Project	**Financial Instruments: Recognition and Measurement**
Topic	**Sweep issues**

Purpose of this paper

1. The purpose of this paper is to identify and ask for decisions on some sweep issues that need to be addressed before an exposure draft (ED) on classification and measurement of financial instruments can be published.

2. This paper addresses the following sweep issues:

   (a) scope

   (b) day one differences

   (c) interaction with annual improvements project

   (d) measurement guidance for particular financial instruments

Scope

Issue

3. Paragraphs 2-7 of IAS 39 *Financial Instruments: Recognition and Measurement* set out the scope of the standard. IAS 39 uses the definition of a financial instrument (set out in IAS 32. 11) that is contract-based and dependent on the definitions of a financial asset, a financial liability and an equity instrument.

4. The scope of IAS 39 currently excludes some contracts that meet the definition of a financial instrument because other standards specifically address the accounting for those contracts (e.g. interest in subsidiaries). However, it

includes some items that do not meet the definition of a financial instrument, eg some contracts to buy or sell a non-financial item.

5. The approach to the scope of IAS 39 and its interaction with other standards has resulted in some application and interpretation issues in practice. The discussion paper *Reducing Complexity in Reporting Financial Instruments* discussed both scope and the way that scope is set. The DP included possible revisions to the definitions of a financial instrument, a financial asset and a financial liability.

Staff analysis

6. The staff does not think the issue of scope should be addressed in this phase of the project because:

    (a) the issue of scope needs to be addressed comprehensively. Scope is also a complex issue that interacts with many other standards. Given the proposed timeline for the ED on classification and measurement of financial instruments, the staff does not think it is feasible to address the issue in this phase of the project.

    (b) the issue of scope is not credit crisis related and hence not an issue that demands immediate change.

    (c) the Board has already tentatively decided to not propose changing the embedded derivative requirements for non-financial hosts in hybrid contracts, because of the interaction with scope.

Staff recommendation 1 and question to the Board.
The staff recommends that the Board not consider proposing changes to the scope of IAS 39 in the ED. Question 1 – Does the Board agree with the staff's recommendation? If not, why? What does the Board wish to do and why?

Day one differences

Issue

7. The issue of day one differences continues to be relevant under the proposed classification and measurement model and guidance on how to account for day one gains is necessary. The Board discussed this issue within the fair value measurement project.

Staff analysis

8. The staff notes that the fair value measurement exposure draft is out for comment until 28 September 2009. That exposure draft contains consequential amendments to IAS 39 that provide guidance on the treatment of day one differences. That guidance is similar to current guidance in IAS 39. AG76 and AG76A.

9. Given the extensive discussions the Board has had many times before regarding this issue, the staff does not believe that this issue can be addressed and concluded on in the timeframe we have available. The staff therefore recommends that the Board should not consider proposing changes to existing requirements as part of the ED.

Staff recommendation 2 and question to the Board.
The staff recommends that the Board not consider proposing changes to existing requirements on the treatment of day one gains and losses in the ED. Question 2 – Does the Board agree with the staff's recommendation? If not, why? What does the Board wish to do and why?

Interaction with annual improvements project

Issue

10. There are several improvements to IAS 39 that will be included in the forthcoming annual improvements exposure draft (to be published in August 2009). These include amendments to:

    (a) effective interest rate (IAS 39.AG7, proposed AG7A and IGB24)

(b) bifurcation of an embedded foreign currency derivative from a non-financial host (IAS 39.AG33)

11. The proposed effective date of these annual improvements is January 2011. The Board has not made a decision on the effective date of the ED proposals. If the Board decides on an effective date before January 2011 (which the staff believes unlikely) such annual improvements might no longer be relevant.

Staff analysis

Effective interest rate (IAS 39.AG7, proposed AG7A and IGB24)

12. The staff thinks that this issue is likely to be addressed when the Board explores the expected cash flow approach to impairment. The Board will be looking at this in phase 2 of the project. The expected timeline for the publication of an ED is October 2009.

13. The staff thinks the issue can be more effectively addressed as part this project than as an annual improvement.

Bifurcation of an embedded foreign currency derivative

14. This phase of the project does not address this issue as it relates to hybrid contracts with non-financial hosts. Since the Board has decided to retain existing requirements for accounting for hybrid contracts with non-financial hosts at this stage, the annual improvement will still be relevant.

Staff recommendation 3 and question to the Board.
The staff recommends that the Board exclude annual improvements to effective interest rate (IAS 39.AG7, proposed AG7A and IGB24) from the forthcoming annual improvements exposure draft (to be published in August 2009). The staff recommends that the amendment to IAS 39.AG33 remain in the forthcoming annual improvements amendments. Question 3 – Does the Board agree with the staff's recommendation? If not, why? What does the Board wish to do and why?

Measurement guidance for particular financial instruments

Issue

15. IAS 39 contains measurement guidance for particular financial instruments. For example:

    (a) Financial guarantee contracts – IAS 39. 47(c) permits an issuer to subsequently measure such contracts at the higher of (i) amount determined in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and (ii) amount initially recognised less cumulative amortisation recognised in accordance with IAS 18.*Revenue*

    (b) Loan commitments – IAS 39. 47(d) permits an issuer of a below-market interest rate loan commitment to subsequently measure such commitments at the higher of (i) amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and (ii) amount initially recognised less cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

    (c) Financial liability with a demand feature (for example, demand deposits) – IAS 39. 49 requires that the fair value of a financial liability with a demand feature (eg a demand deposit is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid).

Staff analysis

16. The staff does not believe that the Board should consider proposing changes to the measurement requirements for these financial instruments in the ED.

17. The issues regarding financial guarantee contracts and loan commitments is related to scope, and interrelated to other standards (for example, insurance) – and hence should be addressed comprehensively whenever the Board considers scope.

18. The measurement guidance for financial liabilities with a demand feature has been discussed numerous times by the Board, without resolution. The guidance that exists in IASD 39 can also be seen as a practical approximation to the fair

value of such instruments, at least in many situations. The measurement of liabilities is also the subject of other projects, including the forthcoming Invitation to Comment on the measurement of liabilities and the insurance project. Therefore the staff believes that the Board should not consider proposing changes to the guidance for such instruments as part of this ED.

Staff recommendation 4 and question to the Board.
The staff recommends that the Board not consider proposing changes to the measurement guidance in IAS 39.47 and IAS 39.49 in IAS 39. Question 4 – Does the Board agree with the staff's recommendation? If not, why? What does the Board wish to do and why?