Project **Fair Value Measurement**

Topic **Other scoping considerations**

Purpose of this paper

1. This paper discusses the scope of an IFRS on fair value measurement with regard to:

   (a) IFRS 3 *Business Combinations*;

   (b) IAS 39 *Financial Instruments: Recognitions and Measurement*; and

   (c) IAS 19 *Employee Benefits*.

2. This paper asks the Board:

   (a) in IFRS 3 *Business Combinations*, not to replace the term 'fair value' when referring to the measure of reacquired rights;

   (b) in IAS 39 *Financial Instruments: Recognition and Measurement* to retain the term 'fair value' for measuring financial liabilities with a demand feature in paragraph 49; and

   (c) in IAS 19 *Employee Benefits*, not to describe the measurement of the reimbursement rights as the present value of the related obligation as a practical expedient for determining fair value.

Summary of the proposals in the IASB's exposure draft

IFRS 3 *Business Combinations*

3. In IFRS 3, the Board proposed to remove the reference to 'fair value' and to have the sentence refer only to the 'value' of reacquired rights.

IAS 39 *Financial Instruments: Recognition and Measurement*

4. Paragraph 49 of IAS 39 *Financial Instruments: Recognition and Measurement* states that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. The exposure draft proposes not to replace that use of the term 'fair value', but instead proposes to exclude that requirement from the scope of the IFRS.

IAS 19 *Employee Benefits*

5. The exposure draft also proposed to amend paragraph 104D in IAS 19 to describe it as a practical expedient to measure the fair value of qualifying insurance policies included in plan assets by reference to the present value of the related obligation.

Overview of comments received on the IASB's exposure draft

6. The invitation to comment for the IASB's exposure draft asked interested parties whether the proposed approaches to IFRS 3 and IAS 39 are appropriate. Although it did not ask a specific question about IAS 19, interested parties were asked to comment on other potential scoping issues.
7. The comments received are summarised below.

IFRS 3 *Business Combinations*

8. Respondents generally agree with the proposal to exclude reacquired rights acquired in a business combination in IFRS 3 from the scope of an IFRS on fair

value measurement. However, some think that it is unnecessary for the Board to amend IFRS 3 by removing the term ‘fair value’, because IFRS 3 already describes its measurement of reacquired rights as an exception to the fair value measurement principle in IFRS 3.

IAS 39 *Financial Instruments: Recognition and Measurement*

9. Many respondents think that if the Board believes that liabilities with a demand feature are not consistent with the proposed guidance on fair value, the Board should not use the term ‘fair value’ to describe them. They prefer the approach taken with IFRS 2 (see Agenda Paper 3A) and IFRS 3 (see paragraph 4 above).

IAS 19 *Employee Benefits*

10. Although this was not a specific question raised in the invitation to comment, some respondents commented on a proposed consequential amendment to paragraph 104D of IAS 19. The proposed amendment offers as a practical expedient that the fair value of qualifying insurance policies included in plan assets should be deemed to be the present value of the related obligation. Respondents think this is an exception to fair value rather than a practical expedient. This is because the related obligations used as the basis for measuring these assets are not measured at fair value under IAS 19, but rather according to the Projected Unit Credit Method.

Staff analysis and recommendation

11. This section analyses scope considerations for:

    (a) reacquired rights in IFRS 3;

    (b) liabilities with a demand feature in IAS 39; and

    (c) the proposed practical expedient in IAS 19.

IFRS 3 *Business Combinations*

12. IFRS 3 requires assets and liabilities to be measured at fair value. However, IFRS 3 includes some exceptions to the fair value measurement principle. One of the exceptions is set out in paragraph 29 of IFRS 3.

13. Paragraph 29 states that a reacquired right is recognised as an intangible asset on the basis of the remaining contractual term of the related contract, regardless of whether market participants would consider potential contract renewals in determining fair value.

14. This project does not intend to change the measurement of reacquired rights in IFRS 3. However, this project does need to determine whether the use of the term 'fair value' is appropriate in this circumstance.

15. The Board can follow one of the following approaches to deal with IFRS 3 and the scope of an IFRS on fair value measurement:

    (a) **Approach 1**: the Board can, as proposed in the exposure draft in Appendix D *Amendments to other IFRSs,* remove the term 'fair value' in paragraph 29 of IFRS 3 and rather refer to the 'value' of reacquired rights.

