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**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board meeting: 20 June 2006, London

Project: Financial Instruments

Subject: Due Process Document (Agenda Paper 2A)

BACKGROUND

1. At the joint meeting the FASB and IASB (the boards) agreed to a goal of issuing a due process document on financial instruments (as envisaged in the Memorandum of Understanding between the FASB and IASB) before 1 January 2008.
2. The boards also directed the staff to prepare a paper outlining the possible contents of the document, including whether it should contain any preliminary board decisions, and proposing a draft timetable.

PRIMARY OBJECTIVES OF THE DUE PROCESS DOCUMENT

3. The staff believes that in order to demonstrate that the staff and the boards are considering and making progress on issues related to achieving the long-term objectives for financial instruments, the primary objectives of the due process document should be to:
 - a. describe the major issues in current accounting standards and practice related to financial instruments,

- b. describe the boards' long term objectives with regard to accounting for financial instruments and the reasons that the boards established those objectives
 - c. present preliminary views on any individual issues on which a majority of the members of either Board have agreed, tentative conclusions supported by a significant minority of members of the boards, and any other results of the boards' deliberations that would aid constituents in preparing responses to the questions in the document,
 - d. ask constituents for their opinions about the issues and possible alternative resolutions that may have been identified, and to request suggestions from constituents about possible ways to achieve the boards' long term objectives with the least cost and disruption in practice, and
 - e. demonstrate to constituents the interaction between the issues related to the long-term objectives for financial instruments and other projects the boards are undertaking (such as the Financial statement presentation project). The due process document should demonstrate the progress made on addressing issues relating to the accounting for financial instruments in the other projects.
4. The staff asks whether the boards agree with the primary objectives of the due process document as set out in paragraph 3.

POSSIBLE EXTENT OF BOARD INVOLVEMENT

5. Because the long-term objective of measuring all financial instruments at fair value is already a tentative decision, the staff has assumed that objective in drafting the following sections (although please note the question to board members in paragraph 16(c)). Hence the due process document will include at least this preliminary view.

6. In addition, the staff has been working on a number of the display issues associated with fair value measurement of financial instruments (see Agenda paper 2A). Although we do not yet have a recommendation as to whether (and if so, how) that research should be integrated into the due process document, it may well be that the boards may wish to take preliminary decisions on some of these issues (the staff also notes that the FASB will, in any case, be considering many related issues in conjunction with their deliberation of the comments received on the FASB Exposure Draft on *The Fair Value Option for Financial Assets and Financial Liabilities*). The boards may therefore wish to include any preliminary views reached on the display issues in the due process document.
7. [Paragraph omitted from observer notes]
8. However, the staff notes that there is some trade-off between seeking the preliminary views of both boards and the aim of issuing a due process document on financial instruments before 1 January 2008.
9. Therefore, it is the recommendation of the staff that:
 - a. the due process document contains preliminary views, to the extent that the boards have reached them already either in this project (such as the long-term objectives of the boards and the decision not to undertake efforts with the single objective of eliminating reconciling items in SEC filings) or in other related projects,
 - b. the staff seeks, and the due process document contains, the preliminary views of the boards on other issues to the extent that the staff and boards believe that it might be possible to reach those preliminary views in the timeframe we have (see paragraph 10 for examples of possible issues on which the staff might seek preliminary views), and
 - c. to the extent that the boards have not discussed (or have not reached) preliminary views on specific issues, the due process document includes a neutral discussion of those issues (and states that no view has been reached).

10. Examples of issues the staff might ask for preliminary views on could include:

- a. A common definition of financial instruments (or financial assets and financial liabilities)
- b. The scope of any future requirements relating to the accounting for financial instruments, i.e., which, if any, contractual arrangements should be included or excluded
- c. Alternative interim steps to the measurement of all financial instruments at fair value, including possible developments of current hedge accounting requirements

11. The staff asks whether the boards agree with the recommendations set out in paragraph 9.

OUTLINE OF POSSIBLE CONTENTS OF DUE PROCESS DOCUMENT

12. Appendix one contains a proposed outline of the due process document.

13. The outline consists largely of a number of questions. The purpose of this format is to provide the boards with:

- a. The key questions and issues which the due process document will seek to discuss, as well as
- b. Providing board members with an indication of the types of questions the staff would propose asking for preliminary views on (assuming that the boards agree with the approach set out in paragraph 9).

