IASB meeting

Staff Paper

IASB Agenda Paper No.	**14D**
Joint board meeting date	**Week beginning 15 March 2010**

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

Purpose of this paper

1. The IASB has made tentative decisions that effectively retain the measurement requirements in IAS 39 *Financial Instruments: Recognition and Measurement* for financial liabilities, **except for the following two items**:

   (a) **Fair value option (FVO)**—the portion of the fair value change that is attributable to a change in own credit risk will be presented in OCI (via the "two step" approach described in AP 14A)

   (b) **Cost exception**—consistent with the requirements for financial assets in IFRS 9 *Financial Instruments*, the cost exception will be eliminated for particular derivative liabilities (refer to AP 14B).

2. The purpose of this paper is to discuss transition provisions. The staff notes that a discussion about the effective date is not necessary at this stage.

3. Furthermore, the staff has not identified any immediate issues in relation to IFRS 1 *First-time Adoption of International Financial Reporting Standards* and hence, no further analysis is presented in this paper.

General approach to transition in IFRSs

4. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires any change in an accounting policy that is required by a new IFRS or

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amended guidance to be treated retrospectively unless that new IFRS provides specific transitional provisions.

5. Retrospective application means that the financial statements are prepared as if the new requirements have always been applied. This includes any comparative information. IAS 8 contains further guidance when retrospective application is deemed not appropriate or not practicable.

6. All differences between the previous amount reported and the amount determined according to the new guidance would have to be recognised in the opening balance of retained earnings (or other component of equity as appropriate) for the earliest period presented.

7. Retrospective application would result in the most relevant information to users. It provides comparable information about the entity for both current and comparative periods and helps address (to some extent) challenges that users may have regarding historical trend information following a significant change to new accounting requirements.

8. Hence, the staff thinks the general guiding principle to transition for the new guidance on financial liabilities should be retrospective application.

9. The staff thinks any deviation from the general principle is only justified if either the resulting information is not useful or the cost of generating information for retrospective application exceeds the incremental benefit.

Analysis of transition implications and staff recommendations

10. The staff thinks it is only necessary to consider transition for the two items that **have changed** (described above in paragraph 1). Where there has not been a change to the existing guidance, there is no need for transition provisions.

FVO

11. The Board is **not** proposing to change the three eligibility criteria in IAS 39 for the FVO. Moreover the Board is retaining the classification and measurement requirements in IAS 39 for financial liabilities. As such, the staff does not think

it is necessary to allow entities to make new designations or revoke its previous designations as a result of the Board's proposals.

12. However, the Board's proposals **would change** how fair value gains or losses are presented in the performance statements for liabilities designated under the FVO. Specifically, the Board's proposals would require entities who invoke the FVO to recognise all changes in fair value in profit or loss, but then transfer the portion that relates to changes in own credit risk to OCI (this "two step" approach is discussed in AP 14A). This is different to today's accounting requirements, which require all fair value changes to be recognized in profit or loss. So transition provisions are necessary.

13. As required by IAS 8, if an accounting policy is changed (eg as a result of the requirements in a new IFRSs) generally that change has to be applied retrospectively.

14. Paragraph 10(a) of IFRS 7 *Financial Instruments: Disclosures* today requires **disclosure** of the own credit portion of a fair value change (both for the period and on a cumulative basis). So the information necessary to apply the Board's proposals is already available for entities applying IFRS 7. Hence, the staff sees no reason to deviate from the general requirement of retrospective application.

15. Thus, the staff proposes to require full retrospective application of the new approach to account for financial liabilities to which the FVO has been applied.

Question 1: transition for the FVO
Does the Board agree with our recommendation in paragraph 15? If not, what does the Board want to do instead and why?

Cost exception

16. In AP 14B the staff recommends that the Board eliminate the cost exception for particular derivative liabilities. That recommendation is consistent with IFRS 9, which eliminated the cost exception for financial assets.

17. As the staff noted during the discussion of transition for IFRS 9, these instruments have been carried at cost less impairment in the financial statements and were exempted from the fair value disclosures required by paragraph 25 of IFRS 7 (see paragraph 29(b) of IFRS 9 for that exemption). Therefore, entities generally will not have the necessary information to generate fair values retrospectively without using hindsight.

18. Paragraph 8.2.11 of IFRS 9 discusses the transition for an entity that previously accounted for an investment in an unquoted equity instrument (or a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument). The fair value for such assets is determined at the date of initial application. Any difference between the previous carrying amount and fair value shall be recognized in the opening retained earnings of the reporting period that includes the date of initial application.

19. **The staff recommends proposing the same transition for derivative liabilities that were previously accounted for under the cost exception.**

Question 2: transition for the elimination of the cost exception
Does the Board agree with our recommendation set out in paragraphs 18 and 19? If not, what does the Board want to do instead and why?