Project **Financial Instruments: Replacement of IAS 39**

Topic **Classification and measurement: cover paper**

Background

1. Since 2005, the IASB and FASB have had a long-term objective to improve and simplify the reporting for financial instruments. Both boards are committed to working together to develop converged guidance. However, the boards decided to deliberate the issues relevant to this project separately with the objective to subsequently reconcile any differences in their technical decisions.

2. The IASB chose to complete the project in three phases:

   (a) classification and measurement— an exposure draft *Financial Instruments: Classification and Measurement* was published in July 2009;

   (b) impairment methodology; and

   (c) hedge accounting.

3. The IASB plans to develop an IFRS from the exposure draft on classification and measurement to be available for early adoption in time for 2009 year-end financial statements. The IASB expects to publish exposure drafts on the other two phases by the end of 2009, with an IFRS to be issued in 2010.

4. The FASB expects to publish one exposure draft that addresses the classification, measurement, and impairment of financial instruments, as well as hedge accounting, by the end of this year or early 2010. However, in August the FASB posted to its website a detailed description of its tentative approach to classification and measurement of financial instruments as a way of informing

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

interested parties and obtaining early input from them. The FASB expects to issue a final standard in the third or fourth quarter of 2010.

Objective of this agenda paper

5. **This agenda paper describes our strategy for the IASB's re-deliberations on the classification and measurement phase. Our plan takes into account (a) the IASB's commitment to issuing an IFRS to be available for early adoption in time for 2009 year-end financial statements and (b) the boards' aim to achieve a converged solution.**

6. This paper

    (a) describes, at a summary level, the primary similarities and differences between the FASB and IASB proposed approaches and

    (b) outlines how we plan to sequence issues for the IASB's re-deliberations.

The IASB and FASB approaches

7. The purpose of this section is to provide sufficient information about the similarities and differences between the proposed approaches such that Board members can understand our strategy for re-deliberations (specifically, why we sequenced issues as we have). That strategy mirrors the format of the questions used to structure the round-table discussions, as well as many of the private outreach meetings undertaken by the staff.

8. The purpose is **not** to provide a detailed comparison of the approaches. We will provide that detailed comparison in subsequent papers when we address particular issues.

Drawing a "line" between the fair value through profit or loss category and the "other" category

9. Both approaches propose two measurement categories—(a) fair value through profit or loss and (b) something else. Under the IASB's approach, the "something else" is amortized cost. Under the FASB's approach, it is fair value through other comprehensive income (OCI).

10. Both approaches propose conditions to "draw a line" between the two measurement categories and those proposed conditions are similar. Both approaches look to:

    (a) **the contractual terms of the instrument**—the IASB uses the notion of "an instrument with basic loan features" and the FASB uses the notion of "debt instruments with principal amounts"

    (b) **the entity's business model for managing the instrument**—the IASB uses the notion of "managed on a contractual yield basis" and the FASB uses the notion of "held for collection or payment of contractual cash flows rather than sold or settled with a third party"

Statement of financial position

11. The statement of financial position would look different under the two approaches.

12. Consistent with paragraph 9 above, under the IASB's approach, a financial asset or financial liability would be presented on the statement of financial position at either fair value or amortized cost.[1]

13. Under the FASB's approach, all instruments would be presented at fair value on the statement of financial position (unless the entity elects the exception described below in paragraph 18). And in addition, an entity must present the amortized cost of the instrument on the face of the statement of financial position if the instrument:

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[1] Paragraph 25 of IFRS 7 requires an entity to disclose in the notes the fair value of all financial assets and financial liabilities in a way that permits it to be compared with its carrying amount.

(a) is the entity's own debt and is measured at fair value through profit or loss, or

(b) is a financial asset or financial liability measured at fair value through OCI[2]

Statement of comprehensive income

14. The statement of comprehensive income would look similar under the two proposed approaches. (However, in come cases, the FASB approach would require additional disaggregation of the amounts presented on the face of the statement.)

Items measured at fair value through profit or loss

15. As noted above in paragraph 9, both approaches would require particular instruments to be measured at fair value through profit or loss. The amounts recognized in the statement of comprehensive income would be the same for those instruments.

Items not measured at fair value through profit or loss

16. Under the IASB approach, the "other" measurement category is amortized cost. For those instruments, gains or losses would be recognized in profit or loss when the instrument is impaired, derecognized, or through the amortization process (i.e., recognition of interest income or expense, including amortization of any premium or discount).

17. Under the FASB approach, the "other" measurement category is fair value through OCI. However, for those instruments, not all changes in fair value are presented in OCI. Current period interest income or expense and credit losses (for financial assets) would be presented in profit or loss. Also, realized gains or losses would be recycled from OCI to profit or loss.

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[2] The FASB approach proposes additional requirements that would reconcile fair value and amortized cost on the face of the statement of financial position.

Exceptions to the approaches

18. Both approaches propose an exception. Under the IASB's approach, an entity can elect to measure particular investments in equity instruments as at fair value through OCI (with no impairment and no recycling). Under the FASB's approach, an entity can elect to measure its own debt at amortized cost in particular circumstances.

Project plan

19. As we mentioned above, our objective is to present issues to the Board in a sequence that takes into account the IASB's commitment to issuing an IFRS by the end of this year and the boards' aim to achieve a converged solution.

20. To that end, we plan to present issues to the Board in the following sequence:

    (a) **Classification conditions**: First, we will discuss how to make the cut between those instruments that should be measured at fair value through profit or loss and those that should not. We will focus on the classification conditions discussed above in paragraph 10. This discussion will include how those conditions should apply to hybrid financial contracts.

    (b) **The "other" measurement category**: Then we will discuss how an instrument should be measured if it is not measured at fair value through profit or loss. In other words, we will address what the other measurement category should be (eg amortized cost or fair value through OCI).

    (c) **Possible exceptions to the approach**: Finally we will discuss whether there should be any exceptions to the approach.

21. In addition to those three primary topics, we will address other items (which will be presented to the Board as soon as possible, not after the topics described in paragraph 20 or necessarily in the sequence below) including:

    (a) reclassifications between measurement categories

    (b) the fair value option (dependent on the outcome of 20(b)),

(c) effective date and transition

(d) sweep issues