IASB meeting

Staff Paper

IASB Agenda Paper No. **8A**

Board meeting date **Week beginning 19 April 2010**

Project	**Financial instruments: classification and measurement of financial liabilities**
Topic	**Disclosures for liabilities designated under the fair value option**

Background

1. For all liabilities designated under the fair value option (FVO), the Board is proposing that the portion of the total fair value change that is attributable to a change in own credit risk must be presented in other comprehensive income (OCI). The Board's proposed "two step approach" was described in agenda paper 14A for the March board meeting.

2. Currently IFRS 7 *Financial Instruments: Disclosures* requires that amount to be disclosed. Paragraph 10 says (in part):

   If the entity has designated a financial liability as at fair value through profit or loss in accordance with paragraph 9 of IAS 39, it shall disclose the amount of change during the period in the fair value of the financial liability that is attributable to changes in the credit risk of that liability…

3. IFRS 7 has a few other disclosure requirements related to changes in own credit risk. For Board members' convenience, the relevant paragraphs of IFRS 7 are reproduced in their entirety in the appendix to this paper.

Purpose of this paper

4. **The purpose of this paper is to**

(a) describe what will happen to the existing disclosure requirements in IFRS 7; and

(b) ask whether additional disclosures are necessary.

What will happen to the disclosure requirements in IFRS 7?

5. Under the Board's proposals, one of the footnote disclosures required by IFRS 7 would instead be presented on the face of the statement of comprehensive income—ie the amount of the change during the period in the fair value of the financial liability that is attributable to changes in own credit risk. Consequently, that disclosure requirement would be deleted from IFRS 7.

6. All of the other disclosures in IFRS 7 would remain unchanged. In other words, an entity still will be required to disclose:

   (a) the **cumulative** amount of the change in fair value that is attributable to changes in the credit risk of the liability (paragraph 10(a) in IFRS 7)[1];

   (b) the difference between the liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation (paragraph 10(b) in IFRS 7); and

   (c) information about the methodology used to determine the effects of changes in the credit risk of the liability and whether that methodology is representational faithful (paragraph 11 in IFRS 7).

Should there be any new disclosure requirements?

User questionnaire

7. In the recent user questionnaire, we asked users if they would like more disclosures in the footnotes around how own credit is determined (and if so, what additional information would be helpful). Responses were mixed—approximately 55% of respondents said that they **would** like additional

[1] This disclosure is still needed because (a) the Board's proposals would not require an entity to present the cumulative gain or loss attributable to changes in own credit risk on a separate line in the statement of financial position and (b) the cumulative gain or loss in the statement of financial position could include amounts attributable to liabilities that have been derecognized.

disclosures. Respondents who sought additional disclosures generally requested more information about how the entity computed the effects of changes in own credit risk (eg the entity's methodology and the assumptions used).

8. Paragraph 11 of IFRS 7 already requires an entity to disclose its method. Moreover, if the entity believes that the disclosure does not faithfully represent the change in the fair value attributable to changes in its credit risk, it must also disclose the reasons for reaching that conclusion and the factors it believes are relevant. Responses to the questionnaire may indicate that some entities are not providing useful or robust enough disclosures when they comply with the existing requirements in IFRS 7. When we prepare the proposed consequential amendments, we can **improve the wording** of that disclosure requirement (but not change its meaning) to require an entity to disclose a detailed description of its methodology and inputs or assumptions used.

9. Other respondents to the user questionnaire noted that since they do not think information on own credit risk is decision-useful, they do not think the benefits of additional disclosures outweigh the costs.

Other feedback from users

10. During our outreach programme, most users told us that they want to know when changes in own credit risk have been realized. As we noted in paragraph 34 of agenda paper 8C for the February board meeting, most users supported recycling amounts from OCI to profit or loss when a liability is derecognized before maturity. Most users said that the own credit risk amount should be reflected in profit or loss if that amount is realized.

11. However, the Board tentatively decided that amounts should not be recycled from OCI to profit or loss. Most board members noted that gains and losses should be recognized in the performance statement **once only** and said that it is inappropriate to reclassify the gain or loss and show it in the performance statement again when it has been realized. The Board also noted that if the liability is settled per its contractual requirements, then the net balance in accumulated OCI would be zero—so recycling is not an issue in many cases.

Recommendation

12. Because most users told us that they want to know when and how much of the own credit amount has been realized (but the Board has tentatively decided to prohibit recycling), we recommend that the following disclosures are proposed in the exposure draft as a consequential amendment to IFRS 7:

    (a) how much of the accumulated OCI balance (attributable to changes in own credit risk) was realized **during the current period**; and

    (b) how much of the accumulated OCI balance (attributable to changes in own credit risk) has been realized **cumulatively**.

13. The disclosure recommended in paragraph 12(a) will tell users how much of the accumulated OCI balance was realized in the current period (ie how much would have been recycled in the current period).

14. The disclosure recommended in paragraph 12(b) will tell users how much of the accumulated OCI balance is attributable to liabilities that have been derecognized (ie how much of the accumulated OCI balance would have been recycled to date).

Question 1: New disclosure requirements
Does the Board agree with the recommended disclosures in paragraph 12?

APPENDIX

Relevant paragraphs in IFRS 7

10 If the entity has designated a financial liability as at fair value through profit or loss in accordance with paragraph 9 of IAS 39, it shall disclose:

(a) the amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability determined either:

(i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see Appendix B, paragraph B4); or

(ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability.

Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates. For contracts that include a unit-linking feature, changes in market conditions include changes in the performance of the related internal or external investment fund.

(b) the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

11 The entity shall disclose:

(a) the methods used to comply with the requirements in paragraphs 9(c) and 10(a).

(b) if the entity believes that the disclosure it has given to comply with the requirements in paragraph 9(c) or 10(a) does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.