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International
Accounting Standards
Board



**INFORMATION FOR OBSERVERS**

**Board Meeting:** **16 November 2006, London**

**Project:** **Financial Instruments – Due Process Document (DPD)**

**Subject:** **Recognition and Measurement (Agenda Paper 5D)**

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## CONTENTS OF PAPER

1. At the September meetings, the Boards deferred any decision about whether to include certain financial instrument contracts that are not currently required to be recognized, except (for example) in business combinations or when an entity has incurred a loss related to them in the scope of the DPD. Such items include loan commitments, lines of credit, letters of credit, and certain credit card contracts.

2. This paper discusses whether the DPD should require the recognition of such items.

## LOAN COMMITMENTS, LINES OF CREDIT, LETTERS OF CREDIT AND CREDIT CARD CONTRACTS

3. The DPD could require that these items are:

    a. Recognized when the entity becomes a party to the contract (which is consistent with other financial instruments). Such items would initially be measured as required by the DPD (see Paper 5A) and subsequently measured using either Approach A (considering only outcomes that are detrimental to the issuer/writer) or Approach B (considering all assumptions that market participants would use)–as previously discussed in paper 5C.

    b. Not recognized unless they are acquired or assumed and, in that case, measured at the transaction price with amortization or impairment being recognized in accordance with business combination standards.

4. Many of these items meet the definition of a financial instrument[1].

5. Putting issues of measurement to one side, then would recognition of such items provide relevant information to the users of financial statements? That is, does it have feedback value or predictive value (or both), and is the information timely for decision making purposes?

6. The Boards have already decided that fair value is the most relevant measurement attribute for all financial instruments. Therefore if such items were recognized, they would be measured at fair value.

7. Hence it is a choice between either providing the information (that is, recognizing such items) or not. Providing such information would be more decision-useful than not providing such information. Furthermore, recognizing such items would

[1] Some credit card contracts may not be financial instruments. A card issued by a retailer that can only be used to purchase goods or services would not (although if the card is issued by a separate finance subsidiary, then that would be a financial instrument).

(subject to the measurement approach chosen) put purchased contracts and internally originated contracts on the same basis.

8. There is also the issue of reliability of measurement. Paper 5C discusses some of the issues regarding the ease (or otherwise) of measuring the contractual parts of a credit card transaction (that is, excluding the value attributable to the non-contractual benefits in the sale of a credit card relationship).

9. The practicality of measuring such items (using either approach A or approach B) has been questioned by constituents in the past. Some constituents have suggested that we should only recognize such items on realization (that is, when portfolios involving such items are bought or sold).

10. Waiting until realization of such items would provide completely reliable measurement. However, the same argument could be made for long-dated structured derivative instruments with significant non-observable valuation inputs.

11. Waiting until realization of such items would not provide the most relevant information–such information would not be timely.

12. **Questions to the Boards:**

    a. **Should the DPD require that the items described above that meet the definition of a financial instrument be recognized consistently with other financial instruments?**

    b. **If such items should not be recognized under the DPD, what are the reasons?**

    c. **If you are not prepared to answer those questions, what additional information do you need?**