an issue that IFRS expert Alaharju had noted to be a challenge already with IAS 39.

What is more, Koskela regarded that irrespective of which business model for managing financial assets Kesko chooses to apply, the business model needs to be relatively stable. In her opinion the business model would not be expected to encounter many changes. She also viewed that one of the current challenges with IFRS 9 is that the requirements and term business model will be assimilated. Even though, she thought that the standard would not eventually present any overpowering challenges.

Anyhow, I do not believe that we can modify the business model for managing financial assets every year, depending on what the management wants. I believe that we are quite stable, also on this other side, so that the business model for managing financial assets would not face lots of changes. I feel that now we just need to assimilate this, what is this all about, and buy this word business model. The understanding of it means that you really become familiar with it. I do not believe that there would be any overwhelming challenges.

(Koskela, interview 23.2.2016)

Ala-Seppälä still noted that a general challenge, which is strongly present at adapting the requirements of IFRS 9, is that decisions are now required to be conducted about future issues. Anticipatory view needs to be taken, admitting that the future is above all uncertain. Again, he found that the limits for selling financial assets are a challenge, which requires more careful examination. Right at the end of the focus group interview, Koskela pointed out that the management's will to become familiar with IFRS 9 may also turn out to be a challenge. (Focus group interview, 23.2.2016)

You have to decide about things that are directed to the future, and the future is uncertain. Moreover, that criteria for selling, though they are quite reasonable criteria but nevertheless that we do not overrun those thresholds. Surely, we have a will to make a very long lasting business model. (Ala-Seppälä, interview 23.2.2016)

Perhaps, I may bring up a single challenge, which it is the management's will to figure out that what is this about. (Koskela, interview 23.2.2016)

Altogether, through theoretical examination, interviewing the IFRS experts and the employees of the case organization an amount of evidence has been received about the different challenges of determining the business model for managing financial assets. Against this backdrop, it may be worthwhile to strive to suggest that what might be the most prominent challenges that companies like Kesko i.e. non-financial companies could face as conducting the business model assessment and choosing the feasible business model. Thus, the below figure composes the issues that may be viewed as the most challenging related to determining the business model in this study.

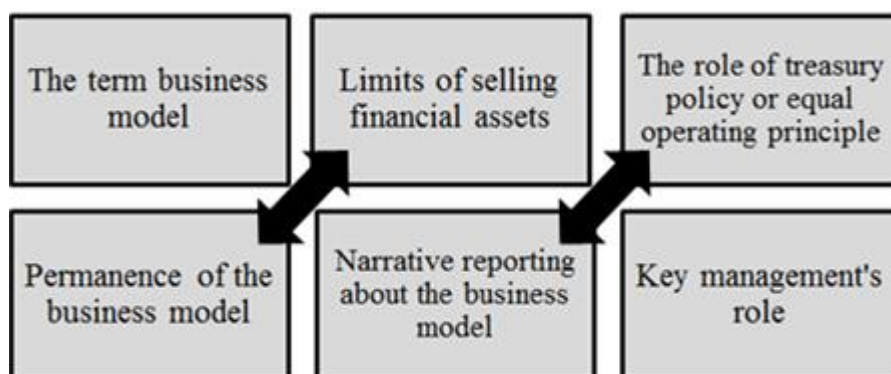


Figure 9 General challenges in the business model assessment

As the figure demonstrates, above all the term business model should be assimilated within the company that conducts the business model assessment. The results of this study have suggested that this may prove to be challenging in many companies because of the novelty and ambiguous of the unfamiliar term. In many circumstances, such as with Kesko, it might be that the term will be truly assimilated only in future, when the company has actually worked with term for some time.

For the more technical challenges with the assessment, as most noteworthy was recognized to be the limits of selling assets within the different business models. The limits seem to be remarkably judgemental issue that will probably require much careful consideration in different companies. Since, in many circumstances the IASB's unclear guidance on the issue will determine the feasible business model. Further, future evidence in financial statements about the selling of assets in different business models will arguably clarify the issue by providing relevant benchmarks. Furthermore, as the figure illustrates the limits connection to the permanence of the business model, in the same context the permanence should be appraised. That is to say, it is disposed that the model may not change too often, thus it has to be built on permanent basis, as the business model is determined. This, in turn, relates to the selling of assets that needs to be carefully estimated, since it may result in the change of business model. Again, future evidence will provide more understanding about how permanent the business model truly needs to be.

What is more, the role of treasury policy or corresponding operating principle in managing financial assets is indisputably of importance in the business model assessment. It may be generally premised that companies are required to use careful consideration about the relation between their intended business models and treasury policies. Specific guiding principles of business models may be even directly derived from treasury policies, such as business objectives. On the other hand, a treasury policy may be entirely overhauled in the same process, as suggested previously. Nevertheless, as the figure shows it may be assumed that in the same way as a treasury policy's principles are exposed in narrative reporting, the business model should be presented in

financial statements. Thus, the existing narrative reporting may be exploited as the basis for the presentation of business model is designed.

Finally, the key management's role will likely have a central effect on how the business model assessment will succeed. In various companies, such as at Kesko, the key management is conceivably not excessively familiar with managing financial assets or with IFRS. Therefore, the transmitting of relevant information about the subject to the key management becomes most important, since the management conducts the final decisions. What is more, with insufficient information or with lacking motivation, the key decisions might not be the most sufficient, as reflected by the experts of managing financial assets.

4.2.5 Contractual cash flow assessment related issues

For the other part of defining a company's business model, contractual cash flow assessment of financial assets, the interviewees did not find any particular obscurity. The assessment and the specific SPPI criterion, which financial assets have to fulfill, in order to be managed under the hold to collect or hold to collect and sell business model, were recognized as relatively unambiguous. Thus, all the interviewees found that the SPPI criterion is quite distinct subject to the financial assets the Treasury manages.

This observation differs from the IFRS expert Sundvik's presumption that in general the cash flow assessment related issues might present a bigger challenge than the business model definition for IFRS 9 adopters. Though, it may be assumed that in this context Sundvik referred to more complex financial assets than Kesko has traditionally managed. He was most likely talking in general about financial institutions' financial assets, such as about structured products. To be noted, Alaharju, in turn thought that the SPPI criterion would be relatively distinct, at least in theory. What is more, Ala-Seppälä stressed that for Kesko it is an essential principal that the company's liquid assets are not overly complex, in terms of that it is possible to liquidate the assets relatively effortlessly.