14. Clearly the outline in appendix one represents an initial attempt to sketch out the contents of the document. Inevitably the contents (and ordering of those contents) will evolve over time.

15. The staff also note that, unlike previous due process documents issued in relation to the accounting for financial instruments (for example, the FASB preliminary views document in 1999 or the JWG document in 2000), this due process document will not discuss, or ask questions, relating to *how to* measure fair value for financial instruments – except possibly for unit of account issues.
16. The staff would like the boards to consider three specific questions with regard to the draft outline:
- a. In chapter 1 (Scope, Definitions and possible Scope Amendments), is *financial instruments* the appropriate basis for the scope of the document with whatever exceptions the boards want to make or additional items the boards want to include? The only difference between financial instruments and many other types of contracts is the nature of the items to be delivered or exchanged (financial assets as opposed to goods or services). Consequently, a scope that included all contracts requiring delivery or exchanges would be easier to describe and implement, as well as easier to justify conceptually.
 - b. In chapter 2 (Recognition and derecognition) the staff would like the boards to confirm that derecognition issues relating to the transfer of financial assets should be included in a separate due process document. The staff would also like the views of board members as to whether other derecognition issues (for example, relating to financial liability extinguishment or debt modification) should be addressed and, if so, in which due process document?
 - c. In chapter 3 (Measurement and reporting of gains and losses), the staff plans to assume the long-term objective of fair value measurement in drafting the document. The Measurement section would include the reasoning for fair value measurement and the problems with the alternatives. Do board members agree on this approach?
17. The staff asks for any additional comments that board members may have at this time on the suggested outline.

DRAFT TIMETABLE

18. Appendix two contains a draft timetable for the due process document. The draft timetable assumes that the possible inclusion of an agenda item relating to financial instruments is considered by the IASB following preliminary discussions with the Standards Advisory Council in June 2006.
19. The timetable suggests that, following agreement of the draft outline and approach of the due process document, regular meetings are held with the boards to discuss technical issues and arrive at preliminary views on those issues where possible. The timetable suggests that such meetings should commence in September 2006 with a discussion on the definition of financial instruments and related scope issues.
20. By holding regular meetings as outlined in the draft timetable, the staff believes that:
 - a. Any concerns the boards may have with regard to the contents or direction of the due process document will be highlighted at an early stage,
 - b. It is demonstrated to constituents that the staff and boards the boards are making progress on issues related to the long-term objectives for financial instruments (and that consideration of such issues is unlikely to be completed in the short-term), and
 - c. The meetings prepare and educate constituents ahead of issuing the due process document.
21. The staff acknowledges that the draft timetable is aggressive, but has been based on the assumption that the staff will work full-time on drafting the due process document.
22. The staff asks whether the boards agree with the approach and draft timing as set out above and in appendix two.

ROLE OF THE FINANCIAL INSTRUMENTS WORKING GROUP (FIWG)

23. The IASB has a working group that includes preparers, users and auditors of financial statements. The role of this working group is to assist the IASB in improving, simplifying and ultimately replacing IAS 39 *Financial Instruments: Recognition and Measurement*.
24. The contents of the due process document will clearly be relevant to this working group, and the staff asks for the views of board members (and specifically the views of the IASB board members) on the role of this working group in the drafting of the due process document.