    (b) **Approach 2**: the Board can leave IFRS 3 unchanged. That is, paragraph 29 would continue to refer to the term 'fair value' and IFRS 3 would continue to make it clear that it is an exception to the measurement principle.

16. The staff recommend Approach 2. This is because IFRS 3 already describes the measurement of reacquired rights as an exception to fair value.

Question 1
Does the Board agree with the staff recommendation in paragraph 16?
If not, why not, and what would the Board propose and why?

IAS 39 *Financial Instruments: Recognition and Measurement*

17. Paragraph 49 of IAS 39 states that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

18. The Board noted that in many cases, the market price observed for such financial liabilities is the price at which they are originated between the customer and the deposit-taker – ie the demand amount. The Board also noted that recognising a financial liability with a demand feature at less than the demand amount would give rise to an immediate gain on the origination of such a deposit, which the Board believes is inappropriate.

19. However, some have argued in the past that if the effect of own credit is taken into account, the fair value of a liability with a demand feature can be less than the amount payable on demand.

20. If the Board thinks that the conclusion in IAS 39, as stated above, is inconsistent with the proposed fair value measurement guidance, the Board should consider whether it wants to exclude liabilities with a demand feature from the scope of an IFRS on fair value measurement.

21. The Board can follow one of the following approaches for dealing with liabilities with demand features in the scope of an IFRS on fair value measurement:

    (a) **Approach 1**: the Board can decide to confirm its conclusion in IAS 39. That is, that the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. If the Board follows this approach, the staff will emphasise, when drafting the amendments to other IFRSs, that the guidance in paragraph

49 of IAS 39 is *deemed* to be fair value for the purposes of liabilities with demand features for the purpose of IAS 39.

(b) **Approach 2**: the Board can decide that the guidance provided in paragraph 49 of IAS 39 is not consistent with the proposed fair value guidance. In that case, the term ‘fair value’ in paragraph 49 would be replaced with another term. This approach would require the Board to create a new defined term to describe the measurement. The staff do not recommend this approach.

(c) **Approach 3**: the Board can decide not to refer to any measurement basis in paragraph 49, and to simply state that the *value* of a liability with a demand feature is not less than the amount payable on demand discounted from the first date that the amount could be required to be paid. The staff do not recommend this approach because it is too vague on what the measurement basis is.

22. The staff recommend Approach 1. This is because the Board concluded that the market price observed for such liabilities is the demand amount (see paragraph 22). This approach will also emphasise that the measurement in paragraph 49 of IAS 39 is *deemed* to be the fair value, so as to remove any doubts.

Question 2
Does the Board agree with the staff recommendation in paragraph 22? If not, why not, and what would the Board propose and why?

IAS 19 Employee Benefits

23. Paragraph 104 in IAS 19 states that when an entity is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, that entity shall recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. However, paragraph 104D states that if the right to reimbursement arises under an insurance policy that exactly matches the amount and timing of some or all of the benefits payable under a defined benefit plan, the fair value of the reimbursement right is deemed to be the present value of the related obligation.

24. In the IASB's exposure draft, the Board proposed to describe the measurement in paragraph 104D as a practical expedient.

25. A practical expedient is in essence is a suitable 'short cut' method to arrive at the same answer that one would arrive at if the step-by-step approach were to be followed. Technically, using the present value of the related obligation as a 'short cut' does not necessarily equate to the same answer as using the proposed fair value guidance applied to measuring a reimbursement right. However, whether this is referred to as a practical expedient or as an exception to the proposed fair value measurement guidance, this does not change the measurement in paragraph 104D. In addition, this project does not intend to change the fact that these reimbursement rights are measured at the present value of the related obligation.

26. The staff therefore recommend that the Board should not amend paragraph 104D to describe it as a practical expedient to measure the reimbursement rights as the present value of the related obligation. This is because the wording in paragraph 104D makes it clear that it *deems* this measure to be the fair value in this specific case for the purposes of IAS 19.

Question 3
Does the Board agree with the staff recommendation in paragraph 26? If not, why not, and what would the Board propose and why?