STAFF PAPER

25 Jan – 27 Jan 2012

REG FASB | IASB Meeting

Project	**Financial instruments: Classification and Measurement**
Paper topic	Working to align the IASB and the FASB classification and measurement models for financial instruments

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Background

1. Since 2005, the International Accounting Standards Board (IASB) and the US-based Financial Accounting Standards Board (FASB) have had a long-term objective to improve and simplify the accounting for financial instruments and to achieve increased international comparability in this area. Both boards have received consistent feedback from constituents reinforcing the importance of the latter objective. This was confirmed by the IASB's recent agenda consultation.
2. The alignment of the IASB's and FASB's respective accounting models for financial instruments has been complicated by the different timetables established by the boards in response to their respective stakeholder groups. In order to address the most urgent issues expeditiously, the IASB adopted a phased approach to the replacement of IAS 39 *Financial Instruments: Recognition and Measurement*. The IASB issued IFRS 9 *Financial Instruments* in November 2009 addressing the classification and measurement of financial assets and in October 2010, added requirements for the classification and measurement of financial liabilities. IFRS 9 has a mixed-measurement model.

3. In May 2010 the FASB issued a comprehensive proposed Accounting Standards Update *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)* (ASU) on accounting for financial instruments that contained proposals on classification and measurement, impairment methodology and hedge accounting. The ASU proposed a full fair value model however, in the light of the feedback received, the FASB has moved to a mixed-measurement model in their subsequent re-deliberations. While both IFRS 9 and the FASB's tentative model are mixed-measurement models, differences remain.
4. In November 2011, the IASB decided to consider making limited modifications to IFRS 9 to address specific application questions raised by constituents; to consider the interaction of the classification and measurement model for financial assets with the insurance project; and also to consider the differences with the FASB's tentative classification and measurement model. In making this decision, the IASB noted that IFRS 9 has generally been found to be conceptually sound and operational. The IASB also noted that many constituents have either already adopted IFRS 9 early or dedicated significant resources in preparation for adoption. The IASB therefore agreed to be mindful of the extent of change to IFRS 9 and to complete the project expeditiously, seeking to minimise the cost and disruption to constituents.
5. In line with these objectives, in December 2011, the IASB confirmed that the scope of the project would be limited. Appendix A contains an extract from the December 2011 IASB Update that describes the scope of the limited modifications to IFRS 9.
6. The FASB is now finalising their re-deliberations of the classification and measurement of financial instruments.

Objective of this paper

7. Despite differences in timing and outcomes, the boards have always stated that they remain committed to achieving increased international comparability in the accounting for financial instruments. They have received consistent feedback from constituents confirming the importance of this. The purpose of this paper is to ask the boards if they would like to try to reduce the differences between their classification and measurement models and if so, how they would like to proceed.

Staff analysis and recommendation

8. The staff believe that it is an appropriate time for the boards to consider ways to reduce differences between their classification and measurement models for financial instruments. The IASB is already considering limited modifications to IFRS 9 and the FASB are nearing completion of their separate re-deliberations on classification and measurement, so they have a near final model as a basis for discussion. The staff note that our constituents are continuing to urge us to take this step.
9. The IASB have already published IFRS 9, some constituents are already using it and many others have undertaken a significant investment preparing to apply it. The IASB has also decided only to address a narrow subset of issues in considering modifications to IFRS 9. In addition, both boards are mindful of the need to complete their classification and measurement projects on a timely basis.
10. Considering the above, staff recommend that the boards try to address key differences between their models. The staff suggest that the boards discuss these issues jointly, with a particular objective of ensuring that the basis for decisions made in their separate models is understood and that possible avenues to align the two models are explored. Each board could then consider what changes, if any, they would propose to make to their separate models and incorporate in their respective exposure drafts.
11. Staff would suggest that the following key areas be discussed by the boards:

a. which instruments are eligible for amortised cost (ie which contractual cash flow characteristics are eligible);
b. the need for bifurcation of financial assets and if pursued, the basis for bifurcation;
c. the basis for and scope of a possible third classification category (debt instruments measured at fair value through other comprehensive income); and
d. any knock-on effects from the above (for example, disclosures or the model for financial liabilities given the financial asset decisions).

Question to the boards
Do the boards agree with the staff recommendation to work to improve the alignment between their classification and measurement models for financial instruments? Do the boards agree with the staff recommendation that joint discussions should focus on the key areas of difference between the models with the boards then separately considering changes to their respective models? Do the boards agree with the staffs' suggestions on the key topics to be considered?

Appendix A – extract from December 2011 IASB Update

In the November 2011 meeting, the IASB tentatively decided to consider making limited modifications to IFRS 9 Financial Instruments. At this meeting the Board discussed the scope of this project.

It was confirmed that the basis for reconsidering items was for three reasons: to address specific application issues in IFRS 9, the interaction of these items with the insurance project and the FASB's classification and measurement model.

At this meeting, the Board tentatively decided to consider the following topics within the scope of this project:

- an instrument characteristics test to decide whether additional application guidance should be provided to clarify how the principle was intended to be applied
- bifurcation of financial assets, after considering any additional guidance provided for the instrument characteristics test; and
- expanded use of OCI or a third business model for some debt instruments.

In addition, the Board tentatively decided to consider the inclusion in the educational materials being prepared for IFRS 13 Fair Value Measurement of specific guidance on how to determine the fair value of an unquoted equity instrument.

Eight board members agreed with the tentative decision.