I guess it (SPPI criterion) is pretty distinct for finance people.
(Koskela, interview 23.2.2016)

I do not believe that it will be challenging to assess this (SPPI criterion). The concept of liquidity, with a company like this, starts from the point that we have distinct products. Since, if these are distinct products the possibility to realize these is good, and that we can reliably report these. (Ala-Seppälä, interview 23.2.2016)

Examining the current financial assets of Kesko, all the interviewees regarded that principally all the liquid financial assets of Kesko would fulfill the SPPI criterion. Soikkeli also viewed that the assets that do not meet the SPPI criterion would mostly be structured products, which Kesko does not hold at present. In this sense, it would presumably be unproblematic to separate the structured products from the more conventional financial assets. However, Soikkeli likewise pointed out that likely not all kinds of structured products would be excluded from qualifying the SPPI criterion.

Now, we have none of these that do not fulfill the SPPI criterion.

(Ala-Seppälä, interview 23.2.2016)

Those (that do not fulfill the SPPI criterion) are mainly structured products, it sounds like that. Thus, there should not be a problem with this.

(Soikkeli, interview 23.2.2016)

It is quite clear that if we start to conduct some structure in which the return comes from something totally different than the underlying or if it is leveraged or something. But, it is good to keep in mind that there are also these structured products, these that are based on totally basic structures, for example, credit index. This would fit in there (SPPI-criterion). Thus, it does not mean that all the structured products would be ruled out. (Soikkeli, interview 23.2.2016)

Consequently, it is possible to arrive to the conclusion that, as mainly all the liquid financial assets of Kesko would meet the SPPI criterion, there would not be any obstacle for the Treasury to apply the hold to collect or the hold to collect and sell business model. Since, for applying either one of these models, and further to measure the assets at AC or FVOCI, the assets are obliged to fulfill the SPPI criterion. (Focus group interview, 23.2.2016)

4.2.6 The business model for managing financial assets at Kesko

For the perhaps most intriguing issue under the examination, subsequently is presented the interviewees' views subject to what kind of business model for managing financial assets Kesko will actually apply in future. Interviewing Koskela previously individually, it became clear that she felt that the most adequate business model for Kesko would be the hold to collect, under which, the assets would be measured at AC. Thus, the associated accounting procedures would be simplified. Further, in especial the clearing of assets' fair values would not require so much work. In the group interview, she still enforced her view, among other things, by suggesting a possible target for

Kesko's anticipated business model, which would have been cited principally outright from the hold to collect model IFRS 9 presents.

Why we could not simply say that our aim is to hold financial assets for gathering cash flows? Further, we would adapt to our own Group's business requirements and for possible acquisitions or for some other things.

(Koskela, interview 23.2.2016)

However, during the focus group interview Ala-Seppälä and Soikkeli expressed ably different opinions about the applicable business model. The gentlemen visibly did not agree with applying the hold to collect model. For one, Soikkeli thought that if there could more than one business model, a combination of the hold to collect as well as the hold to collect and sell models could perhaps be applied. This would, after all, be unnecessary if the hold to collect and sell model could solely serve for the purposes of the two different business models as discussed before. Since, in theory it might be possible to execute all the same procedures under the hold to collect and sell, as under a combination of the hold to collect and the hold to collect and sell models. Thus, operating a combination of two different models would likely to bring about, among other things, technical complexities. In fact, these could be complexities, which arguably merely financial institutions are forced to accept due to the nature of their businesses. In other words, combination of models would most probably be too onerous for Kesko. This might have eventually become clear for Soikkeli, since he inclined to applying the hold to collect and sell business model.

If there may be more than one (business model) in that case it is probably a combination, a combination of number one (hold to collect) and number two (hold to collect and sell). (Soikkeli, interview 23.2.2016)

Or if we were to choose only one (business model) it probably has to be the number two (hold to collect and sell). (Soikkeli, interview 23.2.2016)

Yes, it would probably be much better (to have just one model) so it is probably also more easily manageable. (Soikkeli, interview 23.2.2016)

To underline, Ala-Seppälä and Soikkeli did not had anything against the hold to collect model as such. The main concern they raised about choosing the model was that could the Treasy truly ensure that Kesko would mainly hold its liquid financial assets until their maturity as the model generally describes. Even though, the hold to collect model allows for selling assets, in exceptional circumstances, the guiding idea of the model is to hold assets until their maturity. Thus, Ala-Seppälä noted that in principal the hold to collect model could be a desirable option for Kesko, yet the uncertainty of the

Group's funding needs results in that it is not possible to guarantee that all liquid financial assets would be held until maturity. Particularly, in the case of that there would suddenly raise a need to liquidate specific assets, for example, for investment operations. Soikkeli endorsed Ala-Seppälä's view and emphasized possible unpredictable and substantial funding needs. He also stated that in order to operate under the hold to collect model it would, in a sense, be required to be able to predict cash needs without fail. Additionally, Soikkeli highlighted the constant changes in Kesko's business that may relate to the company's strategic changes or to conducting acquisitions.

In principal, it sounds really great that the return comes smoothly, as with the number one (hold-to-collect) the return comes smoothly. But, in all honesty, there is no way for us to know, if it is possible for us to actually hold those instruments until maturity. (Ala-Seppälä, interview 23.2.2016)

The predictability of cash or finance needs, though it is basically in a way alright, but those swings are so large that it is impossible to manage it like according to this example number one (held to collect). As in, we could tailor it in a way that some investments mature when we need cash for those swings so much. (Soikkeli, interview 23.2.2016)

For me it is just that as these situations change quite a lot, or may change, as company changes its strategy. Thus, what if we conduct an acquisition or something that may change the situation quite a lot? (Soikkeli, interview 23.2.2016)

Therefore, there was an apparent confrontation between the gentlemen and Koskela. As noted many times before, Koskela's promoted model, hold to collect, had now been turned down. What underlined the situation was that Koskela remained silent, as the shortcomings of the hold to collect model was reviewed by Ala-Seppälä and Soikkeli. It seemed that they considered above all the big picture and the nature of Group's funding needs. This framework would not in their opinion allow for applying the hold to collect model. Hence, Ala-Seppälä had the final word as he stated to believe that Kesko would eventually be obliged to choose the hold to collect and sell business model. Once again, he stressed that one of the main reasons for this would be that under the hold to collect it would not be possible to ensure the liquidity of liquid assets, if there would be strict restrictions regarding the selling of assets.

