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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**Wednesday 23 January 2008, London**
Project:	**Financial Instruments**
Subject:	**Discussion paper – *Reducing Complexity in Reporting Financial Instruments* (Agenda paper 4)**

Background

1. Many preparers of financial statements, their auditors and users of financial statements find today's requirements for reporting financial instruments complex. They have urged the International Accounting Standards Board (the Board) and the Financial Accounting Standards Board (FASB) to develop new standards of financial reporting for financial instruments that are principles-based and less complex than today's requirements.

2. The boards have, on many occasions, acknowledged that current requirements are complex. This discussion paper is designed to gather comments from our constituents to assist the boards in deciding how to proceed in developing such new standards.

3. This discussion paper also fulfills the commitment set out in the Memorandum of Understanding (MoU), *A Roadmap for Convergence between IFRSs and US GAAP – 2006 to 2008*, established by the boards in February 2006. One of the goals for 2008 announced in the MoU is 'to have issued one or more due process papers relating to the financial reporting for financial instruments'.

4. [Paragraph omitted from observer note].

FIWG meeting held on 17 January 2008

5. On 17 January 2008, the IASB and FASB staff (and some IASB board members) met members of Financial Instruments Working Group (FIWG) publicly to discuss parts of the draft discussion paper.

6. FIWG members were asked as to (a) whether the arguments set out in the draft discussion paper were understandable and (b) whether there were any additional significant issues that should be included. The purpose of the FIWG meeting was *not* to redebate issues.

Purposes of this board meeting

7. This board meeting is:

   (a) to provide an oral summary of the FIWG discussions to the Board, and
   (b) to ask whether Board members have any comments on the proposed questions for respondents to be included in the discussion paper.

8. The staff does not intend to discuss the draft discussion paper in detail at this board meeting because board members already had the opportunity to provide detailed comments on the preballot drafts.

Proposed questions for respondents to be included in the discussion paper

9. The proposed questions are set out in the Appendix to this paper.

10. The questions for respondents are the most important part of the discussion paper. The remaining part of the discussion paper is effectively background information for seeking inputs from constituents on:

   (a) whether the reporting for financial instruments is an area that the boards should address; and
   (b) if so, how the boards should proceed to develop standards that are principles-based and less complex than today's requirements

Questions for the Board

11. Are the proposed questions for respondents appropriate, as set out in the Appendix to this paper? Do you have any comments on the proposed questions?

12. Are there any additional questions that you want to add? If so, what are they and why should they be added?

APPENDIX – DRAFT QUESTIONS FOR RESPONDENTS

Section 1 Problems related to measurement and the possible long-term solution

Question 1

Do current requirements for reporting financial instruments, derivative instruments and similar items require significant change to meet the needs of preparers and users of financial statements? If not, how should the boards respond to assertions that the current requirements are too complex?

Section 2 A single measurement method for financial instruments and the boards' long-term objectives

Question 2

The many ways of measuring financial instruments are the primary source of complexity. Section 1 suggests that the long-term solution is to measure nearly all financial instruments in the same way. Part A of Section 2 identifies fair value as the only measurement attribute that is appropriate for nearly all financial instruments.

(a) Is there a measurement attribute other than fair value that is appropriate for nearly all financial instruments?

(b) If so, what is it and why do you think that measurement attribute is appropriate for nearly all financial instruments? Does that measurement attribute reduce today's measurement-related complexity and provide users with information that is necessary to assess the cash flow prospects for almost all types of financial instruments?

Question 3

Part B of section 2 sets out concerns with fair value measurement of financial instruments.

(a) Are there any significant concerns with fair value measurement of financial instruments other than those identified in section 2? If so, what are they and why are they concerns?

(b) How should the boards address those concerns (including those identified in section 2)?

