Project: **Financial instruments: classification and measurement of financial liabilities**

Topic: **Liabilities in Category C**

## Purpose of this paper

1. At the 10 February 2010 joint meeting the boards discussed the measurement of two categories of financial liabilities—Category A and Category B. In this paper, we will ask the IASB how financial liabilities in Category C should be measured.

2. Liabilities in Category C are held to pay contractual cash flows and have vanilla contractual cash flow characteristics. As discussed at the meeting on 10 February, the population of liabilities in Category C will be slightly different based on which bifurcation methodology the Board decides to pursue. Alternative bifurcation methodologies are discussed in agenda paper 8B and a few of those differences are illustrated in a table in that paper. However we do not think that those differences are significant enough to affect the Board's conclusion on how the liabilities in Category C should be measured.

## Liabilities in Category C

### *Previous discussions*

3. The exposure draft *Financial Instruments: Classification and Measurement* proposed a two measurement category approach for financial assets and financial liabilities—fair value and amortized cost. Under those proposals, liabilities in Category C would be measured at amortized cost.

4. Almost all respondents supported that outcome. They agreed that amortized cost provides relevant and useful information about particular instruments in particular circumstances. Consistent with the proposals in the exposure draft, those respondents believe that amortized cost provides decision-useful information about the amounts, timing, and uncertainty of cash flows if the instrument gives rise to contractual cash flows that are solely payments of principal and interest and is held for the purpose of paying (or receiving) those contractual cash flows.

5. Consistent with almost all of the feedback received, in October 2009 the IASB tentatively confirmed the proposals in the exposure draft that such instruments should be measured at amortized cost. However, the IASB decided not to finalize the proposals for liabilities—and thus IFRS 9 *Financial Instruments* applies only to assets at this point. However, that decision was not related to the instruments in Category C. Rather it related to instruments in Category B and instruments designated under the FVO—and the issue of recognizing gains or losses arising from changes in own credit in profit or loss.

***Recent outreach***

6. Since the decision not to finalize the requirements for financial liabilities, the staff has continued with extensive outreach to better understand views about how financial liabilities should be measured, and specifically the issue of own credit risk.

7. Specifically, in January 2010 the staff developed a questionnaire to solicit feedback from users on the issue of own credit risk. The questionnaire asked two broad types of questions—(1) how users use the information about changes in own credit risk today (if at all) and (2) what their preferred method of accounting is for selected liabilities.

8. **The vast majority of users preferred that vanilla debt liabilities be accounted for at <u>amortized cost</u>**. In general users noted that amortized cost is appropriate

because it reflects the legal obligation to pay the contractual amounts in the normal course (ie on a going concern basis).[1]

9. That response is consistent with the other feedback that we have received.

## Staff recommendation

10. We recommend that the IASB confirm its previous decision to require financial liabilities in Category C to be measured at amortized cost.

| **Question 1** |
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| Does the Board agree with the staff recommendation that financial liabilities in Category C should be measured at amortized cost (unless the FVO is elected)? If not, how does the Board think those liabilities should be measured and why? |

[1] Agenda paper 2A for the 10 February 2009 IASB board meeting discusses in more detail the results of this user outreach. That paper is attached as an appendix to the cover paper for this session (AP 8).