I believe it (business model) will involuntarily go to the other category (hold to collect and sell). Since, anyhow acquiring any kind of financing or when analysts conduct analyze about the financial position of Kesko, the thing is that it is

expected and we provide and suggest in financial information that financial liquid assets are liquid. Further, it is calculated that Kesko has this much risk-bearing capacity in stress scenarios. Thus, we cannot say that we may terminate specific businesses but financial assets we are required to hold until maturity, it does not work this way, rather the other way round. (Ala-Seppälä, interview 23.2.2016)

All things considered, unanimous conclusion of the business model remained absent during the interview. Since, Koskela seemed to still lean on her proposition of the hold to collect model, whereas Ala-Seppälä and Soikkeli were convinced that the hold to collect and sell model would be the solution. One thing that all the interviewees agreed was that Kesko would not even have to consider the other business models to be applied. Under the so-called other business models, such as trading, assets are measured at FVTPL. (Focus group interview, 23.2.2016)

I think we can ignore this one (the other business models).
(Ala-Seppälä, interview 23.2.2016)

What is interesting, discussions with the interviewees after the actual interview proved that in spite of everything a feasible business model for managing financial at Kesko was found. Since, also Koskela was now determined that Kesko will eventually be obliged to apply the hold to collect and sell business model. She stated that the assimilating of the fact that at the moment Kesko will not be able to apply the hold to collect, which she endorsed, took some time. This relates to that if the hold to collect model would have been applied, her work load as well as other controlling and reporting tasks would have been reduced. She admitted that in theory and possible in some future time, the hold to collect would still be the most desirable option. In main, again this was for the reliefs of accounting procedures the model presents. Nevertheless, at present the inability to guarantee the selling of financial assets within the business model is inclined to determine that the model must to be the hold to collect and sell.

What this means in practice is that the accounting and bookkeeping procedures related to the financial assets of Kesko will change ably slightly. Since, only the assets within the money market portfolio will be measured differently than before. These assets will be measured at FVOCI in future. The FVOCI measurement of the cash portfolio and the bond portfolio that were categorized as AFS under IAS 39 will remain as it has been. The table below illustrates how the financial assets within the different portfolios will be measured in future.

Table 9 Measurement of financial assets in compliance with IFRS 9 at Kesko

Portfolio	Measurement under IAS 39	Measurement under IFRS 9
Cash portfolio	(AFS) = FVOCI	FVOCI
Money market portfolio	(FVTPL) = FVTPL	FVOCI
Bond portfolio	(AFS) = FVOCI	FVOCI

As the table explains, all the different portfolios will be subject to FVOCI measurement as IFRS 9 is applied. This means that the chart of accounts related to the assets in the money market portfolio is required to be reshaped. The chart of accounts will now be similar to the other portfolios. Further, it is expected that the reforming of the said chart of accounts and related accounting procedures will not require much workload. Therefore, for instance the monthly tasks related to the accounting for financial assets will change only lightly and the implementation of the requirements is not painful. To be noted, if the AC measurement of assets would have been put into practice, it would have required much more effort in the initial implementation. Whereas, the tasks related to monthly and quarter end reporting would have relieved significantly. In other words, IFRS 9 does not unfortunately allow for simplifying the accounting procedures of financial assets at Kesko. Thus, eventually a speculation that this study suggested about simplifying the accounting procedures is forced to be turned down.

4.2.7 Following steps in the implementation of IFRS 9

Finally, the subsequent steps related to the implementation of IFRS 9, and especially the plan of adopting the hold to collect business model at Kesko should be considered. First off all, Ala-Seppälä observed that the participants of the focus group interview, namely Ala-Seppälä, Soikkeli, Koskela and the researcher, would commence to further work with the requirements of IFRS 9. Particularly, the previously mentioned group of people would commence to prepare a presentation about the business model for the CFO of Kesko, Jukka Erlund. The presentation would involve general introduction about the standard transition, analysis of IFRS 9's impacts on Kesko and a more detailed description about operating under the hold to collect and sell business model. Related to this, the findings and materials of this study would function as a basis for the presentation. After receiving the presentation, the CFO would then again assess that how major issue the consideration of the business model is for Kesko. Altogether, the matter would be handled in compliance with the regulations and the Corporate Governance Code, which Kesko conforms to.

I believe and my first thought is that, the people around this table are the ones who will start to conduct the analysis and the presentation about this. Subsequently, the CFO of Kesko assesses that how significant decision this is about. Moreover, our general management principle is this one over one, thus probably the Treasurer (Heikki himself) would conduct the presentation of Treasury. Then the CFO considers that may he approve it and do we need the approval of the Group's President for this. Lastly, will this go to the Board of Kesko for verified, which I would not believe at this minute. Anyhow, we have the corporate governance principles and the Board of Kesko is accountable for the financing.

(Ala-Seppälä, interview 23.2.2016)

Consequently, the finished presentation about the hold to collect model and other relevant issues will face the subsequent approval process, which is presented in the figure below. The questions marks in the figure exhibit the uncertainty, which relates to how far the presentation will proceed in the process. Since, each agent involved in the process will evaluate the significance of the matter with its own resources and pass it on to the following agent if recognizing that it is required. For further confirmation, the matter would proceed always further within the process in compliance with the Corporate Governance Code.

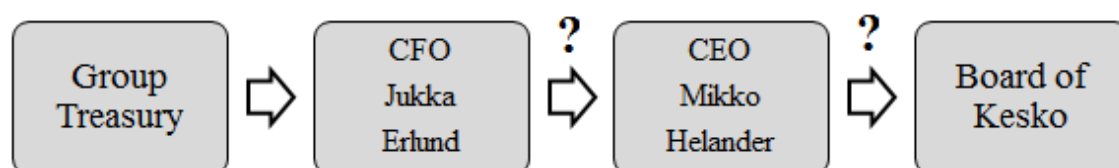


Figure 10 Process of approving the hold to collect model at Kesko

As the figure illustrates, the presentation of the hold to collect model will definitely proceed from Group Treasury to the CFO for consideration and approval as stated. He will for his part evaluate if the matter requires the examination from the CEO of Kesko, Mikko Helander. Accordingly, if it is required the presentation will lastly follow from the CEO to the Board of Kesko for consideration and approval. To be noted, it was regarded that the matter is most likely to be concluded by the CFO. What is more, if the treasury policy would be reshaped, the modification should receive the approval from the Board's Audit Committee of Kesko.

