STAFF PAPER

IFRS Interpretations Committee Meeting

May 2013

Project	**2011–2013 Annual improvements cycle (ED November 2012)—Comment letter analysis**
Topic	**IFRS 13 *Fair Value Measurement*: scope of paragraph 52 (portfolio exception)**

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Introduction

1. The Exposure Draft ED/2012/2 *Annual Improvements to IFRSs 2011–2013 Cycle* published in November 2012 ('the ED') includes a proposal for an amendment to IFRS 13 *Fair Value Measurement* to clarify the scope of the exception for measuring the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long or net short position for a particular risk exposure ('the portfolio exception') as set out in paragraph 52 of the Standard.

Objective

2. The objective of this paper is to provide an analysis of the comment letters received on the proposal to amend IFRS 13 and to obtain a recommendation from the IFRS Interpretation Committee (the Interpretations Committee) for the IASB to include the amendment in the final Annual Improvements to IFRSs that are planned to be published in 2013.

Structure of the paper

3. This paper:

   (a) provides background information and a description of the issue that led to the proposed amendment;

   (b) analyses the comments received as part of the Exposure Draft process; and

   (c) asks the Interpretations Committee to confirm whether it agrees with the staff recommendation to proceed with the proposed amendment.

Background information

4. Paragraph 52 of IFRS 13 defines the scope of paragraph 48 of the Standard. Paragraph 48 permits an entity to apply an exception to IFRS 13 when measuring the fair value of a group of financial assets and financial liabilities. The exception permits an entity that manages a group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risks to measure the price that would be received to sell a net long position for a particular risk exposure, or to transfer a net short position for a particular risk exposure, in an orderly transaction between market participants at the measurement date. The term 'exception' refers to the fact that, strictly speaking, the measurement of an entity's net exposure to a particular risk does not comply with the definition of fair value, because it does not attempt to estimate the price at which an individual financial asset could be sold or the price at which an individual financial liability could be transferred.

5. Paragraph 52 states [emphasis added]:

> The exception in paragraph 48 applies only to **financial assets** and **financial liabilities** within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*.

Description of the issue

6. The inclusion of the terms ‘financial assets’ and ‘financial liabilities’ in paragraph 52 of IFRS 13 has raised the question of whether the IASB’s intention was to explicitly exclude from the scope set out in that paragraph contracts that, even though they are contracts within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*, do not meet the definitions of ‘financial assets’ or ‘financial liabilities’ in IAS 32 *Financial Instruments: Presentation*, such as some physically-settled commodity derivative contracts.

7. The literal reading of paragraph 52 of IFRS 13 leads some interested parties to believe that such contracts would not benefit from this portfolio exception.

8. At the September 2012 meeting, the IASB[1] agreed to propose an amendment to paragraph 52 to clarify that the portfolio exception applies to all contracts within the scope of IAS 39 or IFRS 9, regardless of whether they meet the definitions of financial assets or financial liabilities as defined in IAS 32. The IASB also decided to include this proposed amendment in the ED.

Comment letter analysis

9. In this section, we discuss and analyse the comments received from interested parties on the ED. The comment period ended on 18 February 2013.

10. The ED asked two general questions that were answered individually for each proposed amendment:

    (a) Question 1: Do you agree with the IASB’s proposal to amend the Standard as described in the Exposure Draft? If not, why and what alternative do you propose?

    (b) Question 2: Do you agree with the proposed transitional provisions and effective date for the issue as described in the Exposure Draft? If not, why and what alternative do you propose?

[1] The Interpretations Committee did not discuss this issue.

11. The IASB received 65 comment letters on the ED in total; 61 respondents expressed their views on the proposed amendment to paragraph 52 of IFRS 13.

Analysis of Question 1

12. With respect to Question 1, almost all of the respondents who replied to this question agreed with the proposed amendment to IFRS 13.

13. The reasons why some of those respondents support the IASB's proposal are shown below:

    (a) The inclusion of "other contracts" in paragraph 52 of the Standard is an appropriate modification (GLASS, CINIF and FACPCE).

    (b) The proposal clarifies the IASB's intention that the scope of the exception for measuring the fair value of a group of financial assets and financial liabilities on a net basis (the 'portfolio exception') is aligned with the scope of IAS 39/IFRS 9. Specifically, it clarifies that the portfolio exception would be available to contracts to buy or sell a non-financial item that are in the scope of IAS 39/IFRS 9, if certain criteria are met (KPMG).

14. Some respondents agreed with the proposed amendment, but provided some suggestions. The main comments received are as follows:

    (a) The Basis for Conclusions can be improved in order to make the amendment clearer as to which financial instruments are covered by this amendment (ESMA).

    (b) Clarification should be inserted before paragraph 48 (instead of in paragraph 52) in order to reduce the risk of users' misinterpreting the scope of paragraph 48 (Mazars, JICPA).

