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International Accounting Standards Board

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Note: These notes are based on the staff papers prepared for the SAC meeting. Paragraph numbers correspond to paragraph numbers used in the SAC agenda paper.

INFORMATION FOR OBSERVERS

SAC Meeting: **November 2008, London**

Project: **Recognition and Measurement of Financial Instruments - Agenda Proposal**

(Agenda Paper 3 – Appendix 1)

PURPOSE OF THIS MEMORANDUM

1. At the October 21, 2008 joint FASB and IASB education session, the staff will present to the Boards a brief summary of the comment letters received in response to the IASB's Discussion Paper (DP), *Reducing Complexity in Reporting Financial Instruments*. As of October 1, 2008, the Boards received 157 comment letters. The following table summarizes the constituent profile by type and geographical region:

Type	Number
Public Accounting	27
Preparers	82
Users	9
Others*	39
TOTAL	157
Geographical region	**Number**
Africa	5
Asia-Pacific	26
Europe	59

International	36
Middle East	1
North America	29
South America	1
TOTAL	157

* Others include academics, individuals, associations, standard setters and regulators.

2. The staff has not completed its full analysis of the comment letters received to date. However, the staff would like to present the Boards with a condensed summary of responses to key topics identified by the project team thus far in its comment letter review. Those key topics are (a) the need for a significant change to the current requirements for reporting financial instruments, (b) approaches for addressing complexity issues—including Intermediate Approaches 1 and 2, simplifying hedge accounting requirements (Intermediate Approach 3) and the approach requiring fair value for all financial instruments, and (c) other issues/concerns.

3. For the purposes of this condensed analysis, preparer and auditor comments have been analyzed as a whole and contrasted with user comments as the preparer and auditor responses are generally consistent.

SUMMARY COMMENT LETTER ANALYSIS

A: The need for a significant change to the current requirements for reporting financial instruments

4. <u>Preparers/Auditors</u>: The majority of these constituents believe there is a need for a significant change to the current requirements for reporting financial instruments. Those constituents stated that the current requirements are too complex, do not fit their business models, and should be more principles-based. Some constituents, however, do not agree that a significant change in current reporting requirements is needed. Some of these constituents support a simplified mixed-attribute model, while others argue that financial instruments themselves are inherently complex and that oversimplification would not be a fair representation of the complexity of those instruments.

5. Users: Users stated that there is a need for a significant change to the current requirements for reporting financial instruments, as the current mixed-attribute model is not only confusing for users but creates structuring opportunities for preparers to achieve particular accounting effects.

B: Approaches for addressing complexity issues

Intermediate Approaches 1 and 2 vs. long-term full fair-value method

6. Preparers/Auditors: The majority of these constituents do not support a long-term solution requiring fair value for financial instruments. Many constituents also do not support the intermediate approaches to address the complexity issues. They believe the benefits of those approaches would not outweigh the costs given that those approaches could be replaced. Others support some of the intermediate approaches as a way to simplify current reporting complexity, especially for hedge accounting.

7. Some preparers and auditors agree that reducing measurement categories for financial instruments and eliminating restrictions on the existing measurement categories for financial instruments (Approach 1) would reduce complexity. However, how that should be achieved differed among those constituents. Some of those constituents suggested the Held-To-Maturity (HTM) category should be eliminated. Assets previously categorized under HTM should be moved to either Loans and Receivables or Available-for-Sale (AFS), while others suggested a "Trading" versus "Nontrading" concept.

8. The majority of preparers and auditors do not support replacing existing measurement requirements with a fair value measurement principle with optional exceptions (Approach 2). They believe Approach 2 would add more complexity without apparent benefits.

9. As indicated above, the majority of preparers and auditors do not support requiring fair value for all financial instruments. Those constituents stated that it is not appropriate for financial instruments not held for trading purposes or not

managed on a fair-value basis to be measured at fair value. They also stated that it is difficult to value financial instruments that are not actively traded. In addition, they also believe that moving to a full fair-value method would add artificial volatility to earnings.

10. Users: Users generally support the long-term solution of requiring fair value for all financial instruments and did not express strong support for intermediate Approach 1 or Approach 2. However, some users would support elimination of the HTM category and/or support a requirement for all financial instruments to be measured at fair value with certain exceptions, presuming that those exceptions would limit the ability of management intent to determine the measurement basis.

Reducing hedging-related complexities (Intermediate Approach 3)

11. Preparers/Auditors: The majority of preparers and auditors stated that hedge accounting should not be eliminated and partial hedges should be permitted because they believe such accounting better reflects the reporting entities' risk management strategies. However, many of those constituents would support replacing fair value hedge accounting with a model that permits recognition outside of earnings gains and losses on hedging instruments (similar to cash flow hedge accounting).

12. Preparers and auditors also suggested the following for simplifying existing hedge accounting requirements: remove retrospective effectiveness testing with recognition of all ineffectiveness in earnings, retain only qualitative prospective effectiveness testing, and simplify documentation requirements.

13. Users: Many users expressed support for the Boards working together on a project to simplify the accounting for hedging activities, provided that the simplification reduced the complexity underlying interpretation. Most users also support the elimination of the ability to hedge individual risks as proposed in the FASB ED on simplifying hedge accounting. Those users stated that the changes proposed in the FASB ED would more comprehensively reflect risk exposures.

14. Some users expressed a strong preference for an interim approach that would eliminate hedging altogether. Some of this group of users do not favor the Boards spending any time on changes to hedge accounting if that would result in sacrificing the timely resolution of more critical issues in other projects. These users do not believe that modifications to the current hedge accounting model would provide any benefit for users. Other users expressed concern that changes that simplified the ability to qualify for hedge accounting might further entrench hedge accounting and make the longer term goal of fair value for financial instruments more difficult to achieve.

C: Other issues/concerns

15. Preparers/Auditors: Many preparers and auditors stated that the Boards need to properly define fair value and complete the Fair Value Measurement project before proposing an approach that would require fair value for all financial instruments. In addition, they stated that it is also important for the Boards to complete the Financial Statement Presentation project because it relates to how gains and losses would be disclosed if such an approach were adopted.

16. Users: All users stated the importance of a comprehensive framework for presentation and disclosure of financial instruments in relation to a consistent framework for recognition and measurement. Some users stated that completion of the financial statement presentation project, completion of a comprehensive disclosure framework, and adoption of a fair value measurement framework under IFRS should be prerequisites to requiring fair value for all financial instruments. They stated that these items are critical to ensure that users are provided with the clearest, most complete and up-to-date information about fair values.