Overall, the actual doing that is going to relate to the implementation of IFRS 9's requirements should be summarized. Due to the nature of the study, the focus in this matter relates to implementing the hold to collect model for managing financial assets. Therefore, the below table summarizes the planned actions that will be executed in the near future before IFRS 9 is adopted at Kesko. The presented action plan is based on informal discussions held with the interviewees after the actual focus group interview. To be noted, the deadlines for the suggested actions are not carved in stone.

Table 10 Subsequent actions in the implementation of IFRS 9

Issue	Accountable persons	Anticipated time frame
Presentation of the hold to collect model and IFRS 9's impacts.	Ala-Seppälä, Koskela, Soikkeli and the researcher.	6/2016 - 9/2016
Reforming the chart of accounts for the assets in the money market portfolio and testing the related booking process.	Koskela, the researcher and Tiippana.	6/2016 - 12/2016
Conducting comparison calculations for the money market portfolio.	The researcher and Tiippana.	12/2016 →
Possible reshaping of treasury policy.	Ala-Seppälä, Koskela and Soikkeli.	12/2016 →
Establishing narrative reporting about the business model.	Ala-Seppälä, Koskela and Soikkeli.	→ 12/2017
SEPARATE PROJECT: Hedge accounting requirements	Group Treasury	6/2016 →

As the table demonstrates, the first step in the actual implementation of the business model relates to the preparation of the aforesaid presentation. Thus, Koskela, Soikkeli and the researcher will conduct the presentation, which is expected to be ready at the latest in September 2016. Following, Ala-Seppälä will scrutinize, approve and present the presentation for the CFO according to the approval process as discussed above.

Next, the chart of accounts for the assets in the money market portfolio should be reorganized because in future the assets are expected to be measured at FVOCI. The reshaping of the accounts and testing of the related booking processes may be conducted before the final approval is provided, as the approval of the model is expected to be such certain. Moreover, it is always useful to conduct testing for these kinds of bookkeeping modifications. These actions shall be carried out by Koskela, the researcher and by a Treasury Specialist, Mikko Tiippana before the year 2017. During 2017 comparison calculations will be conducted by the researcher and Tiippana for the assets in the money market portfolio in compliance with the new measurement principles of IFRS 9.

It is also anticipated that during 2017 the possible modification of the treasury policy should be examined and conducted by Ala-Seppälä, Koskela and Soikkeli. What is more, the same persons are accountable for establishing the narrative reporting subject to the hold to collect business model before the end of 2017. The narrative reporting should include several of those same pieces that have been scrutinized throughout the study, such as business objectives of the business model.

Finally, as highlighted in the table the Group Treasury will further commence to work and examine the reformed hedge accounting requirements of IFRS 9. Since, the requirements may allow for the aforesaid new possibilities within the hedge accounting practices Kesko conducts, especially with the hedging foreign exchange derivatives.

5 SUMMARY AND CONCLUSIONS

5.1 Summary

The purpose of this thesis was to introduce today's accounting for financial instruments and especially the IASB's IFRS 9 *Financial instruments*. The standard includes classification and measurement, impairment and hedge accounting requirements for the accounting of financial instruments. In particular, the study pursued to consider certain anticipated effects of IFRS 9, which is to replace IAS 39 *Financial instruments: Recognition and Measurement*. The consideration encompassed both general analysis and more specific ambitions related to the study's case organization Kesko. In this framework, the classification and measurement requirements of IFRS 9 were stressed, since they introduce a new concept of business model for managing financial assets, which was to be defined during the study at Kesko.

The objective of the study was to answer to four research questions. First of all, how IFRS 9 particularly changes the accounting for financial instruments and what key effects are the changes anticipated to cause? For the second, how the term 'business model' for managing financial assets can be comprehended and what key issues should be considered when defining it under IFRS 9? Thirdly, what are anticipated to be the major effects of IFRS 9 at Kesko? For the last, what kind of business model for managing financial assets Kesko aims to apply? The idea was to answer to these questions through theoretical examination and by gathering empirical evidence from expert interviews.

The study was conducted as an action research. Typical for the action research, the empirical phase involved applying a case study method. The study was also performed with a distinctive twofold manner. The first part, the general analysis, consisted of theoretical examination, which had been merged with quotations from the interviewed experts, representing KPMG and PwC. While, the second part or the case study, involved the more distinct motivations related to the standard change at the case organization. Thus, the empirical evidence was gathered by interviewing both IFRS experts from two Big Four firms and experts from the case organization. Moreover, since the literature on IFRS 9 was such scant, the theoretical text was decided to be merged with the IFRS experts' quotations. This strived to strengthen the theoretical examination and also to contribute to the overall objective of the thesis that is to reinforce the body of research related to the subject.

The second chapter of the study addressed issues that generally concern the accounting for financial instruments. The chapter involved examining the definition of financial instrument, the development of accounting for financial instruments and the

transition to IFRS 9. The IASB's standard IAS 32 defines that a financial instrument is any contract that causes a financial asset to one entity and a financial liability or equity instrument to another entity. It is set that financial instruments are classified into financial assets, financial liabilities and equity instruments. Further, financial instruments cover primary instruments, such as receivables, payables and equity instruments as well as derivative financial instruments, such as options, futures, forwards and currency swaps.

Indeed, the diverse field and application of derivative financial instruments has been regarded as remarkable. These often complex instruments connect closely to financial hedging in which companies attempt to reduce exposures to financial risks by setting up offsetting positions with the derivatives. Over the last decades, derivatives markets have ballooned that has presented new means for companies' financial risk management. Yet, the phenomenon has at the same time presented new challenges for financial regulation. Thus, the IASB has strived to keep up the pace by developing enhanced standards for the ever more complex financial instruments.

