IASB meeting

Staff Paper

IASB Agenda Paper No.	**8B**
Board meeting date	**Week beginning 19 April 2010**

Project	**Financial instruments: classification and measurement of financial liabilities**
Topic	**Exposure logistics**

Purpose of this paper

1. In February and March the Board discussed the classification and measurement approach for financial liabilities. The Board plans to publish an exposure draft in the second quarter of 2010.

2. **The purpose of this paper is to discuss**

   (a) **the content of that exposure draft;**

   (b) **the exposure period; and**

   (c) **whether an entity who decides to early adopt any finalized requirements in this phase of the project to replace IAS 39 must also early adopt any preceding finalized requirements in that project.**

Content of the exposure draft

3. The Board has decided to retain the measurement requirements in IAS 39 *Financial Instruments: Recognition and Measurement* for financial liabilities, with **two exceptions**:

   (a) **Fair value option (FVO)**—For liabilities designated under the FVO, the Board decided to propose that the portion of the total fair value change that is attributable to a change in own credit risk must be presented in

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

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other comprehensive income (OCI) via the "two step approach" described in agenda paper 14A for the March board meeting.

(b) **Cost exception**—Consistent with the requirements for financial assets in IFRS 9 *Financial Instruments*, the Board decided that the cost exception in IAS 39 should be eliminated for derivative liabilities that will be physically settled by delivering unquoted equity instruments whose fair value cannot be reliably determined. This issue was discussed in agenda paper 14B for the March board meeting.

Alternatives for the content of the exposure draft

4. We think there are three alternatives for **what** should be exposed:

(a) **The entire approach**—This alternative would expose the entire measurement approach for financial liabilities – that is, the two items that would change (described above in paragraph 3(a) and 3(b)) **and** all of the existing requirements in IAS 39 that will remain unchanged;

(b) **Only the changes to the FVO and the cost exception**—This alternative would expose only the two items that would change (described above in paragraph 3(a) and 3(b)); or

(c) **Only the changes to the FVO**— This alternative would expose only the proposed changes to the FVO (described above in paragraph 3(a)) because that is the only item that has not already been exposed.

Staff recommendation

5. We recommend alternative (c) – that the Board only expose the changes to the FVO.

6. Many constituents told the Board that it should not fundamentally change the requirements in IAS 39 for measuring financial liabilities because practice is working well. Constituents told the Board that the issue of own credit risk is the only issue that needs to be addressed. Consistent with that feedback, the Board decided to keep the requirements in IAS 39 for financial liabilities because that approach does not disrupt current practice and addresses the issue of own credit risk for almost all liabilities. However, that approach does not address the issue of own credit risk in the context of liabilities designated under the FVO so the

Board decided to propose changes to the FVO to address that one remaining issue.

7. If the Board exposes the **entire** approach (ie alternative (a)), we think it will receive a significant number of comments asking the Board to "tinker" with various aspects of the requirements in IAS 39. However, based on the feedback received during the extensive outreach programme that the requirements in IAS 39 for financial liabilities are working well in practice (and the only issue that the Board needed to address was own credit), the Board has decided **not** to disrupt practice by changing or tinkering with IAS 39 at this point. Therefore, we do not see the benefit of exposing requirements that the Board does not intend to change.

8. The elimination of the cost exception (described above in paragraph 3(b)) was exposed in July 2009 in the exposure draft *Financial Instruments: Classification and Measurement*. Moreover, that issue was re-deliberated in September and October 2009 before the Board decided to scope out liabilities from IFRS 9. We think it is unlikely that the Board will receive any new information on this issue if it is exposed again.

Question 1: Drafting of the exposure draft
Should the staff proceed with the drafting of the exposure draft? If not, what would the Board like the staff to do instead?

Question 2: Content of the exposure draft
Do you agree that the exposure draft should contain only the proposed changes to the FVO?

The exposure period

9. The *Due Process Handbook* says that:

> The IASB normally allows a period of 120 days for comment on an exposure draft. If the matter is exceptionally urgent, the document is short, and the IASB believes that there is likely to be a broad consensus on the topic, the IASB may consider a comment period of no less than 30 days.

10. The comment period for the IASB's exposure draft *Financial Instruments: Classification and Measurement* was 60 days.

11. The FASB has not yet discussed what the comment period will be for their exposure draft on financial instruments. However, according to the technical plan on the FASB's website, it plans to publish its proposals in the second quarter and finalize any requirements in the fourth quarter of this year.

12. If the Board agrees with our recommendation to expose only the changes to the FVO, we think the exposure period should be 60 days. Although the proposals are narrow in nature, the Board plans to publish a number of exposure drafts in the second quarter and we think that constituents may need extra time to deal with all of those documents. Moreover, based on the feedback received during our outreach programme, we do not think the proposals are urgent enough to warrant a significantly reduced comment period. An exposure period of 60 days will allow the Board to finalize any requirements by the end of 2010 (which is consistent with the FASB's timeline).

Question 3: Comment period
Does the Board agree that the comment period should be 60 days? If not, what does the Board want the comment period to be?

Early adoption—interaction of the phases

13. At the October 2009 meeting the Board tentatively decided that if an entity decides to adopt early any finalized requirements in the IAS 39 replacement project, the entity must also early adopt any **preceding** finalized guidance. For example, if an entity decides to early adopt the changes to the FVO for financial liabilities (assuming that the Board finalizes those proposals), it also would have to adopt the requirements in IFRS 9 for the classification and measurement of financial assets (assuming that the entity has not already adopted those requirements).

14. Users have noted that if an entity was allowed to "cherry pick" which finalized requirements it wants to early adopt, there would be significant incomparability

among reporting entities until **all** of the phases are (mandatorily) effective. If entities are allowed to choose which phases they want to early adopt, there will be many possible “combinations” of which requirements are early adopted and which are not. Moreover, the period of incomparability would be significant because the phases will not be mandatorily effective before 1 January 2013.

15. We think that requiring an entity to early adopt any preceding finalized requirements will allow entities to benefit from the early adoption of new requirements while limiting the possible “combinations” of what it decides to adopt early.

16. However, the Board has not solicited input on the tentative decision; therefore we think that the Board should include that proposal in this exposure draft.

Question 3: Confirmation of early adoption provisions
Does the Board agree with our recommendation that the exposure draft should ask for feedback on the proposal that if an entity decides to adopt early any finalized requirements in the IAS 39 replacement project, the entity must also early adopt any **preceding** finalized guidance? If not, what does the Board want to do instead and why?