APPENDIX ONE

DRAFT OUTLINE FOR DUE PROCESS DOCUMENT

Background and purpose of document

Questions to the recipients of this document

Introduction

Chapter 1 – Scope, Definitions and possible Scope Amendments

The scope of the document and definitions

- Should the scope be just financial instruments or should it include all rights and obligations arising from any type of contract? (The latter would be easier to describe and result in consistent accounting for a broader range of assets and liabilities.) See question to the boards in paragraph 16(a).
- If the scope is to include only financial instruments, then how should the term *financial instruments* (or the terms *financial assets and financial liabilities*) be defined?
- Should any definition be applied to individual contractual rights/obligations for multiple element contracts or to contracts as a whole? (A single multiple element contract might include both a financial instrument and other types of rights and obligations, for example, a sale of goods and a related cash settled warranty.)

Possible scope amendments

- Assuming that the scope of the document is financial instruments, then which instruments that do (or may) meet the definition should be scoped out?
 - Own equity instruments?
 - Financial instruments, contracts and obligations relating to share based payment transactions?
 - Pensions (the unconditional liability)?
 - Insurance contracts that meet definition of financial instruments (interaction with IASB Insurance project)?
 - Some financial guarantees?
 - Rights and obligations under leases, and other contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item?
 - Ownership interests in consolidated subsidiaries and (for US GAAP) consolidated Variable Interest Entities (VIEs) that are accounted for under other accounting standards?
 - Receivables from and payables to consolidated subsidiaries in separate financial statements and (for US GAAP) consolidated VIEs?
 - Equity method investments?
 - Contingent receivables or payables resulting from business combinations?
 - Contracts between an acquirer and a vendor in a business combination to buy or sell an acquiree at a future date?
 - Certain loan commitments, lines of credit, credit card contracts and other unrecognized derivative-like financial instruments?
- Assuming that the scope of the document is financial instruments, then which items that do not (or may not) meet the definition should be scoped in?

- Servicing rights?
- Rights and obligations under leases?
- Employers' rights and obligations under employee benefit plans?
- Property and casualty insurance contracts that involve exchanges or delivery of nonfinancial items?
- Warranties and guarantees that involve exchanges or delivery of nonfinancial items?
- Contracts for nonfinancial assets that are readily convertible to cash (or meet other specified criteria)?
- Should non-contractual elements arising from financial instruments be included (for example, customer relationship intangibles)? If so, how should they be accounted for?
- Should nonfinancial elements of contracts (for example, insurance contracts if included in scope) be included? If so, how should they be accounted for?

Chapter 2 – Recognition and derecognition

Recognition

- Should *all* financial instruments be recognised when entity becomes party to contract (for example, some commitments, lines of credit and similar items with zero cost are not recognised at all)?
- Should bifurcation of a contractual right/obligation be permitted or required for recognition and subsequent measurement purposes?

Derecognition

- See questions to the boards in paragraph 16 (b)

Chapter 3 – Measurement and reporting of gains and losses

Measurement

- See question to the boards in paragraph 16 (c)

Reporting of gains and losses

- Is reporting of all gains & losses in earnings appropriate?
 - Is recognition of gains/losses relating to changes in own credit standing (or changes over a benchmark rate) appropriate? If not, what is the alternative?
- What are the alternatives to reporting all changes in earnings and how would any distinction between different treatments be made?
- If changes are not reported in earnings, should a gain/loss be recycled when the gain/loss realized (interaction with phase 2 of Financial statement presentation project)?
- What, if any, should be the impact of management intent on reporting gains & losses in earnings or outside of earnings?

Chapter 4 – Hedge accounting

- What are the remaining issues relating to hedge accounting that would not be resolved by fair valuing all financial instruments?
 - Should fair value hedge accounting of ‘portions/specified risks’ continue to be permitted?
 - Should fair value hedge accounting of non-financial hedged items continue to be permitted?
 - Should fair value hedge accounting of non-financial firm commitments continue to be permitted?
 - Should cash flow hedge accounting continue to be permitted?