Fair value accounting, which involves measuring items of financial statements applying fair values, is also of significance, as considering the accounting for financial instruments. Fair values are most commonly applied for financial instruments under IFRS, though the practice has also opponents. On the one hand it has been viewed to provide the most relevant information for users of financial statements and increase the efficiency of resource allocation, but on the other hand it has been regarded that the practice leads to excessive volatility of financial statements and presents artificial risks. Especially, the financial crisis of 2008 led to a heated debate about the practice. The trading of financial instruments had crashed causing numerous companies to suffer significant losses and many thought that the fair value accounting had aggravated the crisis. This led to a critical assessment of the practice's part in demoralizing the stability of financial markets, further political pressure was steered towards the IASB to amend IAS 39, which largely applied fair values.

The recent development of accounting for financial instruments has encompassed diverse phases. In 2005 the IASB and the U.S. national standard-setter FASB commenced a joint project to develop the convergence and improvement of accounting for financial instruments. Today, the convergence objective has not yet come true, since the standard-setters ultimately diverged in their solutions and created their own approaches subject to the reform of accounting for financial instruments. Therefore, the IASB's answer for the reform, IFRS 9, is eventually not a converged standard.

The underlying issue has nevertheless been that the standard-setters' existing standards for financial instruments have been deficient. Above all, the standard that IFRS 9 will replace, IAS 39, has faced wide-spread criticism. Among theoretical examination, the interviewed IFRS experts underwrote various issues that have

stigmatized the standard. Firstly, IAS 39 was to a large extent created around the financial industry, wherein, financial instruments play a key role. Though, the standard applies to all IFRS reporting companies. IAS 39 contains several different classification categories and related impairment models and it has been relatively easy to alter the instruments' classification, which might have caused entirely different accounting results. The incurred-loss method of loan provisioning of IAS 39 has also been criticized. It has been argued that the method has delayed the recognition of loan losses and allowed for earnings management. What is more, the rule-based hedge accounting requirements of the standard have been regarded as overly complex, restrictive and challenging. All things considered, a consensus has been built to replace IAS 39 for its deficiencies.

Against this backdrop, IFRS 9 will replace the infamous IAS 39. The major changes the new standard presents apply to the classification and measurement, the impairment and the hedge accounting requirements of financial instruments. Whereas, the recognition and derecognition requirements and the scope of financial instruments remains practically as it is. Therefore, the classification and measurement of financial assets transforms, since the four classification categories of IAS 39 are replaced. Now, IFRS 9 applies an entirely new approach for the classification with three categories. The impairment requirements are significantly renewed, as the multiple models are replaced with a single expected loss model approach. Further, IFRS 9 reforms the hedge accounting by introducing completely new general hedge accounting model for companies.

It may be stated that the development of IFRS 9 launched as long ago as in 2008. Eventually, through various steps the IASB published the final version of the standard in July 2014 and set the mandatory effective date of IFRS 9 for 1 January 2018. Yet, for EU listed companies the adoption is still contingent on the approval of the EU. In this sense, the interviewed IFRS experts felt that the EU is most likely to approve the standard during 2016. Therefore, IFRS 9 should be applied as proposed. In technical means, the standard shall principally be adapted retrospectively, apart from some exceptions, including the prospective application of hedge accounting requirements.

In the third chapter of the study the requirements of IFRS 9 were scrutinized more thoroughly. Thus, the classification and measurement of financial assets, the impairment and the hedge accounting requirements were investigated. The new approach in classification sets two criteria for determining how financial assets are classified and subsequently measured: an entity's business model for managing financial assets and the contractual cash flow characteristics of a financial asset. The three measurement categories for assets are: amortized cost (AC), fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). Thus, an asset is classified at AC if the following criteria are fulfilled: the asset's contractual cash flows

represent solely payments of principal and interest (SPPI) and the asset is held to collect contractual cash flows only. In turn, classification applies to FVOCI if the asset's contractual cash flows represent SPPI and the asset is held to both collect contractual cash flows and to sell the financial assets. The FVTPL category is a residual category, thus an asset is classified at FVTPL if it does not fulfill the criteria of the other categories.

The aforesaid term 'business model' for managing financial assets was integrated to the vocabulary of IFRS for the first time through IFRS 9. According to the IASB, business model refers to how a company manages its financial assets to produce cash flows. In the field of financial regulation, the term has mainly received a skeptical welcome, though some exceptions are in place. This moderately new addition of management vocabulary is stated to lack a settled meaning, suggested to signify that financial reporting would be based on management's intent and argued to be replaceable with the term 'strategy'. Nonetheless, it seems that the term business model remains ambiguous and challenging to assimilate, which true meaning will most likely require time to grasp.

Notably, under IFRS 9 the classification of financial assets holds two different phases: a business model assessment and a contractual cash flow assessment. The business model assessment determines whether cash flows from financial assets result from collecting contractual cash flows, selling the financial assets or both. That is, companies should start to reflect and document why particular investment operations are conducted. The assessment should regard all relevant evidence about the business model. This would include the amount and frequency of sales activity, the compensation of managers, and the risks and the risk management of the business model. Overall, the business model is required to be a matter of fact, not only declaration. Hence, judgement is unquestionably needed when the business model is assessed.

Whereas, the contractual cash flow assessment covers evaluating whether cash flows from financial assets fulfill the so-called SPPI criterion. In other words, are the contractual cash flows solely payments of principal and interest? The IASB has asserted that the principal is by definition the fair value of a financial asset at initial recognition, while the interest comprises of reflection for the time value of money. Moreover, contractual cash flows meeting the SPPI criterion should be compatible with a basic lending arrangement. The requirements of IFRS 9 contain extensive guidance on the cash flow analysis and features that meet the SPPI criterion.

After the said assessments, there are eventually three different types of business models, identified by the IASB. First, if a company's aim is to hold financial assets to collect contractual cash flows, the assets should be classified under a hold to collect business model and measured at AC. Second, if the business model's aim is realized by

both collecting contractual cash flows and by selling financial assets, the business model should be a hold to collect and sell in which assets are measured at FVOCI. For both of these models it is required that the assets meet the SPPI criterion. Lastly, financial assets are measured at FVTPL if they are not held within neither of the said business models. These business models are referred as other business models.

