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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**December 2008, London**
Project:	**IFRS for Private Entities (formerly IFRS for SMEs)**
Subject:	**Redeliberation of Approach for Financial Instruments (Section 11) (Agenda Paper 5C)**

1. For the December 2008 Board meeting, the private entities agenda papers are organised as follows:
   - **Agenda Paper 5** – Overview
   - **Agenda Paper 5A** – Outstanding issues on financial statement presentation
   - **Agenda Paper 5B** – Redeliberation of approach for impairment of non-financial assets (Section 26)
     - **Attachment to 5B** – Redraft of Section 26
   - **Agenda Paper 5C** – Redeliberation of approach for financial instruments (Section 11)
     - **Attachment to 5C** – Partial redraft of Section 11 (Section11A)

Issues 11.1 and 11.2: Restructure Section 11 to make it easier to understand and easier to identify to what instruments it applies. Split Section 11 into two sections

2. **Reason for revisiting these issues.** At the June 2008 meeting, the Board deliberated a number of financial instrument issues. The Board asked the staff to present a rewritten draft of Section 11 for consideration at a future Board meeting based on the Board discussion.

3. Among the tentative decisions made by the Board were the following decisions relating to the redrafting:

   - Reorganise Section 11 to make it easier both to identify which instruments are within the scope and to apply the section if a private entity has only very simple financial instruments.
   - Restructure as two sections. The basic structure would be one section with the simple payables and receivables and other basic financial instruments, and a second section with the more complex instruments.
   - Clarify by the use of examples that the cost model will be appropriate for the significant majority of financial instruments held by private entities. The examples should reflect the types of financial instruments that a private entity is likely to have, with clear guidance for the accounting required both at acquisition or when issued and subsequently. A private entity that has no other financial instruments would then not need to consider the remainder of Section 11 dealing with more complex financial instruments transactions.
   - Not to rewrite Section 11 as a single section that has cost or amortised cost as the default. Rewriting Section 11 in that way would have required the Board to include definitions and other explicit requirements for derivatives and embedded derivatives to ensure they are measured at their fair value.

4. The rewrite of the part of Section 11 dealing with simple payables, receivables, and other basic financial instruments is presented in the attachment to this agenda paper and identified as Section 11A. The draft of Section 11A does not include disclosures. The Board made tentative decisions on disclosures separately at the September 2008 meeting, and staff will review these once the requirements for recognition, measurement, and presentation are decided.

5. **Views expressed in the comment letters, field tests, and Working Group recommendations.** The views in the comment letters, field tests, and Working Group recommendations regarding these three issues were set out in Agenda Paper 2B for the June 2008 Board meeting and are not repeated here. Briefly summarised, the vast majority of those respondents addressing Section 11 felt the language should be simplified, the structure improved, and requirements should be clarified and simplified further.

6. **Staff recommendation.** Staff believe that the rewrite of the first part of Section 11 as set out in the attachment to this agenda paper reflects the Board decisions in June 2008. Staff have only prepared Section 11A, which deals with basic financial instruments and will be applied by all entities. Section 11A essentially retains the same requirements for the financial instruments in its scope as in the Exposure Draft (ED) of a proposed IFRS for SMEs. However, the restructuring makes it clearer that the cost model is appropriate for the significant majority of financial instruments held by private entities.

7. The parts of Section 11A that are new or revised from similar provisions in Section 11 of the ED are:

   a. The principle and guidance on initial measurement in paragraphs 11.11 and 11.12 were not in the ED. Staff believes that the examples in 11.11(a) and 11.11(b) will be helpful for smaller entities.

b. The guidance on amortised cost in paragraphs 11.14-11.20 was in Appendix A to Section 11 of the ED. However, it has been condensed and simplified here. The effective interest example following paragraph 11.19 is new.

c. Paragraph 11.20 states that when determining amortised cost for receivables and payables with no stated interest rate that are classified as current assets or current liabilities, the entity does not need to apply the effective interest method. The ED had said “may be measured at the original invoice amount if the effect of discounting is immaterial” – in effect requiring a discounting calculation to determine materiality.

d. Staff have adopted the Board’s decision in June 2008 to amend paragraph 11.22(b) in Section 11 of the ED to state that an impairment loss for an equity instrument carried at cost (because its fair value cannot be measured reliably) should be the difference between the asset’s carrying amount and the best estimate (which will necessarily be an approximation) of the amount (which might be zero) that the entity would receive for the asset if it were to be sold. Previously ED paragraph 11.22 (d) required the impairment loss to be determined as “the difference between the asset’s carrying amount and the asset’s fair value”. It was noted that this was wording was confusing since it was being used for an asset whose fair value cannot be measured reliably.

e. The term ‘market value’ is used in place of fair value (paragraphs 11.13 and 11.27 to 11.33). Section 11A only requires fair value measurement in limited cases and in these limited cases staff concluded that market value is a clearer description. The Board has encouraged the staff to find more precise terms for current measurements.

f. The guidance on market value in paragraphs 11.27 to 11.33 was in the ED (referred to as fair value), partly in Section 11 and partly in Appendix B to Section 11. It has been condensed and simplified here.

g. Paragraphs 11.38 to 11.40 on debt factoring are new. They reflect views expressed in many comment letters and a decision by the Board that guidance should be provided on these common transactions of smaller entities. As noted in paragraph 11.35, some factorings (those meeting the criteria in 11.39) result in derecognition, while others do not. Some of those that do not qualify for derecognition will be presented in a ‘linked presentation’ in the statement of financial position.

8. Staff will draft Section 11B for the January meeting. The intention is for Section 11B to be structured to cover additional matters and avoid duplication with Section 11A. Additional matters would include:

- Financial assets and liabilities outside the scope of Section 11A, for example derivatives.
- Hedge accounting.
- Derecognition where significant risks and rewards are retained, but physical control is transferred. (Note, factoring is considered a common issue for private entities and is covered by Section 11A.)

9. It is likely that the vast majority (if not all) of the financial instruments in the scope of section 11B will be at fair value.

<u>Question 11.1</u>
Does the Board agree that the revised requirements for basic financial instruments (Section 11A) appropriately reflect the Board's decisions at the July 2008 meeting and are appropriate for private entities? If not, what modifications should be made?