Question 4

One issue discussed in part B of this section is whether the information required to determine the fair value of instruments with highly variable cash flows is sufficiently objective and verifiable for financial reporting purposes (see paragraphs [56-59]). The resulting question raised is:

> whether it is better to use objective information for recognition purposes (eg cost or proceeds of an instrument) that bears no relation to current value or future cash flow prospects, or to use an amount that is intended to represent current value but is subjective and may change significantly from period to period.

What are your views on this question?

Question 5

Another issue discussed in part B of this section is whether information about gains and losses that are unlikely to be realised is of any use (see paragraphs [65-68]). The resulting question raised is:

> Are the benefits of using a single measurement for nearly all financial instruments outweighed by including in earnings unrealised gains and losses?

What are your views on this question?

Question 6

Some find the reporting in earnings of the effects of changes in fair values of an entity's own financial liabilities counterintuitive. Part B of this section explains reasons why such an intuition might not be well-founded. Part B of this section also acknowledges the importance of separately reporting unrealised gains and losses arising from changes in credit risks.

Do you believe that the benefits of fair value measurement for all financial instruments should be forgone as a result of this issue? If so, please explain why.

Question 7

Part C of section 2 identifies four issues that the boards need to resolve before fair value measurement can become a general requirement for nearly all financial instruments.

(a) Are there other issues that you believe the boards should address before a general fair value measurement requirement for financial instruments? If so, what are they? How should the boards address them?

(b) Do you believe that the boards could require the general fair value measurement of nearly all financial instruments before they resolve all of the issues identified in section 2? In your view, are there any issues that do not have to be resolved before a general fair value measurement requirement? If so, what are they and why?

Section 3 Intermediate solutions to measurement and related problems

Question 8

(a) Should the boards consider intermediate solutions to address measurement-related complexity? Why or why not?
(b) If so, which proposals would you recommend to the boards? Why?

Question 9

Proposal 1 is to amend existing measurement requirements. If you recommend Proposal 1, what specific suggestions would you make to the boards? How are your suggestions consistent with the criteria for any proposed intermediate changes as set out in paragraph [1]?

Question 10

Proposal 2 is to replace existing measurement requirements with a comprehensive principle-based measurement requirement, and to make some exceptions to that principle. If you recommend Proposal 2:

(a) What restrictions would you suggest on the instruments eligible to be measured at something other than fair value? How are your suggestions consistent with the criteria set out in paragraph [1]?
(b) How should instruments that are not measured at fair value be measured?
(c) When should impairment losses be recognised and how should the amount of impairment losses be measured?
(d) Where should unrealised gains and losses be recognised on instruments measured at fair value? Why? How are your suggestions consistent with the criteria set out in paragraph [1]?
(e) Should reclassifications be permitted? What types of reclassifications should be permitted and how should they be accounted for? How are your suggestions consistent with the criteria set out in paragraph [1]?

Question 11

Proposal 3 sets out three possible methods of replacing fair value hedge accounting.

(a) Which suggestion(s) (if any) should the boards consider, and why?

(b) Are there any other methods (not discussed in this section) that should be considered by the boards? If so, what are they and how are they consistent with the criteria set out in paragraph [1]? If you suggest changing measurement requirements under Proposal 1, please ensure your comments are consistent with your suggested approach to changing measurement requirements.

Question 12

Section 3 also discusses how the existing hedge accounting models might be simplified. At present, there are several restrictions in existing hedge accounting models to maintain discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings. This section also explains why those restrictions are required.

(a) What suggestions would you make to the boards regarding how the existing hedge accounting models could be simplified?
(b) Would your suggestions include restrictions that exist today? If not, why are those restrictions unnecessary?
(c) Existing hedge accounting requirements could be simplified if partial hedges were not permitted. Should partial hedges be permitted and, if so, why? Please also explain why you believe the benefits of allowing partial hedges justify the complexity.
(d) What other comments or suggestions do you have with regard to how hedge accounting might be simplified while maintaining discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings?

Question 13

Do you have any other comments for the boards regarding how they could improve and simplify the accounting for financial instruments?