What comes to the impairment requirements, IFRS 9 introduces a completely new impairment model. The model is conceptually a 'loss allowance' model that recognizes a provision for expected credit losses on financial instruments before any of those losses have actually incurred. This forward-looking model eliminates the earlier trigger event in credit risk and introduces a detailed three-stage model for the impairment. Further, the requirements contain some operational simplifications for trade and lease receivables and contract assets, as they are often held by companies that do not have highly sophisticated credit risk management systems. It is viewed that the level of judgment required by the recognition of credit losses will be significant as the financial information for the new model is prepared by taking into account high levels of uncertainty. On the contrary, the new general hedge accounting requirements within IFRS 9 do not revolutionize the types of hedging relationships or requirements as specified in IAS 39. Nevertheless, the new model significantly relaxes specific requirements and allows more hedging strategies used for risk management to qualify for hedge accounting. For instance, the capability to hedge risk components of non-financial items may be welcomed by many companies that have not been able to apply hedge accounting under IAS 39. Altogether, the new requirements are stated to introduce a major overhaul of hedge accounting. What is remarkable, the reformed impairment and hedge accounting requirements have been regarded to be most significant accounting changes introduced by IFRS 9.

The fourth chapter of the study covered the more traditional empirical phase and the case study. In the first part of the chapter were examined issues that relate generally to the standard change at Kesko. This constituted of the theme-centered interview, which was conducted for the Treasury Manager, Kristiina Koskela. Firstly, the interest towards IFRS 9 was admitted to originate primarily from the standard's compulsion. However, Koskela also viewed that the relaxation of hedge accounting and the possible AC measurement for financial assets intrigued with IFRS 9. She stated that the standard change affects most of all to the operation of the Group Treasury of Kesko. Thus, the changes IFRS 9 presents are not crucial to Kesko as a company. It was also accepted that the amount of financial assets Kesko holds, connects to scrutinizing the impact of the standard change, since the quantity of the assets relates to their management and accounting. From this angle, it was perceived that the cash reserves of Kesko, that is to say, the amount of financial assets the Treasury is responsible for managing is

decreasing. The shrinking trend stemmed from specific investments and from an exceptionally large dividend distribution Kesko was conducting.

Discussing about the forerunner of IFRS 9, IAS 39, Koskela regarded that the standard is simply put complex. The most challenging issue with accounting under IAS 39 was judged to be the calculation of hedging instruments' and financial assets' fair values. The documentation requirements of hedge accounting were also judged to be oppressive. Further, the initial implementation of the standard's requirements was generally and especially subject to software systems regarded as challenging. Whereas, anticipating the accounting under IFRS 9, Koskela identified specific opportunities. Most of all, she considered that the hold to collect business model, with the AC measurement, could simplify the accounting of Kesko's financial assets. This could also cover streamlining the current portfolio structures and the Group's treasury policy. Additionally, Koskela regarded that the new hedge accounting requirements could allow for improving the hedge effectiveness of electricity hedge accounting, and possibly enable applying hedge accounting for foreign exchange derivatives.

For the preparation of the standard change, Koskela thought that the baseline would be to evaluate the current treasury policy. Subsequently, Kesko's chart of accounts should be reformed, provided that the hold to collect model would be applied. Notably, the preparation should begin quite soon. Since, retroactive application of the classification and measurement requirements is mandatory, it is required to conduct comparison calculations for the financial year of 2017. Likewise, she felt that it would be essential to inform the management of Kesko about the key issues of IFRS 9. Koskela also viewed that this study could serve as a learning tool in the preparation.

The second part of the case study involved the focus group interview, which was attended, besides Koskela, by the Treasurer, Heikki Ala-Seppälä and the Head of Market Operations, Sami Soikkeli. This part focused on issues with defining the business model for managing financial assets at Kesko. First of all, the role of the treasury policy under which the financial assets are managed was discussed. The interviewees had dissimilar opinions concerning the treasury policy. Ala-Seppälä and Soikkeli viewed that the policy would likely not undergo any notable changes, whereas Koskela reinforced her view about reshaping the policy to be in line with the hold to collect business model. In the same context, came to the fore thought-provoking discussion about the interconnection of business model and treasury policy. Anyhow, it remained ambiguous which one of these should be considered primarily when defining a company's business model. Next, the term business model for managing financial assets was dealt with. In short, the term received a skeptical welcome. The term was for instance felt unclear, artificial and unsuitable for a company like Kesko. Nevertheless, Ala-Seppälä regarded that being forced to apply and assimilate this kind of term might be professionally developing.

Considering business model assessment and relevant evidence related issues, first it was recognized that the overall return generated from financial assets is part of the compensation scheme at the Treasury. Further, the main risks that could affect the performance of business model were judged to be the credit risk and the counterparty risk of financial assets. Ala-Seppälä and Soikkeli also found that it would be conceivable to hold two different business models, yet they regarded that it would be better to have just one model. Whereas, the level of business model's determination set by the IASB was sensed a bit unclear. Moreover, the stress scenarios related to the assessment were regarded as moderately distinct. It was also noted that the scenarios could possibly serve as a relief, through which, the hold to collect business model might have been applied. For the contractual cash flow assessment of financial assets, it was felt that the SPPI criterion is rather unambiguous. In the same breath, it was concluded that practically all the financial assets of Kesko would meet the SPPI criterion. Finally, as the most ambiguous aspect of the business model assessment, was recognized to be the limits, or the absence of those, for selling financial assets within different business models. The consideration of the limits will most likely prove to be generally challenging in non-financial companies adopting IFRS 9.

In the core of this chapter's objective, interviewees' positions on Kesko's anticipated business model were addressed. In this setting, Koskela promoted again her view for applying the hold to collect model. Remarkably, Ala-Seppälä and Soikkeli, in turn thought that Kesko should apply the hold to collect and sell model. The profound reason for this was the concern related to that it would be sincerely difficult to assure that financial assets are held until maturity, as the guideline of the hold to collect model specifies. Ala-Seppälä stressed that under the model it could be impossible to ensure the liquidity of liquid assets if there are strict restrictions regarding the selling of assets. He concluded that Kesko is obliged to choose the hold to collect and sell model. Hence, unanimous decision about the anticipated business model was not achieved during the interview. However, it was agreed that Kesko could rule out the other business models within the consideration.