    (c) The respondent would appreciate the IASB to clarify that the "existing arrangement" mitigating net credit risk exposure in accordance with IFRS 13.56[2] also includes those other contracts that were entered into and

[2] Paragraph 56 of IFRS 13 states that: When using the exception in paragraph 48 to measure the fair value of a group of financial assets and financial liabilities entered into with a particular counterparty, the entity shall include the effect of the entity's net exposure to the credit risk of that counterparty or the counterparty's net

continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements (contracts often referred to "own use" contracts). (IEAF, ACTEO, BusinessEurope).

(d) The wording of the proposed paragraph BC1 should be improved. In some cases, "contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument" are out of the scope of IAS 39 and IFRS 9. According to paragraph 5 of IAS 39 these are the contracts "that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements". These contracts should, therefore, not be affected by the proposed amendments (GASB).

(e) The proposed wording of the basis for conclusions should be improved. The respondent believes that 'some contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument', defined under paragraph AG 20 of IAS 32, could be in circumstances scoped out from IAS 39 and IFRS 9. Therefore these contracts would also be outside the scope of the proposed amendments (EFRAG).

(f) The intended meaning of the word "other contracts" in paragraph 52 is not sufficiently clear. The IASB should consider changing it to "contracts to buy or sell a non-financial item" (JICPA).

(g) The section heading preceding paragraph 52 should be amended to incorporate reference to "contracts within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9" (Deloitte).

15. We have grouped the concerns above into the issues below:

(a) refer to own use contracts;

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exposure to the credit risk of the entity in the fair value measurement when market participants would take into account any existing arrangements that mitigate credit risk exposure in the event of default (eg a master netting agreement with the counterparty or an agreement that requires the exchange of collateral on the basis of each party's net exposure to the credit risk of the other party). The fair value measurement shall reflect market participants' expectations about the likelihood that such an arrangement would be legally enforceable in the event of default.

(b) insert the proposal before paragraph 48;

(c) change “other contracts” to “contracts to buy or sell a non-financial item”; and

(d) amend the section heading.

16. We will analyse the concerns that we have identified above in the following paragraphs.

Own use contracts

17. Some respondents asked the IASB to clarify whether contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements (contracts often referred to as “own use” contracts) could be considered contracts within the scope of the portfolio exception if those contracts were entered to mitigate an entity’s net credit risk exposure in accordance with paragraph 56 of IFRS 13.

18. Other respondents suggested improving the wording of the proposed paragraph BC1 because, in some cases, “contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument” are out of the scope of IAS 39 and IFRS 9. They note that according to paragraph 5 of IAS 39 contracts “that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements” (ie own use contracts) are out of the scope of IAS 39 and IFRS 9 and should therefore not be affected by the proposed amendments.

19. We think that the proposed Basis for Conclusions are sufficiently clear, because in paragraph BC2 it is stated that: “the portfolio exception applies to all contracts within the scope of IAS 39 or IFRS 9”. Paragraph BC1 describes the issue and paragraph BC2 summarises the IASB’s decision (ie the portfolio exception applies to **all** contracts within the scope of IAS 39 or IFRS 9).

20. In our view, the aim of the proposed amendment is not to clarify which contracts are within the scope of IAS 39 or IFRS 9, but to clarify that all contracts that are within the scope of IAS 39 or IFRS 9 (and only these contracts) are automatically

within the scope of the portfolio exception as set out in paragraph 52. In other words, if a contract is outside the scope of IAS 39 or IFRS 9, this contract is also outside the scope of the portfolio exception. IAS 39/IFRS 9 would not require the use of fair value for contracts outside their scope, therefore the exception would not be relevant.

Insert the proposal before paragraph 48

21. A few respondents suggested that the clarification should be inserted before paragraph 48 (instead of in paragraph 52) in order to reduce the risk of users' misinterpreting the scope of paragraph 48.

22. We think that the questions received to clarify the scope of the portfolio exception in paragraph 52 were not raised because of its placement in the Standard; they were raised because the wording of that paragraph was not clear. Consequently, we think that there is no need to move the clarification from paragraph 52.

Change "other contracts" to "contracts to buy or sell a non-financial item"

23. One respondent thinks that the meaning of the word "other contracts" in paragraph 52 is not sufficiently clear, so it suggests changing "other contracts" to "contracts to buy or sell a non-financial item".

24. We think that adding "other contracts" to paragraph 52 clarifies the IASB's intention (ie other contracts that are not financial assets or financial liabilities are also within the scope of the portfolio exception if they are contracts within the scope of IAS 39 or IFRS 9 because **all** contracts that are within the scope of those Standards are within the scope of the portfolio exception). This is confirmed by the fact that almost all the respondents support the wording of the proposed amendment to paragraph 52.

Amend the section's heading

25. One respondent suggested that the section's heading preceding paragraph 52 should be amended to incorporate reference to "contracts within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9".

26. We think that that it is not necessary to amend this heading to clarify the issue raised. The proposed amendment, in our view, it is sufficiently clear.

Analysis of Question 2

27. With respect to Question 2, about 5 per cent of the respondents who replied to this question disagreed with the proposed transitional provisions. They think that the proposed amendment should not be applied retrospectively, because IFRS 13, including paragraph 52, is only applicable prospectively as of the beginning of the annual period in which IFRS 13 is initially applied. Accordingly, the transition requirement in the proposed amendment should be aligned with the general transition requirement of IFRS 13 (KPMG, AFME and ASC).

