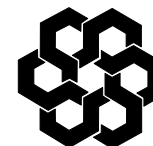


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**International
Accounting Standards
Board**

This document is provided as a convenience to observers at Standards Advisory Council meetings, to assist them in following the Council's 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 Council. Paragraph numbers correspond to paragraph numbers used in the Council paper.

INFORMATION FOR OBSERVERS

SAC Meeting: **June 2007, London**

Project: **Financial Instruments**
 Due Process document – overview
 (Agenda Paper 4)

PURPOSE OF THIS PAPER

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

BACKGROUND

2. At their joint meeting in April 2005 the IASB and FASB (the 'boards') expressed the view that adopting a single measurement attribute (the fair value measurement attribute) would improve financial reporting and significantly simplify their accounting standards.
3. At their joint meeting in October 2005 three *long-term* objectives were established to improve the financial reporting of financial instruments.

4. One of these long-term objectives is that all financial instruments should be measured at fair value with realised and unrealised gains and losses recognised in the period in which they occur (a 'fair value measurement model').
5. The boards noted that fair value measurement would produce more relevant information and solve many problems caused by using different measurement attributes for different instruments.
6. However, the boards noted that a number of issues remain to be resolved before a fair value measurement model could be required.
7. Some of those issues include:
 - a. Which instruments and related assets and liabilities should be subject to a fair value measurement model
 - b. How to estimate fair value for instruments that are not traded or are traded in government-controlled or illiquid markets
 - c. How to present the components of the net changes in fair values, and
 - d. What information to disclose about past changes in fair values and exposure to future changes in market factors.
8. Another long-term objective the boards established is to simplify requirements for hedge accounting and, if possible, reduce or eliminate the need for special accounting.
9. A third long-term objective is to develop a new and converged standard for derecognition of financial instruments that is simpler, easier to apply, and more consistent with concepts of financial reporting than any existing derecognition standard.

MEMORANDUM OF UNDERSTANDING AND THE DPD

10. At their joint meeting in April 2006, the boards agreed to a goal of issuing a due process document on financial instruments by January 2008.
11. This document was envisaged in the Memorandum of Understanding (MOU) between the boards that was issued on 27 February 2006.
12. 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').
13. 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 boards expect to achieve by 2008.
14. Included in the list of other joint projects is the replacement of the existing standards on financial instruments. The progress to be achieved by 2008 in respect of this joint project is to issue one or more due process documents.

PRIMARY OBJECTIVES OF THE DPD

15. The boards determined that the DPD should:
 - a. Set out the boards' long term objectives regarding the accounting for financial instruments (including the fair value measurement model) and the reasons the boards established those objectives, and

- b. Describe the complexity and other 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.

16. In addition, the boards decided that the DPD must include 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).

POSSIBLE CONTENTS OF THE DPD

17. In line with the primary objectives of the DPD set out above, the DPD will discuss topics including:

- a. The complexity created by existing requirements,
- b. How a fair value measurement model would improve and simplify existing requirements, and
- c. How to move towards a fair value measurement model. This will include possible interim steps towards a fair value measurement model.

18. The DPD will hence place particular emphasis on discussing, and seeking the views of constituents regarding, possible ways to move forward towards the boards' long term objectives.

POSSIBLE CHANGES TO EXISTING REQUIREMENTS AS AN INTERIM STEP TOWARDS A FAIR VALUE MEASUREMENT MODEL

19. As discussed above, an 'Interim steps' approach would take one or more steps to achieve the fair value model.

20. An advantage of such an approach is that it allows more time for related projects to make further progress. Such projects include the Financial Statement Presentation project.
21. However an interim steps approach would require considerable time and resources from the boards, staff and constituents to develop and implement each interim step. Hence there is a risk that the boards might never achieve their long-term objective.
22. Moreover, numerous interim steps might be required to achieve the fair value measurement model is achieved. Multiple steps may require multiple systems changes.
23. Furthermore, each interim amendment requires the development of transitional provisions to help constituents implement the amendment smoothly. Such transitional provisions might impair the comparability and decision usefulness of information in the financial statements.
24. There are many different possible interim steps to move towards the fair value measurement model. Therefore, criteria have to be set to assess possible interim steps.
25. Such criteria might include whether any possible interim step will:
 - a. Reduce today's complexity associated with interpretation, application and understanding, and
 - b. Improve financial reporting and move towards the fair value measurement model.
26. It is intended that the DPD will include an example of a next possible interim step, and seek suggestions from constituents of other possible interim steps that are consistent with the criteria set out above.

QUESTIONS TO MEMBERS

- 27. What are your comments regarding the approach and suggested contents of the DPD?**
- 28. What are your comments on the suggested criteria against which any changes to existing requirements (as part of an interim step towards the fair value measurement model) should be assessed? (see paragraph 25)**
- 29. What are the likely reactions of our constituents to the DPD? How can we help constituents to respond constructively to one of the principal aims of the DPD – namely, to help the boards decide how to move forward?**