What is interesting, discussions after the interview with the interviewees and especially with Koskela proved out that a solution for the business model was ultimately found. In other words, Koskela admitted that Kesko would eventually be obliged to adopt the hold to collect and sell model. For her part, the fact had been unpleasant to recognize because the model would not allow for simplifying the accounting procedures, as she had imagined. On the contrary, the hold to collect model would have allowed for relieving controlling and reporting tasks subject to the financial assets.

Finally, the subsequent steps with implementing the business model and IFRS 9 were scrutinized. First of all, it was recognized that the people in the focus group interview would commence to further work with requirements of IFRS 9. Thus, a presentation that

involves general introduction about the standard transition, analysis of IFRS 9's impacts on Kesko and a more detailed description about operating under the hold to collect and sell business model would be prepared for the CFO of Kesko. The CFO would address the matter in compliance with the Corporate Governance Code, which Kesko obeys. The preparation for the standard change would also include, reforming the chart of accounts for the assets in the money market portfolio and testing the related booking processes before the end of 2016. Now, the assets in the money are going to be measured at FVOCI in compliance with IFRS 9. What is more, after June 2016 the Treasury would begin to examine the reformed hedge accounting requirements of IFRS 9 for the new possibilities in hedge accounting of foreign exchange derivatives.

5.2 Conclusions and suggestions for further research

The main conclusion of this thesis is first of all that IFRS 9 reforms most fundamentally the existing impairment requirements of financial instruments. Hence, the new expected credit loss model is anticipated to reshape credit risk management systems, cause significant implementation costs and increase the amount of credit loss provisions, especially in the financial industry. Moreover, the reformed and in particular relaxed hedge accounting requirements are expected to allow for more hedge relations within hedge accounting. This, in turn is anticipated to encourage more companies to commence the application of hedge accounting. For the second, the study concludes that the term business model for managing financial assets is very challenging to assimilate. Above all, the meaning of the term remains ambiguous, though it is assumed that the term may be better comprehended over time, as companies have truly worked with it. Considering the key issues in defining the business model, it is recognized that the limits for selling financial assets embody the most puzzling aspect of the related guidance that calls for especial attention. Thirdly, this study concludes that that the key effects of IFRS 9 at Kesko associate with possibly reshaping the current treasury policy to be in compliance with the new standard. After all, the new classification and measurement requirements do not present any drastic changes. Besides, further examination is expected to be conducted about the possibility of applying hedge accounting for foreign exchange derivatives. The fourth and the last conclusion of the thesis is that Kesko will apply the hold to collect and sell model for managing financial assets in future. Even though, it is recognized that the hold to collect model would be more desirable, which would allow the simplification of accounting procedures, but precisely the vague limits for selling the financial assets are prone to hinder this.

In consideration of the quality of this thesis, it should be noted that it has been generally accepted that evaluating the quality of a qualitative research is more complex

than evaluation with quantitative research. This arises from, for instance that the quantitative research applies characteristically more unequivocal analysis techniques than the qualitative one. (Eskola & Suoranta 1998, 208.) Validity and reliability are concepts that are frequently employed to evaluate the quality of a study, though subject to qualitative studies these are often considered as merely principles. The quality of qualitative research calls for, among other things that the research methods are extensively reported and that the relationship between the researcher and the research subjects is examined. (Koskinen et al. 2005, 256, 258–259.)

Despite the challenges of reporting about validity and reliability, it has also been premised that the issues of the concepts do not need to be compromised. Thus, validity is interested in that does the researcher study the phenomenon the study alleges to be examined. Validity of a study is compromised if research design or research methods account for that the researcher is involuntarily studying more than or less than the alleged phenomenon. On the contrary, reliability is interested in that does the researcher gather data on which can be trusted. Reliability is compromised if the gathered data is not free of random circumstances within the research setting. (McKinnon 1988, 35–36.) Given the background, to overcome the issues with validity this study pursued to address the research objectives with a distinctively outlined twofold manner. Whereas, to ensure adequate reliability of the study, data was gathered by interviewing two IFRS experts from different Big Four firms and by interviewing relevant experts from the case organization.

In regard to the generalization of this study, it is acknowledged that especially case studies encounter noteworthy challenges subject to the generalization of a study's results. However, it has also been argued that a high quality case study can develop credibly generalizable results with the aid of contextual generalization rhetoric. This requires that the researcher comprehends and communicates the real business context and exposes deeper structural relationships about the case organization. Besides, persuasive linkage of relevant history, institutions and markets around the case study is indispensable. (Lukka & Kasanen 1995, 76, 85.) This study strived for fulfilling these presumptions by orientating carefully to the operations of the case organization, by exposing spontaneous stances of the interviewees and by scrutinizing relevant history of the case organization's operations. Thus, it may be assumed that the results of this study, especially subject to the case study part, are partly generalizable. At least, to some extent when different non-financial companies adapting IFRS 9 are considered.

Opportunities for further research around IFRS 9 are in plentiful. The research subject will become most topical when the standard is eventually applied and naturally some years after the implementation, as certain results are measurable. After the actual implementation of IFRS 9, it could for instance be intriguing to study how the IASB has succeeded with its expressed objectives and generally in the reform of accounting for

financial instruments. This might involve examining that has the recognition of loan losses become more timely? Does hedge accounting better reflect the risk management of companies? Has the relevance and quality of financial information enhanced after adopting IFRS 9? Has the implementation of IFRS 9 impacted different KPIs of companies, and diminished hedge accounting applying companies' volatility of profit? Moreover, it might be interesting to examine the validity of certain claims of this thesis. That is, has credit loss provisions of companies increased and have more companies commenced to apply hedge accounting in consequence of IFRS 9? Eventually, it could also be worthwhile to study that have companies and treasuries better grasped the meaning of the term business model for managing financial assets, after they have worked with the concept for some years.