28. We think that the proposed amendment is only a clarification of the IASB's intention. Consequently, we do not think that retrospective application would cause undue cost and effort. This is supported by the fact that about the 95 per cent of the respondents who replied to this question agreed with the proposed transitional provisions.

Staff's recommendation

29. On the basis of the analysis in the previous section of the paper, we think that the Interpretations Committee should recommend to the IASB that it should proceed with the proposed amendment to paragraph 52 of IFRS 13, which proposes clarifying that the portfolio exception applies to all contracts within the scope of IAS 39 or IFRS 9, regardless of whether they meet the definition of financial assets or financial liabilities in accordance with IAS 32.

30. Appendix A shows the proposed final amendment, highlighting differences from the currently effective Standard.

31. Appendix B shows revisions to the wording in the previously published Exposure Draft.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree to recommend to the IASB that it should proceed with the amendment to paragraph 52 of IFRS 13? 2. Does the Interpretations Committee agree with the proposed wording of the amendment as shown in Appendix A of this paper?

Appendix A—Proposed final amendment to IFRS 13

A1. The proposed amendment to paragraph 52 of IFRS 13 is presented below.

Amendment to IFRS 13 *Fair Value Measurement*

Paragraph 52 is amended and paragraph C4 is added. New text is underlined and deleted text is struck through.

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk

52 The exception in paragraph 48 applies only to financial assets, ~~and~~ financial liabilities and other contracts within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*. The references to financial assets and financial liabilities in paragraphs 48–51 and 53–56 should be read as applying to all contracts within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9, regardless of whether they meet the definitions of financial assets or financial liabilities in IAS 32 *Financial Instruments: Presentation*.

Effective date and transition

C4 *Annual Improvements 2011–2013* cycle, issued in [date], amended paragraph 52. An entity shall apply that amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after 1 January 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

Basis for Conclusions on the amendment to IFRS 13 *Fair Value Measurement*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

After paragraph BC119 a subheading and paragraphs BC119A–BC119B are added.

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk

Scope of paragraph 52

BC119A After issuing IFRS 13 the IASB was made aware that it was not clear whether the scope of the exception for measuring the fair value of a group of financial assets and financial liabilities on a net basis (the 'portfolio exception') includes all contracts that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*. The exception is set out in paragraph 48 and the scope of the exception is set out in paragraph 52. In particular, questions were raised about whether the scope included contracts that are accounted for as if they were financial instruments, but that do not meet the definitions of financial assets or financial liabilities in IAS 32 *Financial Instruments: Presentation*, such as some contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments.

BC119B The IASB did not intend to exclude such contracts from the scope of the portfolio exception if they are within the scope of IAS 39 or IFRS 9. Consequently, the IASB amended paragraph 52 of this Standard to clarify that the portfolio exception applies to all contracts within the scope of IAS 39 or IFRS 9, regardless of whether they meet the definitions of financial assets or financial liabilities as defined in IAS 32.

Appendix B— Changes from the Exposure Draft published in December 2012

B1. The proposed amendment to paragraph 52 of IFRS 13 is presented below. New text that is proposed to be added, is shown with a double-underline. Text that is proposed to be deleted with respect to the proposed amendment included in the ED (December 2012), is shown with a ~~double-strike through~~.

Amendment to IFRS 13 *Fair Value Measurement*

Paragraph 52 is amended and paragraph C4 is added. New text is underlined and deleted text is struck through.

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk

52 The exception in paragraph 48 applies only to financial assets, ~~and~~ financial liabilities and other contracts within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*. The references to financial assets and financial liabilities in paragraphs 48–51 and 53–56 should be read as applying to all contracts within the scope of, and accounted for in accordance with, IAS 39 or IFRS 9, regardless of whether they meet the definitions of financial assets or financial liabilities in IAS 32 *Financial Instruments: Presentation*.

Effective date and transition

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Basis for Conclusions on the amendment to IFRS 13 *Fair Value Measurement*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

After paragraph BC119 a subheading and paragraphs BC119A–BC119B are added.

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk

Scope of paragraph 52

BC119A After issuing IFRS 13 the IASB was made aware that it was not clear whether the scope of the exception for measuring the fair value of a group of financial assets and financial liabilities on a net basis (the 'portfolio exception') ~~set out in paragraph 52~~ includes all contracts that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*. The exception is set out in paragraph 48 and the scope of the exception is set out in paragraph 52. In particular, questions were raised about whether the scope included contracts that are accounted for as if they were financial instruments, but that do not meet the definitions of financial assets or financial liabilities in IAS 32 *Financial Instruments: Presentation*, such as some contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments.

BC~~2~~119B The IASB did not intend to exclude such contracts from the scope of the portfolio exception if they are within the scope of IAS 39 or IFRS 9. Consequently, the IASB ~~proposes to~~ amended paragraph 52 of this Standard to clarify that the portfolio exception applies to all contracts within the scope of IAS 39 or IFRS 9, regardless of whether they meet the definitions of financial assets or financial liabilities as defined in IAS 32.