Chapter 5 – Presentation and disclosures

- [Possible inclusion of research findings and any preliminary views on the related disaggregation project the boards have reached]

Chapter 6 – Next steps

- What next steps should the boards take?
 - Move to requirement to measure all financial instruments at fair value in one go?
 - Move by way of interim steps? What should they be?
 - *Measurement* – examples might include: eliminate/consolidate categories one at a time, streamline categories eliminating distinctions between different types of financial instruments, etc.
 - *Hedging* – examples might include: eliminate portions for fair value, make fair value hedge accounting harder/cash flow hedge accounting easier, alternative treatments for gains/losses on hedging derivatives etc.
 - Eliminate IFRS/US GAAP reconciling items? If so, which ones and how should they be eliminated?
 - Do nothing? Why?

APPENDIX TWO

DRAFT TIMETABLE FOR DUE PROCESS DOCUMENT

STEP	DATE	Concurrent work
1 Submit first outline to Boards	June 7, 2006	IASB FVM Presentation and Disclosure
2 IASB education session	June 19, 2006	IASB FVM Presentation and Disclosure
3 FASB education session	June 20, 2006	IASB FVM Presentation and Disclosure
4 Prepare IASB agenda papers	July 5, 2006	IASB FVM Presentation and Disclosure
5 IASB Board meeting	July 17, 2006	IASB FVM Presentation and Disclosure
6 FASB Board meeting	July 19, 2006	IASB FVM Presentation and Disclosure
7 Analyze and discuss results of meetings Papers on scope and definition of financial instruments	July 26, 2006	IASB FVM Presentation and Disclosure
8 IASB meeting	September 6, 2006	IASB FVM Presentation and Disclosure
9 FASB meeting	September 18, 2006	IASB FVM Presentation and Disclosure
10 Follow-up papers on scope and definition	September 20, 2006	IASB FVM Presentation and Disclosure
11 Joint meeting	October 4, 2006	IASB FVM Presentation and Disclosure
12 Papers on measurement issues	October 23, 2006	IASB FVM Presentation and Disclosure
13 IASB meeting	November 1, 2006	IASB FVM Presentation and Disclosure
14 FASB meeting	November 13, 2006	IASB FVM Presentation and Disclosure
15 Follow-up papers on measurement	November 15, 2006	IASB FVM Presentation and Disclosure
16 IASB meeting	November 29, 2006	IASB FVM Presentation and Disclosure
17 FASB meeting	December 11, 2006	IASB FVM Presentation and Disclosure
18 Papers on presentation and disclosure	December 13, 2006	IASB FVM Presentation and Disclosure
19 IASB meeting	Early January 2007	IASB FVM
20 FASB meeting	late January 2007	IASB FVM
21	late January 2007	IASB FVM
22 Follow-up papers on presentation and disclosure	Early February 2007	IASB FVM
23 IASB meeting	late February 2007	IASB FVM
24 FASB meeting	late February 2007	IASB FVM
25 Papers on hedge accounting	Early March 2007	IASB FVM
26 IASB meeting	late March 2007	IASB FVM
27 FASB meeting	late March 2007	IASB FVM
28 Papers for joint meeting on interim steps	early April 2007	IASB FVM
29 Joint meeting	late April 2007	IASB FVM
30 Follow-up on hedge accounting and interim steps	early May 2007	IASB FVM
31 IASB meeting	late May 2007	IASB FVM
32 FASB meeting	late May 2007	IASB FVM
33 Paper on specific questions and wrap-up	early June 2007	IASB FVM
34 IASB meeting	late June 2007	IASB FVM
35 FASB meeting	late June 2007	IASB FVM
36 Begin final drafting process	early July 2007	IASB FVM
37 Complete draft to Boards	September 1, 2007	
38 Receive comments on complete draft	September 8, 2007	
39 Draft to outside reviewers	September 15, 2007	
40 Comments from outside reviewers	September 30, 2007	
41 Preballot draft to Boards	October 7, 2007	
42 Joint meeting	later October 2007	
43 Receive comments on preballot draft	October 24, 2007	
44 Ballot draft to Boards	October 31, 2007	
45 Receive ballots from Boards	November 8, 2007	
46 Submit DD to production departments	November 15, 2007	
47 Issue final due process document	November 30, 2007	