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Straight away

IFRS bulletin from PricewaterhouseCoopers

Guidance for financial liabilities unchanged except for those at fair value through profit or loss

What is the issue?

The IASB has published a proposal for dealing with the accounting for financial liabilities. It proposes that the accounting and presentation of financial liabilities should remain the same except when the financial liabilities are designated at fair value through the profit or loss. The exposure draft also asks for comments on whether to require the adoption of preceding finalised IFRS 9 guidance when an entity chooses to adopt this finalised section of IFRS 9 before its mandatory application date.

New measurement guidance

Except for the proposal below, the IASB intends to retain the existing guidance in IAS 39, 'Financial instruments: Recognition and measurement', regarding the classification and measurement of financial liabilities. The IASB decided not to change the accounting for liabilities substantially, as the existing requirements for liabilities generally work well and none of the other approaches considered would be less complex or provide more useful information.

However, the main concern regarding liabilities is the impact of 'own credit' for liabilities recognised at fair value − that is, fluctuations in value due to changes in the liability's credit risk, in the income statement. This can result in gains being recognised in income when the liability has had a credit downgrade, and losses being recognised when the liability's credit risk improves. Many users find this result counterintuitive, especially when there is no expectation that the change in the liability's credit risk will be realised. The IASB's proposals to address this concern are described below.

As there has been no change to the general requirements for financial liability accounting, there will continue to be two measurement categories for financial liabilities: fair value through profit or loss (FVTPL) and amortised cost. Entities will also still be required to separate derivatives embedded in financial liabilities where they are not closely related to the host contract. The separated embedded derivative will continue to be measured at FVTPL, and the residual debt host will continue to be measured at amortised cost.

Under the proposals, entities with financial liabilities designated at FVTPL would follow a two-step measurement approach. First, all changes in fair value of the financial liability would be recognised in the profit or loss. Second, the change in value due to changes in the liability's credit risk would be recognised in other comprehensive income (OCI) with an offsetting entry to profit or loss. There would be no subsequent recycling of the amounts in OCI to profit or loss.

Financial liabilities that are required to be measured at FVTPL (as distinct from those that the entity has designated at FVTPL) will continue to have all fair value movements recognised in profit or loss with no transfer to OCI. Derivatives (including embedded derivatives) − such as foreign currency forwards or interest rate swaps − or a bank's own liabilities that it holds in its trading portfolio will continue to have all fair value movements recognised in profit or loss.

The ED includes the IASB's previous decision to allow early adoption of IFRS 9 in phases but also proposes that the preceding finalised guidance should be adopted at the same time.

Am I affected?

The proposals impact entities that have designated financial liabilities at fair value through the profit or loss. For example, they will impact financial institutions that have designated liabilities at FVTPL to eliminate an accounting mis-match with financial assets that are held at FVTPL, or to avoid bifurcating an embedded derivative.

If the proposals are agreed, they will be applicable for financial periods beginning on or after 1 January 2013.

What do I need to do?

The comment period closes on 16 July 2010. Management should consider if they wish to comment on the IASB's decision not to change the existing IAS 39 guidance except for the proposals noted above.

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