IASB Update

15 & 16 October 2009

From the International Accounting Standards Board

This IASB *Update* is a staff summary of the tentative decisions reached by the Board at a public meeting. As a project progresses, the Board can, and sometimes does, modify its earlier tentative decisions. Tentative decisions do not change existing requirements until those decisions are incorporated in a new or amended standard.

The International Accounting Standards Board met in London on 15 and 16 October 2009, when it discussed:

Other information

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Financial Instruments: Replacement of IAS 39

The Board and the US Financial Accounting Standards Board (FASB) are seeking to improve and simplify the reporting for financial instruments. IAS 39 *Financial Instruments: Recognition and Measurement* sets out the requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items.

The Board is replacing IAS 39 in three phases.

- Phase 1: Classification and measurement. The Board published an exposure draft in July 2009. The Board has been considering the comments it received on the proposals and expects to publish a final IFRS in November 2009.
- Phase 2: Impairment (methodology). The Board plans to publish an exposure draft proposing a change to the incurred loss impairment methodology in IAS 39 in October 2009.
- Phase 3: Hedging. The Board expects to publish an exposure draft in December 2009.

The relevant part of IAS 39 will be replaced as each phase is completed.

At this meeting the Board continued to discuss all three phases of the project.

Classification and measurement - phase 1

Unquoted equity instruments: elimination of cost exception

IAS 39 has an exception for investments in unquoted equity instruments (and some related derivatives). The exception requires that these instruments be measured at cost (less impairment) if fair value cannot be determined reliably. The ED proposed to eliminate this exception.

The Board tentatively decided to eliminate the cost exception, and measure all equity instruments currently covered by the exception at fair value. However, the final standard will contain guidance on how to determine fair value for these instruments when they are difficult to value because of little or no timely or relevant information (including when cost might be representative of fair value).

Reclassification

The ED proposed to prohibit reclassification between the amortised cost and fair value categories.

The Board tentatively decided to require reclassification between fair value and the other measurement categories when there is a change in the entity's business model. Reclassification would be prohibited in all other circumstances. The Board noted that such reclassifications would be expected to occur infrequently, if ever.

The Board tentatively decided that all reclassifications would be accounted for prospectively:

- If an instrument is reclassified from another category to fair value, the instrument should be measured at fair value on that date, and any difference between the carrying amount and fair value would be recognised in a separate line in profit and loss.
- If an instrument is reclassified from fair value to another category, the fair value of the instrument on the date of reclassification becomes its new carrying amount.

The Board tentatively decided to amend IFRS 7 *Financial Instruments: Disclosures* to include disclosures for all reclassifications between measurement categories.

Instruments measured at fair value through other comprehensive income

The ED proposed a presentation option for investments in equity instruments except for those held for trading. Under the proposal, an entity can make an irrevocable election at initial recognition to present all fair value changes for these equity investments in other comprehensive income.

The Board tentatively confirmed the proposal in the ED. However, as a change to the ED proposal, the Board tentatively decided to require recognition of dividends received from these investments in profit or loss, so long as they represent a return on investment (as opposed to a return of investment). The Board tentatively reconfirmed that recycling of gains and losses between profit or loss and other comprehensive income will be prohibited.

The Board tentatively decided to retain all disclosures proposed in the ED. In addition, the Board tentatively decided to require disclosure of dividends presented in profit or loss related to investments measured at fair value through other comprehensive income.

Concentrations of credit risk

The ED addressed the accounting for concentrations of credit risk created by using multiple contractually linked and subordinated interests (ie tranches). The ED stated that the most senior tranche would be eligible for measurement at amortised cost (if the other classification criteria are met), while all other tranches would be measured at fair value through profit or loss.

The Board tentatively decided to require separate assessment of the classification criteria by the issuer of the contractually linked instruments that affect concentrations of credit risk.

The Board tentatively decided to require a 'look through' approach for holders of tranches to determine their measurement. The holder would look through the underlying instruments pool until the assets generating (and not only passing through) the cash flows were identified.

The Board tentatively decided that to qualify for measurement at amortised cost, the underlying instruments pool can contain instruments that:

- have only basic loan features;
- change the cash flow variability of the instruments with basic loan features in accordance with the 'basic loan features' criterion; and/or
- align the cash flows (eg for interest rates or currencies) of the issued instruments with the underlying instrument pool.

Measurement at fair value will be required if the underlying instruments pool contains any instrument used to create additional leverage or any non-financial items. Reassessment of the underlying instruments pool is not permitted. However, if the underlying instruments pool can change subsequent to initial recognition in a manner that would prohibit classification at amortised cost, this would prohibit measuring any of the issued instruments (ie tranches) at amortised cost.

Financial assets acquired at a discount that reflects incurred credit losses

The Board tentatively decided that the fact that an asset is acquired at a discount that reflects incurred credit losses does not in itself disqualify it from being measured at amortised cost.

Impairment - phase 2

Drafting of ED and comment period

The Board tentatively decided to proceed with the drafting of an ED to replace sections of IAS 39 relating to impairment. The ED will be drafted as a stand-alone document to be published later this month (October 2009).

The Board tentatively decided to establish a comment period of eight months for the ED with the objective of issuing a final standard by the end of 2010.

Hedge accounting - phase 3

Eligibility of financial instruments managed on a contractual cash flow basis in a fair value hedge

The Board discussed an analysis on the eligibility of financial instruments managed on a contractual cash flow basis in a fair value hedge. The Board tentatively confirmed that financial instruments managed on a contractual cash flow basis are eligible hedged items of a fair value hedge.

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Future Board meetings

The Board will meet in public session on the following dates in 2009. Meetings take place in London, UK, unless otherwise noted.

19-23 October

26-27 October *(IASB and FASB joint meeting, Norwalk USA)*

16-20 November

14-18 December

Go to the meetings section of the IASB website

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