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APPENDIX 1 INTERVIEWS

Person: Peter Sundvik	Senior Manager	KPMG Oy Ab
Type of interview:	Semi-structured	
Time: 9.12.2015	10:00	
Place: Töölölahdenkatu 3 A	FI-01010 Helsinki	
Duration of the interview:	1:00:25h	
Person: Nina Alaharju	Director	PricewaterhouseCoopers Oy
Type of interview:	Semi-structured	
Time: 17.2.2016	09:00	
Place: Itämerentori 2	FI-00180 Helsinki	
Duration of the interview:	0:59:33 h	
Person: Kristiina Koskela	Treasury Manager	The Kesko Group
Type of interview:	Theme-centered	
Time: 5.2.2016	12:00	
Place: Kruunuvuorenkatu 4	FI-00016 Kesko	
Duration of the interview:	0:35:31 h	
Person: Kristiina Koskela	Treasury Manager	The Kesko Group
Type of interview:	Focus group interview	
Time: 23.2.2016	15:00	
Place: Kruunuvuorenkatu 4	FI-00016 Kesko	
Duration of the interview:	0:59:50 h	
Person: Sami Soikkeli	Head of Market Operations	The Kesko Group
Type of interview:	Focus group interview	
Time: 23.2.2016	15:00	
Place: Kruunuvuorenkatu 4	FI-00016 Kesko	
Duration of the interview:	0:59:50 h	
Person: Heikki Ala-Seppälä	Treasurer	The Kesko Group
Type of interview:	Focus group interview	
Time: 23.2.2016	15:00	
Place: Kruunuvuorenkatu 4	FI-00016 Kesko	
Duration of the interview:	0:59:50 h	

APPENDIX 2 INTERVIEW GUIDE FOR THE IFRS EXPERTS

Peter Sundvik	KPMG Oy Ab	9.12.2015
Nina Alaharju	PricewaterhouseCoopers	17.2.2016

General information about the interviewee

- Work history and current position
- How IFRS 9 is related to the current position

The reform of accounting for financial instruments: From IAS 39 to IFRS 9

- How significant project IFRS 9 has generally been?
- What have been the main reasons for creating IFRS 9?
- How necessary it is to replace IAS 39 with IFRS 9?
- What are the main effects of IFRS 9 related to financial reporting of companies?
- How IFRS 9 affects the quality and the information value of financial reporting?
- How companies should prepare for the standard change?
- What do you think about the timetable in which IFRS 9 has been completed?

Classification and measurement – Business model for managing financial assets

- What kind of is the new approach that is based on the business model and nature of cash flows compared to the approach of IAS 39?
- What does the term 'business model' signify in this context?
- How unambiguous is the definition of business model?
- What issues should especially considered when determining the business model?
- What kind of information should a company produce to reason the business model it has chosen?
- In what kind of cases a company may have more than one business model?
- In what circumstances the chosen business model could change?
- What procedures the implementation of the new approach causes for companies?
- To what kind of companies this reform will affect the most?
- How the booking of own credit changes into the other comprehensive income differs from the model and the requirements of IAS 39
- How the effects of this new booking practice appear in the financial statements of companies?

Impairment

- What kind of is the new expected credit loss model compared to the guidance of IAS 39?
- What happens to the recognition of credit losses and impairment after the new model?
- What matters should be taken into account in the implementation of the new model?

- What kind of risks the new model can bring forth?
- How the new model affects the volatility of a company applying it?
- What kind of costs the implementation of the new model may cause?
- To what kind of companies this reform will affect the most?

Hedge accounting

- How desired the new hedge accounting requirements are from companies' standpoint?
- How the reform will affect to the relation of companies' risk management and financial reporting?
- How the applying of hedge accounting changes in general?
- How this reform will effect to the companies' volatility of profit that apply hedge accounting?
- What kind of information the new hedge accounting model produces for companies' decision making?
- How the reform impacts to the perceiving of companies' risk management?
- What kind effect the reform may have on the amount of hedge accounting applying?

Lastly

- To what certain IFRS 9 will come into effect in January 1, 2018?
- What kind of companies might be premature appliers of the standard?

APPENDIX 3 THEME-CENTERED INTERVIEW FOR THE TREASURY MANAGER OF KESKO

Kristiina Koskela The Kesko Group 3.2.2016

Themes

- The interest of Kesko in IFRS 9
- The major expectable effects of IFRS 9 at Kesko
- Background of managing financial assets at Kesko
- Classification and measurement of financial assets under IAS 39
 - Current three-fold portfolio classification
 - Tasks related to accounting the financial assets
- New classification and measurement requirements under IFRS 9
 - Business model for managing financial assets
 - Possibility of simplifying the accounting of financial assets
- Preparation for the standard change
 - Upcoming actions
 - Timetable

APPENDIX 4 FOCUS GROUP INTERVIEW FOR THE TRESURER, THE HEAD OF MARKET OPERATIONS AND THE TREASURY MANAGER OF KESKO

Heikki Ala-Seppälä	The Kesko Group	23.2.2016
Sami Soikkeli	The Kesko Group	23.2.2016
Kristiina Koskela	The Kesko Group	23.2.2016

Current treasury policy

- How would you describe the current treasury policy (its basis, objectives etc.)?
- What kind of treasury policy Kesko is expected to have in the future?

Business model for managing financial assets

- What kind of thoughts the term business model for managing financial assets evokes?
- Which of the said business models (held-to-collect, held-to-collect and sell or other business models) Kesko could apply in the future?

Cash flow assessment

- How distinct do you find the SPPI-criterion is?
- How challenging it is to judge that does Kesko's financial assets fulfill the SPPI-criterion?
- What kinds of Kesko's financial assets fulfill the SPPI-criterion in your opinion?

Business model assessment

- Who belong to the key management of Kesko?
- Who might participate in defining the business model?
- How distinct is the specified level for defining the business model?
- What this kind of level could be?
- Could it be possible that Kesko would have more than one business model?
- What could be a specified 'stress scenario'?
- How distinct the guidance for the assessment is?
- What might be challenging subject to the assessment?

Considerable evidence related to the business model assessment

- How the performance of the business model and financial assets within is assessed?
 - How the performance is reported to the key management?
- Risks that affect the performance of the business model?
 - The way the risks are managed?
- How the management of the business is compensated?

- Is the compensation based on the fair value of the managed assets or on the collected contractual cash flows?

Forthcoming actions

- What will be the grounds for the definition of future business model?
- What kind of role the treasury policy has in the definition of business model?
- What do you find as the most challenging issues in regard to the definition?
- Who will commence to examine the issue and with what kind of timetable?
- What do you wish regards to complying with IFRS 9?