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**International
Accounting Standards
Board**

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

Note: These notes are based on the staff paper prepared for the Financial Instruments Working Group Meetings. Paragraph numbers correspond to paragraph numbers used in the Financial Instruments paper. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IASB Meeting: **Financial Instruments Working Group**
Paper: **Agenda Paper 5**

Financial Instruments Due Process document – overview

PURPOSE OF THIS PAPER

1. This paper summarises the background to, and intended approach of, the Financial Instruments Due Process Document (DPD).

MEMORANDUM OF UNDERSTANDING

2. At their joint meeting in April 2006, the IASB and Financial Accounting Standards Board (FASB) agreed to a goal of issuing a due process document on financial instruments.
3. This document was envisaged in the Memorandum of Understanding (MOU) between the IASB and FASB issued on 27 February 2006.
4. The MOU sets out goals to be worked towards for the IASB-FASB convergence programme. These goals are:

- a. to conclude whether major differences in a limited number of focused areas should be eliminated through one or more short-term standard-setting projects and, if so, what work should be completed or substantially completed ('short-term convergence')
 - b. to have made significant progress on joint projects in areas identified by both boards where current accounting practices of US GAAP and IFRSs are regarded as candidates for improvement ('other joint projects').
5. With respect to the other joint projects (and following consultations with representatives of the European Commission and the SEC staff), the MOU sets out the progress the IASB and FASB expects to achieve by 2008.
 6. Included in the list of other joint projects is the replacement of the existing standards on financial instruments¹. The progress to be achieved by 2008 in respect of this joint project is to issue one or more due progress documents.

PRIMARY OBJECTIVES OF THE DPD

7. The boards determined that the DPD should:
 - a. set out the boards' long term objectives regarding the accounting for financial instruments and the reasons the boards established those objectives², and
 - b. describe major issues associated with the application of current accounting standards on financial instruments and request constituents to give suggestions regarding the possible ways to achieve the boards' long term objectives with the least cost and disruption in practice.
8. In addition, the boards decided that the DPD must 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).

¹ Also included in the list are liability and equity distinctions and derecognition. See later comments regarding derecognition.

² See <http://www.iasb.org/NR/rdonlyres/1D416A93-DF17-4F43-B49B-C687C658F5DF/0/FinancialInstrumentslongtermobjectives.pdf>

DERECOGNITION OF FINANCIAL INSTRUMENTS

9. As noted previously, derecognition is also included in the list of other joint projects.
10. The boards decided that all issues relating to the derecognition of financial instruments should be included in a separate due process document (as described in the MOU) rather than in the financial instruments DPD.

PROPOSED CONTENTS OF THE DPD

11. In line with the primary objectives of the DPD (as set out above), the staff has proposed that the DPD should comprise of two parts.
12. The first part of the DPD will set out the principal components of an accounting model that is based on the preliminary view of the Boards that all items in the scope of the DPD should be remeasured at fair value, with changes in fair value being recognized in the period in which they occur (the 'fair value model').
13. However, the DPD will not propose solutions to all issues related to the fair value model. For example, given the tight timetable, the DPD is unlikely to comprehensively address presentation and disclosure issues (such as aggregation or disaggregation of changes in fair values).
14. The second part of the DPD will discuss how the Boards might move towards the fair value model following issuance of the DPD.

PRELIMINARY VIEWS OF THE BOARDS

15. Past experience indicates that constituents are better able to respond constructively to documents that express preliminary views or tentative conclusions than to documents that simply list issues and alternatives.
16. However, given the target date for publication of the DPD, there are some trade-offs between seeking the preliminary views of both boards to include them in the DPD and the aim of issuing the DPD before 1 January 2008.

17. Therefore, the boards determined that the DPD should only include the boards' preliminary views and any other results of the boards' deliberations on individual issues to the extent that such views can be reached by the target date for the publication of the DPD.
18. The DPD will include at least a preliminary view that all financial instruments should be remeasured at fair value with changes in the fair value being recognised in the period in which they occur. Such a long-term objective has been tentatively decided by the boards previously.

ISSUES DISCUSSED BY THE BOARDS TO DATE

19. One or both boards have discussed the following topics related to the fair value model to date:
 - a. Scope and related issues (including a revised definition of a financial instrument)
 - b. Unit of account and measurement
 - c. Initial measurement
 - d. Reporting of fair value gains and losses
 - e. Measurement of certain contractual instruments that meet the definition of a financial instrument (including credit card agreements and liabilities with a demand feature)
 - f. Measurement of liabilities with a contractual or non-contractual guarantee
 - g. Exceptions from the normal accounting principles (in the form of hedge accounting)
20. In addition, the IASB has started to discuss how the boards might move towards the fair value model following issuance of the DPD.